Summary: Intervention & Options

Department /Agency:	Title:	
Communities & Local Government	**Impact Assessment of Exempting some New Supply from the HRA Subsidy System**	
Stage: Final Proposal	**Version:** 1	**Date:** 4 October 2007
Related Publications:		

Available to view or download at:

http://www.communities.gov.uk

Contact for enquiries: Stephen BIddulph **Telephone:** 020-7944-0060

What is the problem under consideration? Why is government intervention necessary?

In order to contribute to an increase in the supply of affordable housing, we want to remove disincentives to the provision of new affordable housing by local authorities. Local authorities currently build fewer than 300 new council homes each year. Part of the reason is the treatment of the rental income from those properties in the Housing Revenue Account subsidy system. No central capital subsidy is provided for new build by councils, yet if an LA invests its own resources in new properties around 25% of the rent is redistributed nationally through the HRA subsidy system.

What are the policy objectives and the intended effects?

The provisions should incentivise the release of more local authority land for development as affordable housing. This is intended to be additional to, rather than a replacement for, development by Registered Social Landlords (RSLs) on land provided by local authorities. We would expect most of the local authority new build to be on sites not suitable for RSL development, such as infill within a council's existing stock, other small parcels of land, and places where new supply is linked to council-led renovation and regeneration schemes.

What policy options have been considered? Please justify any preferred option.

We considered three options: (the first is the one we prefer and are pursuing)

Enabling new affordable housing provided by local authorities to be held outside the HRA subsidy system. This would allow a local authority to retain the full income return from its capital investment.

Creating a new build allowance within the HRA subsidy system. This could achieve a similar outcome but would add further complexity to a complex system.

Do nothing: this would retain the disincentives to new supply of affordable housing within the HRA. We would not expect any increase in the outputs.

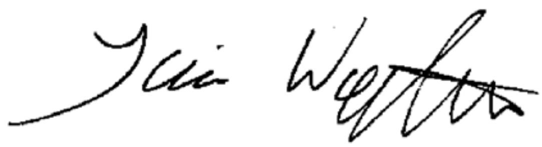
When will the policy be reviewed to establish the actual costs and benefits and the achievement of the desired effects?

The policy will be formally reviewed after two years.

Ministerial Sign-off For final proposal/implementation stage Impact Assessments:

> ***I have read the Impact Assessment and I am satisfied that, given the available evidence, it represents a reasonable view of the likely costs, benefits and impact of the leading options.***

Signed by the responsible Minister:



Date: 9 November 2007

Summary: Analysis & Evidence

Policy Option:	**Description: Enable new affordable housing provided by local authorities to be held outside the HRA subsidy system**

COSTS

ANNUAL COSTS		Description and scale of **key monetised costs** by 'main affected groups' The cost is a transfer of resources between central and local government. Surplus rental income from up to 300 additional HRA properties each year would be retained locally instead of being redistributed nationally through the HRA subsidy system.
One-off (Transition)	**Yrs**	
£0		
Average Annual Cost (excluding one-off)		
£245,000		**Total Cost** (PV) **£245,000**

Other **key non-monetised costs** by 'main affected groups' None

BENEFITS

ANNUAL BENEFITS		Description and scale of **key monetised benefits** by 'main affected groups'
One-off	**Yrs**	
£0	0	
Average Annual Benefit (excluding one-off)		
£0		**Total Benefit** (PV) **£0**

Other **key non-monetised benefits** by 'main affected groups'
The changes should incentivise more council house building, from under 300 across England each year for the last ten years to several thousand.

Key Assumptions/Sensitivities/Risks Levels of council house building are assumed to continue on current trajectories if the policy changes are not made, and allowances are assumed to continue at current real levels.

Price Base Year	Time Period Years	Net Benefit Range (NPV)	NET BENEFIT (NPV Best estimate)
2006	1	**£N/A**	**£N/A**

<table>
<tr><td colspan="3">What is the geographic coverage of the policy/option?</td><td colspan="2">England</td></tr>
<tr><td colspan="3">On what date will the policy be implemented?</td><td colspan="2">On BIll’s enactment</td></tr>
<tr><td colspan="3">Which organisation(s) will enforce the policy?</td><td colspan="2">CLG</td></tr>
<tr><td colspan="3">What is the total annual cost of enforcement for these organisations?</td><td colspan="2">£0</td></tr>
<tr><td colspan="3">Does enforcement comply with Hampton principles?</td><td colspan="2">Yes</td></tr>
<tr><td colspan="3">Will implementation go beyond minimum EU requirements?</td><td colspan="2">No</td></tr>
<tr><td colspan="3">What is the value of the proposed offsetting measure per year?</td><td colspan="2">£0</td></tr>
<tr><td colspan="3">What is the value of changes in greenhouse gas emissions?</td><td colspan="2">£0</td></tr>
<tr><td colspan="3">Will the proposal have a significant impact on competition?</td><td colspan="2">No</td></tr>
<tr><td>Annual cost (£–£) per organisation (excluding one-off)</td><td>Micro</td><td>Small</td><td>Medium</td><td>Large</td></tr>
<tr><td>Are any of these organisations exempt?</td><td>No</td><td>No</td><td>N/A</td><td>N/A</td></tr>
</table>

Impact on Admin Burdens Baseline (2005 Prices)		(Increase – Decrease)
Increase of £0	Decrease of £0	**Net Impact £0**

Key:	**Annual costs and benefits: Constant Prices**	**(Net) Present Value**

Evidence Base (for summary sheets)

[Use this space (with a recommended maximum of 30 pages) to set out the evidence, analysis and detailed narrative from which you have generated your policy options or proposal. Ensure that the information is organised in such a way as to explain clearly the summary information on the preceding pages of this form.]

The need for intervention

The Government has a target to increase the supply of affordable housing in England to at least 70,000 a year by 2010-11. This is to include at least 45,000 social homes, a 50% increase over 3 years and more than doubling the level of housing in six years. To help meet this ambition, we want to give local authorities a greater role in the direct provision of social housing and thereby incentivise the release of more local authority land for development.

Local authorities are not precluded from building council housing. However, the vast majority of new social housing is built by Registered Social Landlords (RSLs), with councils building less than 300 homes in total each year. RSLs are able to build more homes for the same amount of public investment because they can lever in extra private sector borrowing. For this reason, Government direct investment will continue to be directed towards organisations which can mix public grant and private borrowing. But the pressing need for affordable housing means there is a need to examine all opportunities to build more housing. We therefore wish to remove disincentives to local authorities who are prepared to invest their own resources, including land and grant, to deliver more council housing.

Policy objectives and intended effect

We intend that the extra council housing delivered through these policy changes should be additional to, rather than a replacement for, development by Registered Social Landlords (RSLs). Where it is more efficient to work with an RSL partner, councils should continue to support that model of development. Some potential developments may not be suitable for RSL development, such as infill within a council's existing stock, other small parcels of land, and new supply linked to council-led renovation and regeneration schemes. Some councils may also be more willing to support new development with land and grants if they retain a stake in the new properties.

No targets have been set for the increase in new build within the HRA from the proposed changes. But we expect the policies to increase LA new build from a few hundred a year to a few thousand, including a mix of social rent, low cost home ownership and market sale.

The rationale for the proposed changes

Local authorities have in total across England built fewer than 300 social rented homes within the HRA each year since 1997. The local authority housing finance system has two key disincentives to new build within the HRA which appear likely to be major factors in this low level of new council house building, related to capital and revenue funding:

i) the Government has directed its capital subsidy for new social housing (social housing grant – SHG) at RSL developers, because they bring in private borrowing to supplement public investment. No capital support is provided by Government for new council housing within the HRA, either as reprovision or additional supply (with the exception of the Housing Private Finance Initiative (PFI) programme);

ii) through the HRA subsidy system, the notional operating surpluses of new supply HRA homes (after allowances are made for the notional costs of managing and maintaining the homes) are taken from an authority and recycled through the HRAS system. No provision is made within these allowances for the cost of financing capital debt where the local housing authority has borrowed to provide the new housing. So if a council provides an additional new social home, its notional rental income would exceed the allowances received by way of management, maintenance and major repairs. On average, allowances are 74% of rents at present.

Government provides grants to bodies for the provision of new affordable housing through bidding programmes. These programmes assess schemes for value for money and calculate the need for additional Government subsidy. Changes to the policies for allocating capital subsidy are not addressed here. Government has opened up bidding this year to local authorities who wish to develop through Arms' Length Management Organisations (ALMOs) and Special Venture Vehicles (SPVs), but <u>not</u> to local authorities who wish to build within the HRA (i.e. not to those properties which would benefit from the policy proposal covered by this impact assessment.)

The intention of the current policy proposal is to enable local authorities to assess the local business case for new build schemes, given the ability to retain locally the full returns (i.e. rents) from their investment. As social rent levels are not high enough to generate operating surpluses sufficient to cover the costs of schemes, authorities will normally need to provide additional resources to subsidise schemes. This may be in the form of local authority grants or land, or from cross-subsidy from capital receipts from sales of some related market housing.

Policy options

The policy intention is to in effect make new supply dwellings invisible to the HRA subsidy system – allowing authorities to retain the actual rents from new supply properties within the HRA, rather than providing allowances for these properties through the HRA subsidy system and recycling any notional surpluses nationally. This would allow local authorities to use the surplus (that is the amount left over once the costs of management, maintenance and repairs have been deducted from the rent received) to service the debt or to provide a return on capital.

The alternative would be to create an allowance which achieves the same effect. This would however be administratively complex, requiring annual calculations on the guideline rents for the new homes and the allowances which those specific properties are attracting within the HRA subsidy system, so that a new allowance could be paid which equated to the difference between the two.

A simpler form of allowance might be one related to the investment need rather than the annually varying relationship between rents and subsidies. But this would undermine the principle of the policy, which is to make the investment decision to build a local one, based on the actual returns from a local investment. An allowance that was based on an assessment of need would also have an additional cost to Government and would need to be made after a Government assessment of the merits of each individual scheme.

The intention is that this 'new supply' should be dwellings built, acquired and possibly also properties brought back into use by the authority after a certain date. We would however need to ensure that the provisions did not allow authorities to move properties out of the HRA subsidy regime simply in order to increase their income. The properties subject to the new rules should represent a significant local investment and an addition to the housing stock.

The value of the proposed changes to a local authority and the cost to Government

The HRA subsidy system makes assumptions about housing income (mostly rent) and need to spend (such as management and maintenance) on housing stock owned by each local authority. Allowances are made for the assumed need to spend on housing by each local authority. The amount of assumed income remaining after need to spend has been deducted is considered to be an operating surplus. This notional surplus is taken from the local authority and is recycled nationally to subsidise those authorities where assumed need to spend is greater than assumed income. One of the elements of subsidy is an allowance to support housing borrowing. This supported borrowing does not however include any costs incurred in providing new homes (except for housing PFI schemes). In general, the net effect for a council which builds a new council house is that its net income increases by an amount smaller than the value of the rent on that property because the dwelling is generating an assumed operating surplus which is captured by Government.

On average in 2007-08 the notional operating surpluses of HRA dwellings equated to 26% of the notional rental income. The average guideline rent was £3,137. So the average dwelling was producing a notional operating surplus of £816. This is the part of the rent taken from the local authority and redistributed within the HRA subsidy system. If the proposed changes were made, none of the notional surplus on any new supply by a local authority would be recycled nationally. Instead, the full rent from new properties would be retained locally, and any surplus after actual spending on management, repairs and maintenance could be used to support the capital costs of development.

Fewer than 300 new homes have been built within the HRA across the whole of England in any of the last 10 years. Without the proposed changes to the HRA subsidy system, we would expect new build within the HRA to continue at these low rates. The policy changes would therefore mean foregoing notional rental operating surpluses to the HRA subsidy system from those 300 homes.

£816 x 300 = £245,000. This represents around 0.015% of the nearly £1.7bn of operating surpluses currently redistributed through the HRA subsidy system from the 2m homes.

After 10 years, the stock numbers exempted from the HRA subsidy system would have been expected to rise to 3000 (10 x 300) and the annual loss of surpluses to the HRA subsidy system would rise to £2.45m (£816 x 3000). This would represent around 0.15% of total stock and surpluses.

Any future increases in the numbers of homes built in the HRA would be driven by the policy changes we are proposing here. So the rental surpluses from this increase would not otherwise have been generated and should not be considered as losses to the HRA subsidy system.

Potential impact on public borrowing

The changes would incentivise more new build by councils. This would be financed in part from additional borrowing by local authorities. A typical RSL scheme, with a capital cost of £150,000, includes around £54,000 of borrowing to add to grant, discounted land and other landlord contributions.

A local authority scheme is likely to lever in a similar level of borrowing, using the rental surpluses to support this. This borrowing will be done within local government prudential borrowing rules, but it will still impact on national policies and targets. Each additional unit built by an authority above the current 300 per year would, on this basis, increase public borrowing by £54k.

Government has not set targets for the increase in council house building which it expects from this policy change. Responses from individual local authorities and representative bodies suggest that it could lead to a significant increase on current low levels, in percentage terms, but that in absolute terms it would not be large. This new build would not be eligible for capital subsidy from Government (i.e. social housing grant), and social rents alone are not sufficient to finance new build. So each local authority scheme would depend on the provision of discounted land and/or other receipts from the council to supplement borrowing.

An increase from 300 units a year to 2,500 would increase public borrowing by (2,500 – 300) x £54k = £119m.

As each local authority would have to apply to the Secretary of State for an exclusion from the HRA subsidy system for its new build scheme proposals, Government could, if needed, use this to manage the impact on national public borrowing policies by restricting the numbers approved.

Specific Impacts on policy areas

The policy proposal would simply change the financing structure for some local housing authorities who were considering building more social housing. This would have no direct impact on any of the areas of policy set out below. National and local housing policies would remain in place. The new council homes would continue to be subject to any national policies on allocations, rent levels etc.

For this reason, no specific impact assessments have been conducted on the areas listed below. However, as the policy is intended to increase the supply of social housing, those groups who disproportionately depend on social housing would benefit disproportionately. These include some **ethnic minorities**.

Poor housing is generally identified as having a significant impact on **health and well-being**, as well as educational and future life prospects. The policy will increase the supply of good quality housing for those in need.

Rural authorities will have the same opportunities as urban authorities to benefit from the changes.

Specific Impact Tests: Checklist

Use the table below to demonstrate how broadly you have considered the potential impacts of your policy options.

Ensure that the results of any tests that impact on the cost-benefit analysis are contained within the main evidence base; other results may be annexed.

Type of testing undertaken	Results in Evidence Base?	Results annexed?
Competition Assessment	Yes	No
Small Firms Impact Test	Yes	No
Legal Aid	Yes	No
Sustainable Development	Yes	No
Carbon Assessment	Yes	No
Other Environment	Yes	No
Health Impact Assessment	Yes	No
Race Equality	Yes	No
Disability Equality	Yes	No
Gender Equality	Yes	No
Human Rights	Yes	No
Rural Proofing	Yes	No

Annexes

None.