Informal Policy Group

Rent Setting Policy for New Build Council Properties

Previous Meeting and Papers

The previous papers to this Informal Policy Group covered the following areas:

- Group Terms of Reference
- National rent setting policy
- Winchester's local policy for rent setting on new build schemes
- How viability for new build schemes is assessed
- The financial impact of rent setting options
- Commentary on each of the options considered.

The Group Terms of Reference were agreed as *"To review how rents are set for new build Council homes and to consider the impact of any recommendations on the HRA Business Plan."*

The discussion paper presented to the Group briefed Members on the remaining items. The key recommendation from the previous meeting was for officers to present an Options paper to inform further debate.

Options Considered

Officers have identified 6 options that range from charging social rents to 80% of market rents to be considered and debated by Members and these are discussed in detail below. The options are:

1. Affordable rent at 80% of market rents
2. Social rent based on the existing Government formula
3. Social rent + 5% "tolerance factor" as allowed in the regulations governing social formula rents
4. Current rent policy for new build schemes where the rent applied provides a financially viable scheme over 30 years
5. Affordable rent at 70% of market rents
6. A rent calculated to make the scheme viable but with land purchase, lost garage income or appropriation costs stripped out.

The impact of applying these various rent options has then been applied to the latest (February 2015) HRA Business Plan (HRABP) to gain an understanding of whether each option is achievable financially over the 30 year life of the HRABP.

Appendix 1 shows the average rental values against existing, in progress and future schemes in respect of each of the 6 options.

Appendix 2 groups the information in Appendix 1 for a small number of schemes in chart form.

Appendix 3 picks out some key factors from the HRABP and shows how these are affected when the various rent options are applied.

The following briefing notes look at the base assumptions in the current HRABP and then discusses the options in detail including what the rents would look like under each scenario and whether the current HRABP is affordable if applying that rent option. Please note that the Chesil Street Extra Care scheme has been excluded from the scenario testing as it is a requirement of the HCA grant funding that the Council will charge 80% affordable rents (after allowance for service charges).

HRA Business Plan Base Assumptions

The following assumptions were made when preparing the HRABP and Budget in January 2015:

- Inflation rates at 2.5% for RPI and 2% for CPI, both from 2016/17;
- Rent increases at CPI + 1% with void and bad debt losses at 0.9%;
- Garage increases at RPI with void losses at 3%;
- Right to Buy sales at 16 per annum;
- Salary cost increases at 1% to 2018, then at RPI until 2020/21 when they become RPI + 0.5%;
- Other management costs inflation at RPI;
- Maintenance (reactive and planned) inflation at RPI + 0.5% from 2016/17;
- New Build programme at existing (known) scheme levels until 2017/18 then at 30 new units per year.

These assumptions have been retained when testing the various rent scenarios described below.

Affordable (80% of market rent value) Rents

It is important to note that the rents shown in Appendix 1 are net of service charges that are eligible for Housing Benefit.

The rents are calculated using the latest market valuation data obtained for each scheme although best estimates have been used for those schemes that are in the early stages of development e.g. Mitford Road as well as property acquisitions and future schemes.

Excluding the Chesil Street extra care scheme, where rents are artificially low due to the level of service charge involved, average rents in all but 2 projects fall between £152 and £168 per week. These rents still compare favourably with the Winchester Broad Rental Market Area (BRMA) Local Housing Allowance rates for 2015/16 that averages out at £180.87 for one to three bedroom properties.

In relation to the HRABP, applying 80% rents across all new developments in future would make little difference to results over 30 years, mainly due to the majority of future projects assuming 80% rents as a starting point. As a result, there would be little opportunity to reduce the balance of loans outstanding at year 30 (much of which is long term borrowing at very favourable interest rates) or reduce the total capital (interest) charges payable.

Applying this policy consistently would give generally high rents, especially when compared to current social rents, but would also generate strong returns on some schemes that could then be re-invested in future projects.

Social (Formula or Target) Rents

Again, the rents shown are based on the latest valuation data provided by an independent valuer with best estimates used for the schemes in the early stages of development.

The key point to note with this assessment is that the HRA working balance at the end of the HRABP period (2044/45) is, at £35.2 million, substantially lower than the amount still owed in loans, projected at £67.15 million. Whilst not explicitly stated in the self-financing regulations, there is an expectation from the Government that the HRABP is fully funded i.e. it should have sufficient balances to cover the debt outstanding at the end of 30 years.

There would also be a requirement for internal borrowing as early as 2016/17 and the current Government set HRA borrowing limit (debt cap) would be exceeded in 2019/20. This would result in the Council having to reduce expenditure on capital projects (either new build or maintenance) by over £300,000. Although this is a relatively small amount when compared against a capital programme of over £22 million in 2016/17, it would result in one or more projects being delayed.

It is also worth noting that interest charges using these rents would be over £12 million more over the 30 year HRABP period.

Average rents under this scenario would be between £106 and £138 per week before service charges.

Applying social rents across all schemes consistently would result in almost all not being individually viable over a 30 year period (only 1 of 8 completed or in progress schemes shown in Appendix 2 has an average social rent higher than or equal to the average current policy rent).

Social (Formula or Target) Rents Plus 5% Tolerance

When formula rents were being introduced in 2002, there was an acceptance that some social landlords, mainly housing associations, would have viability issues if formula rents were applied to all of their stock. As a result, a 5% “tolerance factor” was allowed to enable marginally higher rents to be charged.

This factor has been applied to the social rents referred to above and would result in an additional £600,000 per annum rental income by year 30 of the HRABP. Average rents under this example would run from £111 to £144 per week excluding service charges.

However, the increased income is not sufficient to mitigate the situation with the HRABP in the short term and additional internal borrowing would still be required in 2016/17. Similarly, the additional loan(s) would cause the HRA borrowing limit to be exceeded in 2019/20 unless a cut in expenditure of at least £152,000 was made.

Also, as for social rents, the projected HRA working balance is still significantly below the loan balance outstanding at year 30 (by £18.5 million) although interest charges have reduced by over £5.3 million.

Even adding 5% to the social rent would still leave all but one of the currently completed or in progress schemes not viable when assessed on an individual basis.

Current Policy Rents

As is to be expected, this gives a broadly similar result as the current business plan – the only reason for the difference being due to updates to a couple of schemes following new valuations or cost information since the HRABP was last presented to Cabinet (Housing) in February 2015.

This means:

- a fully funded Business Plan with a working balance of £87.3 million at year 30;
- a remaining loan balance at year 30 of £66.5 million – substantially below the working balance;
- annual rental income of £27.7 million in 2016/17, rising to £73.8 million by 2044/45;
- average rents of between £132 and £168 per week at 2015/16 rates before service charges;
- no additional funding needed and the debt cap not being exceeded;
- interest charges at the same level as the current HRABP.

This policy would mean that rents for individual schemes are set so that the development is fully financially viable over a 30 year period.

Affordable Rents at 70% of Market Rent Values

This policy would see the average rent reduce at the lower end to £130 per week but increase to nearly £171 at the top of the range of schemes. However, the difference it would make to individual schemes is stark. For example, New Queens Head would see a reduction of over £20 per week on average whilst (if the policy had been applied from the first new build scheme) Itchen Abbas would have seen an increase of nearly £26 per week.

With regard to the HRABP, the Plan would not be fully funded if this policy was applied across all new build schemes. The HRA working balance at year 30 would be exceeded by loans outstanding by £6.5 million.

In addition, new funding would be needed by 2019/20 and interest charges would increase by £2.6 million over 30 years.

On the positive side, the HRA borrowing limit (debt cap) would not be exceeded in the early years of the HRABP.

Under this scenario, only 2 schemes (at Itchen Abbas and Abbotts Barton) would be fully viable on an individual basis.

Rents With Land Costs Removed

This policy could cause rents to be substantially different to the current or proposed levels and it is the potential effect on future schemes that results in the HRABP not being fully funded by Year 30. However, most developments should be financially viable on an individual basis.

There would be a natural drop in annual rental income (by nearly £2.3 million per annum by 2044/45) and this would contribute to a reduction in the HRA working balance in Year 30 of around £33 million.

This, in turn, would result in a situation where the loan balance outstanding would exceed the HRA working balance i.e. the HRABP is not fully funded by around £12 million.

However, no additional loans would be needed until 2024/25 – after the first planned debt repayments have been made – which means that Winchester would not exceed the debt cap.

Individual scheme average rents would drop to between £124 and £166 per week and whilst this benefit would be felt at schemes with a large capital outlay for land (such as New Queens Head), there would be no “gain” at other schemes where there is no land purchase or income loss to be offset e.g. Swanmore.

Another Alternative

There is a further alternative – that we apply a criterion that individual schemes should be viable over 35 or 40 years.

It is not possible to assess this over the life of the HRA Business Plan (as this only runs for 30 years), however, the average rents that would be applicable against the schemes currently “in progress” have been detailed below so that the differences can be seen.

		35 Year Viability			40 Year Viability		
Scheme	Current Policy Average Rent	Average Rent	Lowest Weekly Rent	Highest Weekly Rent	Average Rent	Lowest Weekly Rent	Highest Weekly Rent
New Queens Head	£164.19	£148.76			£135.90		
Victoria House	£153.37	£140.61			£128.61		
Westman Road	£160.42	£144.58			£132.50		
Spring Vale	£166.15	£147.00			£133.00		
Hillier Way	£164.57	£159.50			£154.50		

It can be seen from the table above that, with the exception of the Hillier Way scheme (where cost estimates are in their early stages), average rents show a reduction of around £12 to £15 for each 5 years added to the viability assessment.

Although the highest weekly rent for Westman Road still looks high (£202 on a 35 year viability) this is for a 4 bedroom property in an area where the market rents have been assessed by an independent valuer at over £346 per week.

Considerations and Summary Comments

One consideration that has not been discussed above (as it does not have nay direct impact on the HRA Business Plan) is the saving to tenants living in the new houses by virtue of the high specification of energy efficiency and water saving features that are built into the design of the properties. As an example, the Energy Performance Certificates (EPC) for the new houses at Otterbourne for combined heat/power indicated a monthly bill of £35-40. This compares extremely favourably with existing Council stock where the average is estimated to be over £100 per month for an equivalent size property.

It is an obligation on the Council to maintain a viable 30 year HRABP. The mainstays of this requirement are to ensure that the HRA borrowing limit (debt cap) is not exceeded and that the Council always has sufficient funds to pay debt charges whilst maintaining the stock to a decent standard.

The current rent policy for new build developments is for an individual scheme to be viable over a 30 year period i.e. the rental (and service charge) income would cover the development costs, interest charges and future management and maintenance costs. However, this would not stop the Council having a flexible approach to allow some developments to be “cross-subsidised” by other schemes if this policy were changed.

Another alternative would be to consider open market sales as part of future developments – this could allow marginal schemes to become fully viable.

From the rent scenario testing done, applying social rents or social rents + 5% across all future new build developments would result in the debt cap being exceeded by 2019/20 and many individual schemes not being financially viable.

Whilst applying a 70% average market rent would require additional borrowing in 2019/20 over that already planned, the Council would not exceed the debt cap. It is also worth noting that, although the HRABP is not fully funded at the end of 30 years, the difference between the HRA working balance and the loan balance outstanding is relatively small.

If land costs were removed from the scheme cost and the Council then continued the current policy to calculate rents on a scheme by scheme viability basis, this has a positive effect on some developments whilst having no effect on others. It is difficult to assess the exact impact on both rents and the HRABP with this scenario as the Council will, ultimately, run out of land available for development. In order to continue the ambitious new build programme, this will require extra investment in land with the associated additional cost. However, it is impossible to estimate the likely effect on scheme costs and, in turn, the HRABP of such land purchases.

Finally, applying an 80% affordable rent across the board does, as could be anticipated, give the best return to the Council overall. The difficulty with this approach is that although it provides sufficient capacity to continue with the new build programme over 30 years, there will be continuing questions over affordability for those who are or will be in need of assistance with housing in the future. Unless other providers and developers continue to invest heavily in both social/affordable and open market housing within the Winchester area, demand will continue to outstrip supply resulting in continuing increases in rent values.

Future Risks

One risk that hasn't been considered as part of the HRABP analysis carried out for this exercise is that of future inflation rates for rents. As Members will be aware, the latest Government guideline on rents (at least until April 2024) is for them to be increased at Consumer Price Index (CPI) plus 1%. With inflation now forecast as remaining low for some time, this will have a direct impact on the future viability of the HRABP. The same restrictions in contractor pricing do not apply and it could reasonably be expected that contractor prices for new build schemes will increase at above inflation rates.

There is no risk of new properties remaining unlet for any length of time, however, it is increasingly possible that only Housing Benefit claimants and "better off" tenants would be able to afford new properties at 80% affordable rents. Nevertheless, the majority of vacancies coming forward under Choice Based Lettings (CBL) will still be at social rents.

Conclusion

This Group needs to consider “What is the longer term priority of the Council?” In simple terms, more rent collected will mean more new homes for those tenants waiting to move to a more suitable property and in turn help to tackle the shortages and help those on the waiting list. Current national housing policy supports the approach of maximising rents. In the short term, there will be very limited capital support for new build through either an increase in the Council’s debt cap or grants from the Homes & Communities Agency.

Officers could recommend a default 70% rent on all new build schemes except those where external grant funding is received (as grant conditions will assume 80% rents are to be charged). This could be linked to moving to a 35 year payback, rather than the existing 30 years, in order that viability can be demonstrated.

Alternatively, if Members want to maximise new build whilst retaining strong levels of investment on existing stock, charging 80% rents on new properties is the sensible approach. If this were the way forward, officers would suggest a review in, say, 2017 of the background of applicants housed from the waiting list (or transferred from existing stock) to understand who we are housing.