Informal Policy Group

Rent Setting Policy for New Build Council Properties

Previous Meeting and Papers

The previous meeting of this Informal Policy Group discussed a range of options for rent policy for new build schemes and it was agreed that officers would refine a small number of options in detail for the next meeting.

It is worth noting that the Group Terms of Reference, agreed in September 2014, are *"To review how rents are set for new build Council homes and to consider the impact of any recommendations on the HRA Business Plan."*

It is hoped that this meeting will result in a recommendation for a way forward to be agreed and presented to Cabinet (Housing) Committee on 30 June.

Introduction

In order to assist in narrowing the scope of discussion, a smaller number of in progress schemes have been used to assess the impact of various rent options rather than considering completed or "far in the future" projects.

The schemes chosen are New Queens Head, Stanmore; Westman Road, Weeke; Spring Vale, Swanmore; and Victoria House, Winchester. Three of these schemes are due for completion and first letting during the 2015/16 year. Each of these projects has firm contracted costs or sound cost estimates, enabling officers to assess the impact of different rent options more accurately.

However, before continuing with the options analysis, Members may want to discuss whether they wish to keep the current policy of ensuring that each new build scheme is viable in its own right or to adopt a more overarching policy where potential subsidies between schemes are allowed.

If individual scheme viability is considered a priority, where necessary officers will look at potential for market or shared ownership sales when assessing schemes to assist in the funding of the development.

If an approach that allows subsidies between schemes is the preferred policy, officers would continue to assess individual projects for viability and monitor the effect on the overall HRA Business Plan to ensure that this remains fully funded. This may include the use of market or shared ownership sales to help with the funding of individual developments.

Projects Considered in Further Detail

Before looking at the rent options being considered, it is worth reminding Members of some of the factors specific to each of the projects that will have an impact on the costs and subsequent rents:

- *New Queens Head* – unlike many of the schemes being progressed by the New Homes Team, this site had a high land acquisition cost. This has directly impacted the viability of the scheme and meant that the rents being considered are substantially higher than those faced by tenants in the Council's social housing in the locality.
- *Westman Road* – this scheme is benefitting from high local market rents with a relatively small offset cost for lost garage income. This means that the rents chargeable under the current policy to make the scheme viable over 30 years are around 60-65% of the assessed market rents for equivalent properties.
- *Spring Vale* – this is a small scheme of just 2 dwellings and although there is no land cost, the size of development has a direct effect on viability. It is also in an area where market rents are relatively low when compared to other areas of the District.
- *Victoria House* – this is a mixed scheme of 18 rented and 9 shared ownership dwellings on a site that previously had a sheltered accommodation block. There are additional costs for demolition and archaeology and is in an area close to Winchester station where market rents are very high.

Rent Options

Appendix 1 to this paper shows the weekly rents for each of the above schemes, split by bedroom number and property type. The figures show the approximate rents that would apply if the Council were to adopt a policy of charging 80% or 70% market value rents, or where the scheme was assessed to provide a payback over 35 years (in place of the existing 30 years). The calculated rent under the existing policy and social rents +5% are shown for information, together with a revised net present value (NPV) for the development against each rent option. Local Housing Allowance rates for 2015/16 for the Winchester rent area are also shown at the foot of the table for information.

Commentary on each of the rent options when applied to the 4 schemes follows.

New Queens Head

1. If viewed on its own, this scheme would not be close to being viable if rents at 70% or social rents +5% were to be applied.
2. This is primarily due to the effect of land costs on the scheme, as mentioned above.
3. When calculating the rent over a 35 year payback period with the intention of achieving a similar NPV, rents would be between £11 and £28 less than the

current policy and be around 73% of the market rent (as last measured for the project in October 2013).
4. However, even when applying the 35 year payback policy, the 3 bedroom rent is still nearly £65 per week higher than the social rent average in Stanmore with 2 bedroom rents around £48 per week higher.

Westman Road

1. This scheme is unusual in that the current policy rent is below 70% of market rents due to the high market rent values in that area.
2. This results in a very high return if 70% or 80% market rents were to be applied.
3. If the contingencies applied to the appraisal (including elements of the open space mitigation) are not required, the extra savings this would provide would enable rents at the scheme to be reduced further.
4. The average 3 bedroom social rent in the Weeke area is currently around £122 per week with 2 bedroom rents about £10 lower.

Spring Vale

1. With such a small development, any apparently minor change to costs or income can have a marked effect on the viability of the scheme.
2. Interestingly, with this project, revising the payback term to 35 years means that 70% market rents would be sufficient to provide a viable scheme.
3. Nevertheless, the standard payback term of 30 years would result in the project not being viable with anything less than 78% of current market rents.
4. Tenants of 3 bedroom social rent houses in Swanmore are paying an average of about £126.50 per week at 2015/16 rates.

Victoria House

1. The high rents for this scheme under the current policy reflect both the high market rents in the City Centre area and the extra costs attributable to the scheme in replacing the old building.
2. Once again, applying 70% market value rents results in the scheme not being viable on its own merits but 80% rents give a more positive return.
3. Changing the payback to 35 years in this instance does help reduce rents by between £10 and £16 per week.
4. The rents shown in the table compare with an average 2 bedroom social rent of £99 but it should be noted these are mostly within the Council's sheltered schemes.
5. The assessment done here is based on the costs from the last tender undertaken in early 2015. The decision to re-tender is likely to impact on the viability for this scheme.

Applying the Rent Options to the HRA Business Plan

The key criterion when assessing the rent options against the HRA Business Plan is to ensure that the Council can meet all our capital expenditure requirements whilst

remaining below the debt cap threshold. This threshold is, by March 2017, £167.5m of which £156.3m is borrowed using medium or long term loans with the Public Works Loan Board (PWLB). The first of these loans is due for repayment in 2022/23. The HRA also has an internal borrowing arrangement with the Council General Fund which will remain available as long as the Council has a surplus cash facility.

Applying the rents for each scheme discussed above does not cause an issue with the debt cap but, when applied to all future schemes as well, the social rent +5% policy option would cause the debt cap to be exceeded by 2019/20. It would also require additional internal borrowing as early as 2016/17.

The remaining options allow the Council to stay within the debt cap (assuming costs for future new build projects do not increase significantly above inflation in the next 3 to 4 years). However, both the 70% market rent and 35 year payback options will require additional internal borrowing if applied consistently to all schemes – this is estimated to be needed in 2019/20.

As the HRA Business Plan is predicated using rents that are at, or close to, 80% market values, applying a consistent 80% rent would have a marginal impact on the current Business Plan. The debt cap would not be exceeded and no additional borrowing would be required before the first fixed term debt falls due in 2022/23.

It is also worth noting the effect on overall rent income when compared to the existing policy. By year 30, applying 70% market rents would reduce rental income by around £790,000 per year. This is increased to approximately £815,000 for 35 year payback rents.

The other impact would be on the HRA working balance at the end of the 30-year Business Plan and how this compares to the loans outstanding at the time. The current Business Plan has a balance of £88,121,000 with £66,553,000 loans outstanding – in accounting terms it is "fully funded". Applying 80% rents consistently would increase the working balance to around £88.5m. None of the other options, when applied to all future schemes, would give this comfort although 70% market rents and 35 year payback rents are relatively close at £60,102,000 and £58,865,000 respectively.

HRA Business Plan Base Assumptions

The detail on Business Plan assumptions was provided to the last IPG meeting but they are repeated here for information.

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 above.

<u>Comments and Conclusions</u>

It is likely that the Council will need to adopt a flexible approach if the requirement to maintain a viable 30 year Business Plan is to be matched with continuing to provide good quality housing together with providing new housing at what can be (subjectively) considered affordable rents.

It is apparent that a social rent + 5% policy option would ensure affordable rents but would leave the HRA with difficult choices in the near future between maintaining the existing stock to a good standard or new homes – it simply would not be financially possible to do both. It is, therefore, not really an option for further consideration.

Both 70% market rents and 35 year payback rents are more promising options and, with consideration for market and shared ownership sales on future developments, could be the way forward to help make new build rents more affordable to our tenants.

There will be occasions where 80% rents are required or expected to be charged as a result of HCA grant conditions and these will help with the ongoing viability of the Business Plan.

It would also be difficult to retrospectively apply any new policy to properties that have been first let over the last year or so and it is recommended that these rents are not affected by any changes proposed to Cabinet (Housing) by this Group.

The following is a suggested approach to be discussed by the Group:

- The starting point will be to assess the scheme over 30 years;
- If the scheme is viable with rents at under 70% then we apply a 70% market rent;
- If a 30 year assessment gives a rent at over 70%, we consider a rent of up to 80%.
- If this is not considered affordable, we then re-assess a scheme on 35 year viability and adjust the rent accordingly;
- If the project is still not viable we look to market sales/shared ownership sales to support the scheme.

There are also some matters that were highlighted in the previous paper to this Group that are still relevant:

- The high specification for energy efficiency and water saving features benefits our tenants of new build homes by an estimated £60 to £70 per month.
- There is continuing risk over inflation rates for rents and how this will compare with inflation factors affecting future management and maintenance costs. This will have a direct impact on the viability of future HRA Business Plans.
- For many years, the majority of lettings coming forward in Council properties under Choice Based Lettings (CBL) will still be at social rents, rather than affordable 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.