CELG(4) Hsg 25

Communities, Equality and Local Government Committee

Inquiry into the provision of affordable housing in Wales

Response from Professor Steve Wilcox

The Welsh Government faces difficult choices in developing its policies to support the provision of affordable housing. Not only is its overall budget set by the Barnett formula, the concordats in respect of council housing finances and housing benefit costs also constrain Welsh choices.

The Barnett Formula

The Barnett Formula is typically used as a term to describe the method by which the UK government arrives at the total budgets for the governments of the devolved countries. Strictly speaking the Barnett Formula (which applies per capita adjustments to historical patterns of funding) is only one part of the far more complex arrangements used to compute the total devolved budgets.

Other elements of the total budget settlement are based on non Barnett formulas, and others are covered by a range of 'concordats' – including important provisions dealing with council housing finances.

Even in its wider sense the Barnett Formula deals with the 'Departmental Expenditure Limits' for the devolved countries; not the various areas of spending (such as local government capital spending financed by prudential borrowing) that are defined as 'Annually Managed Expenditure'.

The overall limitations of the Barnett Formula based budget settlements for Wales have been clearly documented by the Holtham reports. However in addition there are concerns about the continuing transfers of payments of notional surpluses from council housing revenue accounts that are annually made over to H M Treasury. These are projected to be some £72 million in 2011/12.

Those ptransfers are a hangover from the housing subsidy regime that required council rental income to be applied in part to cover the costs of housing benefit. While it is accepted that equivalent post 2003/04 budget adjustments have applied in England; this is not the case in Scotland, where the 1989-2003 housing subsidy regime for England and Wales did not apply.

Thus in Scotland councils were never required to contribute from their HRA (housing revenue accounts) toward the costs of housing benefit, and post 2003/04 they have not been required to contribute any notional surpluses to HM Treasury. Nor do Scottish councils face controls over their borrowing against their HRA rent streams. This is deemed to be prudential borrowing; and does not count against the main Scottish Government 'DEL' budget.

With each passing year these markedly different treatments of the housing finance arrangements for council housing in Scotland and Wales become ever more anomalous.

Social housing Investment in Wales

Investment in new social sector dwellings has been relatively low over the last decade. 'Starts' of new build housing association dwellings averaged some 560 a year over the decade to 2010; compared to an average of just over 2,000 a year over the previous decade. This level of provision is also very low against the assessment of some 5,000 'non market' dwellings a year estimated to be required by Holmans and Monk in their report for the (then) Welsh Assembly Government published in 2010.

There has been an increase in funding and output over the last few years, partly in response to the Wanless report, partly under the Strategic Capital Investment Fund, and partly by rescheduling existing funding plans in response to the post credit crunch economic and housing market downturns.

While welcome those initiatives have run their course, and Welsh Government funding for investment in new social sector is set to fall back to £61 million in 2012/13, and £48 million in each of 2013/14 and 2014/15.

In this context there have been a number of initiatives to examine options that might increase the output of new social sector and other forms of non market housing while making less call (per dwelling) on government financial support. These are important – but expectations must be realistic – there is no magic bullet.

Options to increase the output of affordable housing

The costs of new building cannot be substantially reduced; even when the construction industry is under considerable competitive pressure due to the limited future demand for their work.

There are existing mechanisms to minimise land costs, either through the identification and supply of publicly owned land at sub market costs, or through the exercise of planning powers to secure an element of the development gain that accrues with the grant of residential planning permission. However the latter remains constrained in the context of the currently subdued housing market.

Community land trusts are a socially valuable innovation – but their primary characteristic is their ability to retain land values within the trust over time. They only reduce initial costs if their social appeal serves to secure the input of land from either the public or private sector at below market value.

Competitive pressures also apply to the housing association sector, some of whom have the financial capacity to cross subsidise new developments. The extent, and distribution, of that financial capacity will, however, be potentially impacted by the Welsh Governments proposals to reform the policy framework for social sector rents. This is discussed in more detail below.

A further recent innovation has been to introduce a further degree of market segmentation in the provision of non market affordable housing. Intermediate rented dwellings are targeted on households that cannot afford to buy in the private sector; but have working incomes some way above those typical for social sector tenants. Rents are typically set at some 80% of open market value. Hitherto provision for households within those income ranges has primarily taken the form of shared ownership schemes; but they have become more problematic in the current mortgage and housing market.

In this context intermediate rent schemes can, in principle, provide a cost effective approach for assisting households with moderate incomes that are unable to secure market accommodation.

These are, however, typically households with a degree of market choice. It will sometimes be the case, for example, that cheaper rented accommodation could be secured at the lower end of the local private rented market. This is particularly the case for intermediate rented dwellings provided with the objective of introducing a degree of economic and social mix into private developments in high value localities.

It is also the case that many intermediate rented dwellings are being provided for households that, were they able to secure an appropriate mortgage, would prefer to buy rather than rent. There are policy tools available to the Welsh Government to assist in the provision of low deposit mortgages that may be preferred by many of the households now being offered intermediate rent. The unit costs of such mortgage support are modest.

Social sector rents

A further important option in reducing the grant costs for the supply of new social rented dwellings would be to set rents at a higher level than is currently the case for new housing association dwellings.

The trade off is that the higher rents would make the dwellings that much less affordable, and in particular would make it more likely that households in low paid work would require assistance in the form of housing benefit in order to pay the rent.

Moreover while it would be possible to move to higher rents for new developments this approach would be inconsistent with the Welsh Governments desire to move towards a more consistent – and equitable - rent policy for local authority and housing association dwellings.

However it must also be acknowledged that there are a range of constraints that inhibit the development of an aggregate social sector rent policy that would support investment in new social sector rented dwellings.

Housing association rents in Wales are currently, on average, somewhat above local authority rents; although the position varies as between individual landlords in each sub sector.

The policy proposals now under consideration by the Welsh Government would introduce a unified framework of target rents that apply consistently across both the local authority and housing association sub sector. This will tend to increase local authority rents more than housing association rents. Within that policy framework higher housing association rents would imply an even greater rise in council rents.

Nor are there currently mechanisms that would readily enable the higher local authority rents to be applied to cross subsidise the supply of new local authority rented dwellings. This is essentially because the local authority HRA (housing revenue account) regime currently requires notional rental surpluses to, in effect, be transferred to HM Treasury. Under those arrangements higher council rents could simply, on their own, lead to an increase in the revenues transferred to HM Treasury.

There is also a potential difficulty with the terms of the concordat governing housing benefit costs in the event that council rents in Wales increase more rapidly than is the case in England. This could result in some housing benefit costs falling to be met from the Welsh Government budget. There are no similar constraints in respect of housing association rents.

These arrangements are currently under discussion between the Welsh Government and HM Treasury, in the context of the reforms now proceeding in England to bring the HRA subsidy regime to an end.

HM Treasury have, however, resisted the argument that Wales should benefit from the same arrangements in respect of council housing finance as those that apply in Scotland. Without the requirement to transfer revenues of their Housing Revenue Accounts, and with no constraints on their borrowing, councils in Scotland have now embarked on a substantial programme of new build supported by a relatively modest level of grant, as they draw on their relatively untapped advantages of low historic costs for their existing stock.

Even if it is not possible to secure full parity with Scotland in the treatment of council housing finances, the negotiations with HM Treasury over the terms for ending the HRA subsidy regime, and annual revenue transfers, are critical. A relatively successful outcome would be a settlement that minimizes the payment to HM Treasury to bring the annual transfer payments to an end, and at the same time provides councils with a substantial capacity to borrow against their rental income.

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Note : In a personal capacity I am currently working for the Welsh Government in respect of their rent policy and council housing finance reviews. The views expressed in this paper are my own.