BREIFING: COUNCIL OWNED COMPANIES ESTABLISHED TO BUY AND BUILD HOMES – 16.08.19

Introduction on councils building homes: Councils have always had powers to build or buy homes and at different times there have been requirements for them to do so with varying levels of government subsidy and/or ability to borrow money to do so.[i] *(The reference here, is to a list at the end of the briefing to some of the key legislation relating to housing from 1890 to 1988).* The emphasis on building new council homes has principally been split between the need to build homes in the face of housing shortages and replacing homes as a result of slum clearance.

From the 1970's a shift commenced away from delivering low-cost rented council homes (in terms of policy, subsidy and ability to borrow), with gradually, a redirection of subsidy to support homes ownership and (during the 1980's) a diversion of public spending from education and capital costs of housing to health and social security (including housing benefit).

2011 Localism Act introduced two important reforms to the Housing Revenue Account which have potential in terms of construction of new homes built by councils. The Act (i) gave councils more powers to borrow money and (ii) provided local authorities with the General Power of Competence which allows them to carry out any action which is not explicitly forbidden by legislation – such as setting up a private company.

However, the ability of local authorities to borrow is considerably restricted by borrowing caps, which are based on financial settlement reached when the HRA self-financing began in April 2012. The cap was £29.8 billion at its opening level. This was increased by £300 million over 2015-17 in the government's 2013 autumn statement. The limits include the debt that boroughs already have. Anything above that limit is called 'headroom'. The impact of the caps is pretty arbitrary – some councils that need to borrow have no or little headroom, others have significant headroom and may not need it.

Arguments for lifting the HRA borrowing caps: Many of the arguments for lifting the borrowing caps (set out below) have been stated for years, but with little effect, however it is interesting that councils (and indeed the London Mayor) are arguing for the borrowing caps to be lifted.

(i) The international norm is a narrower definition of public debt than that adopted in the UK.
(ii) In 1995 the Chartered Institute of Housing (CIH) published a commissioned report which concluded that the UK was an outlier in Europe in its choice of budget deficit (then called the Public Sector Borrowing Requirement, now Public Sector Net Cash Requirement) and that there was no evidence that this was in anyway superior as an indicator of relative fiscal performance, to that of its major international rivals (which is based around General Gross Debt). The CIH commissioned UK Housing Review continues to make the argument.
(iii) It is perverse that prudential borrowing is permitted against local authorities' General Funds but not against asset-rich HRA.
(iv) The London finance Commission estimates that increased borrowing would be 'modest compared with government borrowing overall'.
(v) Recent modelling work indicates that London's council housing asset stock could double its current borrowing headroom capacity overnight (to £2.8 billion) assuming only a continued income stream at social rents, were the caps lifted. On that basis 10,000 council homes could be built in London for let at social rents.

What are London Councils doing in the absence of the borrowing cap being lifted? Councils are doing a variety of things; some are delivering affordable rent homes through government funding (via the Mayor's Office). Some are delivering a mix of affordable rent homes and private homes on council owned land (including on existing council estates) to deliver some social rented council homes (such as Camden). Others are focusing on buying or delivering new homes of different tenures outside the Housing Revenue Account; most through setting up partnerships with the private sector including establishing separate wholly owned council companies.

Council owned companies: Board members of these new companies are variously made up of executive officers, elected members, and 'independent' experts – the set-up varies slightly between companies. As they are wholly-owned by councils, they are bound to act in the interests of their local authorities and their policies.

Some of the criticisms that have been made about this as a method of delivering new homes are that:

- councils are only looking at this because of the borrowing caps on the HRA. It is not the best way of delivering to meet priority needs;
- council land should be used for delivering council homes not private homes
- the percentage of new social-rented homes being delivered through this method is relatively low;
- private sector partners necessarily demand a profit;
- despite these models being deemed 'innovative' they are simply making use of a model that has been used in the commercial sector for a long time;
- while some councils say their companies will avoid the Right to Buy, the government has consistently argued that they will prevent this.

A round up London Boroughs who have set up council owned companies as follows:

Barking and Dagenham Council developed a special purpose vehicle (SPV), with Laing O'Rourke to build new homes through a 'sale and leaseback' arrangement. The council transferred land to the SPV; the SPV raises private finance to fund development of new homes (on a 60 year lease). On termination of the lease the ownership of the properties are to transfer to the council. The council is to manage the homes on a contractual basis. The rental income is retained by the council with a return being paid to the funder. Known as Barking and Dagenham Reside is wholly owned by the council designed to own 477 new homes. The homes are at a variety of rent levels (20% at 50% local market rent, 6% at 65% market rents and 74% at 80% market rent).

Croydon Council has proposed setting up a housing company to address the shortage of homes across tenures (including affordable homes) – aiming to exempt RTB and liberate the council from government HRA borrowing cap.

It also joined L&Q Foundation in investing in a Real Lettings Property Fund that builds homes to rent to London's homeless households (launched in 2013 with initial investment of £16.25 million from five founder investors). It aimed to reach £45m and to buy 220 properties across the capital.

Ealing Council set up its council owned company - Broadway Living - in June 2014 to build mixed-tenure housing outside the borrowing limits imposed under the HRA. The council has committed to building 500 homes over a five year period. Ealing already builds social housing through its HRA borrowing, and is taking on regeneration schemes on two estates in-house. As the council is approaching its HRA borrowing cap it is looking for ways to continue to develop housing while keeping new debt off the books. The company's start up with a loan was from the council's General Fund, which will not count towards the HRA borrowing cap. Avoidance of right to buy was a contributory factor although not a primary one for the council.

Enfield council set up a wholly-owned private company, Housing Gateway, in April 2014 to buy homes which could be used to discharge the council's statutory homeless duties. The company identifies appropriate housing within a reasonable price bracket and arranges purchase and renovation via the council, which then transfers the properties back to the company to own and manage.

The company was drawn up with a social investment firm Social Finance, which was appointed by the Department of Communities and Local Government to develop and institutional investment model with the aim of substantially increasing the supply of long-term private rented accommodation for homeless households.

The council provided the start-up loan from its general fund, which will be recovered through the term of the nomination agreement. The council retains full control of the company along with the allocations, selection of properties and rent. The structure gives the council full flexibility to set a rent for the target population which will be similar to local housing allowance rates.

Because the company is wholly council owned and provides services exclusively to the council it benefits from it means that a procurement procedure is not necessary.

In October 2014 Enfield Council and Keir Property formed a partnership to fund and build council homes. This is a Special Purpose Vehicle (SPV) which will develop both affordable and private housing for rent in North of Enfield. Funding has been raised through Enfield Innovations limited (another council owned company). Kiers are to build homes on seven small sites across the borough. On six of these the original council owned bedsits were no longer fit for purpose and a seventh site was a disused garage. The new development of 94 homes comprises 37 affordable homes (20 social for rent, 17 intermediate) and 57 private rented. Again the attractiveness for the council was the avoidance of RTB.

Greenwich Council has set up a wholly-owned company to trade as a housing delivery vehicle. Meridian Home Start Ltd provides intermediate rented products through an arms-length company that owns and rents out family homes with gardens at 75-80% market rents. 28 properties were transferred to Meridian in April 2011. The council is looking for options for growing the company including trickle transfer.

Havering Council agreed in May 2015 to set up a company to create properties for market rents and some for sale.

Kensington & Chelsea A business case and recommendation for establishing a council owned company was presented to the council in January 2015.

Lambeth Council is planning 'estate regeneration' including demolition and building new homes using a Special Purpose Vehicle.

Newham Council set up a council owned company – Red Door Ventures – which aims to create thousands of rented homes (3,000 over the next 13 years). The council will also acquire 500 existing properties. 30% will be at affordable rent and the rest at market rent.

Southwark Council is setting up its own housing company Southwark Housing Company Ltd. It aims to deliver 11,000 new social rented homes at social rents over 30 years.

Sutton Council agreed in July 2014 to set up a housing company to build new private and council homes.

Waltham Forest Council is setting up a housing company (SPV) to build homes.

Wandsworth Council has suggested that it may set up a housing company to develop homes in estate regeneration schemes on three estates

What is a Special Purpose Vehicle? A special purpose vehicle is a legal entity created for a limited purpose. They are used for a number of purposes including the acquisition and/or financing of a project, or the set-up of a securitisation or a structured investment vehicle.

Securitisation is a technique used to sell financial assets on the seller's balance sheet to outside investors. The assets to be sold generate future cash flows that are used to provide the return to investors who buy the assets. In order for the risk to be acceptable to investors, the uncertainty of cash flows re-routed has to be controlled through the provision of appropriate security. It is the quality of these cash flows, enhanced in some cases, that provides the security.

The financial assets are sold to investors through an intermediate structure (a special purpose vehicle company, or "SPV") to provide them with a return using the cash flows generated by the assets. The investors don't buy the assets directly. They serve as collateral in a dedicated structure that re-routes the cash flows to investors. The loans are said to be "securitised" by the assets.

Securitisation's primary use has been by businesses that are capital intensive, such as finance institutions. It has also been used widely in commercial real estate. As a technique, it has converged with other funding methodologies, such as project financing and PFI.

Special Purpose Vehicles (SPVs) have been household words within financial circles for decades. They assumed centre stage in the wake of the financial crisis and its continuing after-effects – mostly around the Enron and Lehman Brothers scandal. Since then they are subjected to greater scrutiny, governance and transparent reporting.

Current council housing in London: There are still more than 400,000 council homes in London (almost double the proportion elsewhere in the country). There are some 380,000 people on Local Authority Housing waiting lists. The backlog of housing need in London (alone) is (according to the London 2013 Strategic Housing Market Assessment) 121, 399; 50% of which (60,893) for social rented homes. This would take 12.5 years to address at the average rate of delivery (over years 2007-13).

270,000 council homes have been sold in London through Right to Buy since it was introduced.

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[i] **The Housing for the Working Classes Act 1890** allowed London local councils to build and home and clear slums - most was focused on building and regulating private Common Lodging Houses that catered for those in the most need. London councils began to build some houses from this time; this included the London County Council Boundary Estate in Bethnal Green, and the Millbank Estate in Westminster completed in 1902 which provided 4,430 rented homes. Most of the council homes built at this time were high density tenement blocks with small rooms and limited facilities including shared kitchens and toilets. Rents were high / not accessible to those on low or irregular wages. At this stage there was no subsidy from central government.

The 1900 Housing of the Working Classes Act extended the 1890 Act to places outside London.

The Housing and Town Planning Act of 1919 (The Addison Act) was probably the most important in terms of the history or council housing (although initially only intended to be a temporary measure with an assumption that the private sector would resume responsibility for working class housing once the British economy had recovered) . It required local authorities to prepare housing schemes to meet need and to carry out the schemes and provided subsidy to help finance 500,000 homes. Post war there was an acute shortage of housing, building costs were inflated and there was a scarcity of both material and labour.

The housing programme was however abandoned in July 1921 when only 170,000 out of the 500,000 houses promised had been built. There had been problems in London around the availability of labour and materials. The provision of finance was also difficult (revealed by Addison to the cabinet in April 1920) – with local government was facing difficulties raising money. In 1920 90% of the London County Council's £7,000,000 Housing Bond had been left with the underwriters

The largest and most ambitious started at this time (in London) was the Becontree Estate in Dagenham. Farms were compulsory purchased and by 2932 over 25,000 houses had been built. New homes had gas and electricity, inside toilets and front and back gardens. There were strict rules around home and garden maintenance, children's behaviour and keeping pets. Still rents were high.

The Wheatley Act of 1924 aimed to secure a continuous building programme for 15 years and to erect houses that could be let at lower rents that lower wage earners could afford (although in practice ability to pay would have played a crucial factor in allocations). Density and space standards suffered during this period.

The 1930's Housing Act encouraged mass slum clearance and introduced a sliding scale of rents depending on income.

The 1933 Housing Act required all authorities to concentrate efforts on slum clearance; each having to submit a programme of building and demolition aimed at eliminating slums.

Post the Second World War it was estimated (in 1945) that 750,000 new homes were needed. 156,622 prefabs (with fitted kitchens and bathrooms) were built and repairs made to existing structure. The 1946 Housing Act greatly also increased the subsidy available to local authorities to build new homes and they were allowed to borrow from the Public Works Loans Board.

The 1949 Housing Act enabled local authorities to build homes for the population generally not just for those most needy – so focused on mixed social classes. In 1951 the Conservative government set a target for 500,000 public and private homes to be built.

The 1952 Housing Act of raised subsidies. 1.5 million new homes were built by 1955. The percentage of people renting from local authorities rose from 10% in 1938 to 26% by 1961. The 1956 Housing Subsidies Act confined funds to replacing those lost through slum clearance.

The 1957 Housing Act and Rent Act encouraged increases in rent and enabled local authorities to sell stock. 2.5 million homes had been built (post 1946) 75% of them by local authorities.

A 1963 White Paper argued for increased provision of public housing. The cabinet agreed an annual target of 400,000 new homes a year both public and private. In 1965 a white paper outlined a programme to build half a million new dwellings (both owner-occupied and council housing every year until 1970).

The 1967 Housing Subsidies Act supported local authority borrowing. A 1968 White Paper recommended that funds were channelled towards the investment of existing homes, which were implemented in the 1969 Housing Act. 1.8 million homes were built between 1965 and 1969 50% of them council homes.

The 1972 Housing Finance Act reduced council housing subsidy and controlled rents were replaced with 'fair' rents (in effect a rent increase). The 1973 White Paper proposed ways for reviving the private sector through housing associations and provided grants to local areas of poor quality housing.

A 1974 White Paper emphasised owner occupation as the most desirable form of tenure.

In 1974 Housing Finance Act implemented the 1972 Housing Finance Act although councils who defaulted were not pursued for the arrears. The Act also introduced significant state funding for housing associations.

The 1975 Housing Rent and Subsidies Act reversed the policy of fair rents and empowered local authorities to set rent levels.

The 1980 Housing Act introduced the Right to Buy

The 1988 Housing Act made housing associations the primary developers of social housing (in terms of subsidy) and introduced large scale voluntary transfers.