

Levelling Up, Housing and Communities Committee inquiry into the finances and sustainability of social housing

Evidence from ARCH and the NFA 12 May 2023

About ARCH and the NFA

4 out of 10 social homes in England are owned by local authorities, and either managed by them directly or through Arm's Length Management Organisations (ALMOs). The Association of Retained Council Housing (ARCH) represents councils that have chosen to retain ownership of council housing and manage it directly. The National Federation of ALMOs represents the Arm's Length Management Organisations managing council homes on behalf of their parent councils.

About this submission

This joint submission focuses on the council housing sector; we have not attempted to answer questions relating to private Registered Providers. Our answers to many of the questions draw on the findings of three major reports we commissioned jointly, in partnership with the Local Government Association, from Savills Affordable Housing Consultancy, which are based on research carried out during the summer and autumn of 2022. The reports cover:

- The expected income requirements of local authority housing; this report was prepared during consultation on the Government's proposal to limit rent increases in 2023/24
- Expenditure needs, short and longer term
- The financial impact of the Right to Buy policy on local authority HRAs.

Relevant findings are detailed in the answers to individual questions; the full reports, which provide more information on the wider context and the research methodology, can be accessed at:

- <https://www.local.gov.uk/publications/research-income-and-rents-within-housing-revenue-account>
- <https://www.local.gov.uk/publications/research-expenditure-within-housing-revenue-account>
- <https://www.local.gov.uk/publications/research-right-buy-within-housing-revenue-account>

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The current state of financial resilience of social housing providers

Q1: How would you assess the financial resilience of the social housing sector currently? Are increasing pressures and requirements putting financial viability at risk?

Prior to the implementation of a 7% limit on the 2023/24 increase, Government policy envisaged an annual rent increase of CPI + 1% each year until 2025; there is no defined rent policy after 2025 despite both local authorities and housing associations making the case for longer-term certainty to support longer term business planning. To inform consultation on the Government's proposal for a rent increase cap in 2023/24, we asked Savills to model the impact of alternative scenarios for future rent increases, up to and beyond 2025. The following results are drawn from the Savills report on Income and Rents in the HRA.

The modelling showed that continuation of a CPI +1% policy (i.e. beyond 2025 and with no cap in 2023/24 or 2024/25) would barely provide sufficient income to meet known expenditure requirements over the next decade. Any restriction of rent increases below current rent policy would cause significant financial difficulties for most local authorities in the shorter or longer term.

Modelling of inflation-driven cost pressures on management and day-to-day maintenance spending suggested that local authorities would need to levy "stand-still" rent increases averaging 8.2%, with most in the range 7-9%. Combined with the impact of cost pressures affecting capital programmes, the modelling suggested that imposition of a 7% cap means that authorities are typically now looking to make savings of 5% from revenue budgets or make equivalent use of reserves, where these are available. We are not aware that any authority is currently at risk of being unable to balance its HRA, but the current imbalance between costs and permissible rent increases is not sustainable. We understand that the Government is not planning to cap rent increases in 2024/25, however long-term financial viability is not guaranteed unless rent levels are allowed to catch up with what they would have been had the rent increase cap not been imposed, implying rent increases above CPI + 1% into the future. Savills model scenarios with rents catching up over 5 or 10 years.

This modelling does not take full account of future capital expenditure pressures arising from building safety, an enhanced Decent Homes Standard or achievement of net zero homes, which are considered in the Savills report on Expenditure in the HRA and discussed below.

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Q2 What pressure has high inflation, increased energy costs and any additional costs placed on the finances of social housing providers?

Savills provided us with the following estimates of the impact of inflation on revenue repairs and housing management budgets.

- Consolidated inflation for repairs budgets is estimated at 9.2% for 2023.24 and 6.4% for 2024.25.
- Consolidated inflation for housing management budgets is estimated at 16.4% for 2023.24 and 9.4% for 2024.25.

Taken together, the total *additional* inflationary pressures on day-to-day revenue costs in the HRA amount to an estimated £5.1billion over 5 years. These estimates do not include the impact of cost pressures on capital spending.

Q3 To what extent can social housing providers maintain output levels in housing development to provide a counter-cyclical balance in otherwise tightening market conditions?

Rent restrictions and pressures to prioritise investment in the existing housing stock are limiting the number of new housing starts local authorities are able to make, and they are also subject to the same cost pressures arising from building, building materials and borrowing cost inflation as is the case in the private sector. Scope for countercyclical investment is therefore very limited. However, in the case of schemes already under construction – particularly joint ventures between local authorities and private developers - we are aware of cases where local authorities have intervened to secure continuing scheme viability, for example by redesignating as social housing homes originally designated for sale and purchasing them from HRA resources.

Q5 Does the cross-subsidy model, by which market housing helps pay for social and affordable housing, have any continuing viability?

It would be premature to write off the cross-subsidy model given the high level of uncertainty about future housing market trends, but it is unlikely in the short term, or in the decade ahead to help deliver anything close to the number of social and affordable homes that it has delivered over the last decade.

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New challenges to the social housing sector

Q1 The Secretary of State has specified that more resources need to be directed towards maintaining and improving the existing stock. How feasible is this for social housing providers?

There are a variety of pressures for additional expenditure on the existing council housing stock, the most important of which are:

- The impact of inflation on housing management and revenue repairs costs, discussed above.
- Tighter enforcement of existing standards, including the Decent Homes Standard, through the new regulatory regime to be introduced by the Social Housing (Regulation) Bill.
- Any enhancement of the Decent Homes Standard as a consequence of the current review.
- The recently introduced requirements of the Fire Safety and Building Safety Acts, particularly but not exclusively in relation to high rise blocks of flats.
- The ambition, to make progress towards net-zero carbon housing by 2050, to raise all council homes to EPC Band C by 2030 and begin widespread introduction of clean energy.

Estimates for the cost of each of these is provided by the modelling in the Savills expenditure report. The unavoidable conclusion from the modelling is that no adequate funding can yet be identified for a significant proportion of the necessary expenditure. The Government has no policy on rents after 2025, and currently allocated grants for energy efficiency and net-zero works fall well short of what is needed to tackle the number of homes in need of improvement. We are hoping that the Secretary of State will soon take the opportunity to discuss with us the quantum of additional resources needed to make the existing stock fit for the future and how those additional resources will be found.

Q2 How do social housing providers choose whether to undertake new development or to focus on management and upkeep of existing stock? providers are undertaking new developments, what consideration has been given to the types of homes they are building? For example, houses versus flats?

The first priority of any landlord is to ensure the homes they own and let out to tenants are safe, decent and meet minimum health and safety standards.

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However, council landlords should also be looking at their stock in the round, its capital investment requirements, how well the size, location and type meet the needs of the population who needs it and how best to manage their assets, income and expenditure in light of meeting the needs of both people already in their homes, those in temporary accommodation and those on the waiting list for social housing.

A growth plan for the HRA can actually help many councils afford much needed investment in their existing stock due to the additional rental income that the new properties bring in and the fact that these properties typically do not require major investment for the first 15 – 20 years of their lives. However, the threat of losing a large proportion of those new builds through RtB, which a council has no control over and cannot accurately plan for, presents a real financial risk to any large scale growth plan which we believe limits most councils' development programmes alongside other factors like cost and land availability.

Local authorities also have duties to meet housing need and to respond to homelessness. Annual social housing lettings are at a historical low and Savills modelling suggests that local authorities can expect to lose around 7% of their homes over the next 10 years as a result of Right to Buy. Experience to date of the RTB replacement scheme suggests that only around half of these homes are likely to be replaced. In addition, a growing percentage of the existing stock will need replacement over the next decade, either because it is reaching the end of its useful life, no longer suitable for occupation, or uneconomic to make safe or bring up to zero-carbon standards. Major renovation of other homes will need tenants to be rehoused, whether temporarily or permanently. All these create a demand for new homes that all local authorities face to a greater or lesser extent. Local authority housing strategies are expected to assess these competing priorities in detail and arrive at a programme that achieves the most effective response overall.

In terms of deciding what types and tenures of homes they build, councils and ALMOs will look at the need for housing in the area, what is financially viable as well as what is permitted by planning rules and regulations. In some areas councils will be looking for high density blocks of flats to make the most of good transport links and provide as much housing as possible where land is in high demand and very expensive; in other areas it will be more appropriate to build family houses with gardens or bungalows for older or disabled families. After consideration of all of the issues, any resulting development plan will aim to get the best mix of type, size and tenure for the site and the finance available.

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Q3 What issues does the requirement on housing associations to carrying out building safety present?

While this question is not explicitly directed at local authorities, we would like to comment that the Savills modelling includes a costed estimate of the financial impact of local authorities complying with the requirements of the Building Safety and Fire Safety Acts for their own stock.

Q4 Has the lifting of the cap on Housing Revenue Account borrowing made a difference to supply or improved housing from local authorities?

The cap on local authority HRA borrowing was abolished in October 2018. In that year's Autumn Budget, the Treasury estimated that this would lead to 10,000 additional council homes over the next 5 years. In January 2020, ARCH and the NFA published the results of a survey carried out jointly with the Chartered Institute of Housing, which asked 40 authorities about the impact of abolition of the cap on their investment plans; all reported plans to build more homes. Taken together the survey results suggested that the Treasury estimate was likely to be met if not surpassed. But respondents also made clear that the borrowing cap was not the only, and for many, not the most important obstacle to housebuilding. Land shortages, planning problems, uncertainty over future rent policy and shortage of key skills were already issues at the start of 2020, the subsequent onset of the COVID pandemic and post-pandemic supply chain issues facing the building and building supply industries have reinforced this conclusion, impacting both starts and completions. The number of new council homes started in each year since 2018 was:

2019	1480
2020	1670
2021	2580
2022	1580

Abolition of the borrowing cap has, however, been of benefit to many authorities which have been forced to borrow in the current year to fund capitalised repairs which could not be funded from rent income due to the rent increase cap.

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Q9 What contribution have council owned companies made to increasing social housing supply? Is the collapse of Brick by Brick – wholly owned by the London Borough of Croydon – a one-off or the tip of the iceberg?

ALMOs are council owned companies which, if their performance was rated 2* by the Audit Commission, were able to bid for government grant from 2008. Since that time ALMOs have been slowly developing their expertise and experience in building new homes both for their direct ownership and within the HRA. We calculate from our membership surveys over the years that since 2008 ALMOs have built around 15,000 new homes for both ALMO ownership and for the HRA. These have been a mixture of general needs social and affordable rent, shared ownership and supported housing. Although ALMOs have been closed down over the years by their parent councils this has never been due to the financial collapse of the company and ALMOs continue to be well governed, well managed housing management companies who, although smaller in number than before still have plans to build 1,682 homes over the next 12 months, and approximately 6,300 homes in the next five years.

The key to ALMOs' success in building new council and ALMO owned housing has been starting with small in-fill sites of 4-5 homes to test the concept and developing skills and experience by learning and growing over time. This steady approach has been overseen by robust governance arrangements with tenants, councillors and independent board members scrutinising plans and monitoring outcomes, including full financial risk assessments by audit and risk committees with independent expertise, often from the housing association development sector. ALMOs have not sought to be the volume housebuilders in their areas but by having a steady programme of a few hundred a year have consistently added to the council stock of affordable homes and have been able to meet specific unmet needs in the community for larger or adapted homes, often making the best use of disused garage sites or increasing density on existing estates.

Other than for ALMOs, we are not aware of an authoritative assessment of the number, functions or performance of local authority housing companies since the report prepared by the Smith Institute in 2017 <https://www.smith-institute.org.uk/book/delivering-renaissance-council-built-homes-rise-local-housing-companies/>. This report stresses the diversity of local housing companies; its definition includes companies wholly and partly owned by local authorities.

The report estimates the number of local housing companies then in operation at 150 and predicts an increase in their number to 200 by 2020. We have no data to confirm or disconfirm this prediction. However, a significant driver behind early establishment of many local housing companies was the freedom to borrow outside the HRA borrowing cap restrictions. The HRA borrowing cap

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was abolished in October 2018, and many local authorities which were formerly planning to build outside the HRA may since have reverted to traditional HRA borrowing.

Local housing companies, like any other organisations, undoubtedly vary in the quality of their governance and management and given their diversity and the diversity of local housing markets, in their resilience to adverse market changes; they have, like other housing organisations, been heavily affected by the impact of the COVID pandemic and subsequent inflationary pressures and interest rate increases. A number may have had their resilience severely tested by these shocks, but we have no reason to suppose that the Croydon failure is the first of many.

What are the policy and regulatory challenges to the Department and the Regulator?

These questions are mainly directly to the Government and the Regulator; however, we would like to comment on two of them where our work suggests that there is a case for reconsideration of current policies. These are:

Q3 Has any evaluation been undertaken of the impact of the additionality guidance on the supply of social housing?

In the context of a homelessness crisis and a major national shortage of housing for social rent we understand why the Government should seek to focus financial assistance for new social housing on the provision of additional dwellings. However, looking ahead, particularly in the context of meeting net zero targets, we believe the current approach needs reconsideration. It is likely that it will prove uneconomic to bring a significant proportion of the existing council housing stock to net zero standards – in other words it will be cheaper to demolish and replace them. Savills estimate that this could apply to as much as 25% of the stock. They propose amendment to the current additionality rules governing AHP to address this problem that we believe deserve serious consideration.

Q4 Is the current range of grant funding available appropriate to address the issues and challenges that the social housing sector faces?

The answer to the previous question is also relevant here. In relation to the current grant regime more generally, we are concerned that current grant rates have not been adjusted to take account of the impact of building cost inflation.

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We would also like to see a larger overall pot for funding social rented homes given the rising need for this tenure as evidenced by the growing numbers of homelessness families stuck in temporary accommodation as well as the growing number of families stuck in overcrowded social or privately rented homes, desperate for larger family homes which are in short supply.

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