

## **Response to “Better Value From Housing Association Grant” – Changes to Grant from 2008/09.**

### **1.0 Introduction**

We are pleased to have the opportunity to comment on the proposed changes in the HAG Appraisal Methodology as outlined in Communities Scotland correspondence dated 12<sup>th</sup> February 2008.

#### **Achieving Better Value**

We understand and share the Scottish Government’s objective of achieving better value for money in the production and delivery of new affordable housing. In our response to Firm Foundations we have generally supported the Government’s proposed approach to delivering affordable housing. We do, however, believe that there should be a strategic debate around how to secure the optimum balance between affordability for tenants, organisations maximising borrowing capacity and the Scottish Government securing a better return for public investment.

Instead, these proposals focus on changes to standard grant assumptions to drive down grant levels in the short term. This means that the consultation process will invariably concentrate on the rights and wrongs of the changes to the standard assumptions rather than consider the potential in the RSL sector to deliver new housing at lower grant levels.

It would appear these proposals are a short term reaction by Communities Scotland to meet the Scottish Government’s wish to “secure immediate progress in reducing the cost of subsidy per house”. Any reduction in grant levels will inevitably be challenging for RSLs seeking to grow through new development. Changes to the funding systems need to be planned so that the impact on individual RSLs can be managed and informed business decisions made. Rushed changes to a long established funding system may threaten the longer term financial status of many RSLs or reduce the capacity of the sector.

We would urge Communities Scotland and the Scottish Government to consider the potential impact of the proposed changes on the housing system prior to issuing any mandatory guidance.

#### **Basis of Consultation**

We are extremely disappointed with the consultation process and believe that this falls well short of the standards previously set by Communities Scotland.

**Validity of Consultation** - We are concerned that Communities Scotland did not in their correspondence of 12<sup>th</sup> February 2008 fully highlight the impact of their proposals through the omission of important key information in relation to the new methodology and the derived private finance factors.

**Timescales for Consultation** – We are also concerned at the timing of this consultation process and would question the degree that feedback will be taken account of given the response date of 25<sup>th</sup> March 2008 and the fact that the financial appraisal assumptions are usually effective from 1<sup>st</sup> April. RSLs will have approved their individual Business Plans for 2008/09 including projected development programmes and borrowing strategies before 1 April.

**Year End Submissions.** Clarification is needed on Communities Scotland's intentions in the interim period between concluding this consultation process and issuing mandatory guidance given the likelihood of projects being submitted for approval early in April that were held over at the financial year end.

## 2.0 Detailed Comments

### 2.1 Appraisal Methodology

We recognise that any appraisal system has to be a combination of assumptions and real costs. The assumptions set by funders establish the value for money assessment framework. Within the current HAG Appraisal Methodology there are two main variables - costs and rents. All other inputs are published assumptions.

The HAG Appraisal Methodology only calculates the grant awarded to any particular project. RSLs will then undertake their own assessment of project viability based. Within the appraisal system the cost based standard assumptions all underestimate real costs.

As detailed below the proposed amendments to the standard assumptions in the HAG Appraisal Methodology do not stand up to scrutiny.

### 2.2 Rent Assumptions

The proposals assume that rents shall increase by RPI +1% over the 30 year period. This is substantiated from actual rent increases within the sector. Although Castle Rock Edinvar has given customers a commitment not to increase rents by more than RPI +1%, the actual increases have been lower than this. New build properties have higher rents than older properties and for organisations like our own with

active development programmes rent levels will be distorted by new completions.

We cannot understand the logic of setting long term assumptions on rent increases without setting assumptions on base rents. This has two impacts:

- It will limit the ability of RSLs to raise additional private finance through generating additional income
- The impact on those RSLs with higher rents will be greater.

We have for some time held the view that standard rents should be adopted in respect of development appraisal. This will remove the vagaries of individual RSL rent policies and will address the situation where Associations who charge slightly higher rents are effectively subsidising the grant requirements of organisations with lower rents

We have concerns that if rent increase assumptions of this magnitude are translated into rent policies this will impact on affordability particularly as we become more reliant on development through Local Authority Affordable Housing Policies where we are seeing a real increase in the extent of service charges to be funded by tenants over and above their basic rent.

We note that the proposed assumptions will apply different inflation adjustments to rental income and operating costs. We believe as a minimum the same adjustments should be applied to both rent and costs.

### **2.3 Management, Maintenance and Major Repair Assumptions**

We note that it is proposed to freeze these costs at current levels.

This decision appears to be taken on the basis that the current levels are realistic. On the basis of our APSR return for 2006/07 our management and maintenance costs were as follows:

	CRE Actuals 2006/07	Communities Scotland Allowance
Management per Unit	568	263
Maintenance per Unit	919	702

From the above it is clear that the assumption levels do not cover our actual costs.

Furthermore the proposals appear to take no cognisance of the fact that the BMI Public Housing Maintenance Output Price Index indicates costs are rising between 6 – 8% per annum.

As an absolute minimum we would suggest there should be at least an inflationary increase albeit even at this level it is not likely to meet our rising costs.

We also note it is intended to freeze the current major repairs allowance at 0.80% of construction cost capped at £510 per unit. Historically RSLs have advised that this allowance is insufficient to meet the future costs of major repairs. Again we would suggest as an absolute minimum an inflationary increase.

A strong case could be made in respect of Management, Maintenance and Major Repairs costs that these should be the subject of above inflation increases and on the basis of statistical information this increase should be greater than the adjustment on rental income i.e. the converse of the proposed new appraisal model.

## **2.4 Adjustment of Benchmarks**

By implementing the proposed appraisal system the current benchmark system will require to be reviewed as much lower grant requirements will be generated. The current benchmark system operates a year in arrears and therefore there will be no statistical information to set benchmarks for 2008/09. Communities Scotland has given no indication as to how value for money assessments will be affected by the proposals and clarification of this should be sought.

## **3.0 Implications of the Proposed Changes**

The proposals will have a direct impact on RSLs ability to deliver affordable housing.

For Castle Rock Edinvar new developments under the proposed financial regime will not be viable without a new approach to long term rent setting. We suspect that this position will be widespread across the sector and the capacity for new development which is viable to individual RSLs and lenders may be limited.

This is somewhat contradictory in that the Scottish Government is seeking on the one hand to increase the supply of housing across all tenures to 35,000 per annum by 2015 whilst on the other hand is seeking to introduce measures that will seriously impact on the ability of RSLs to contribute to this target being achieved.

Furthermore RSLs future viability could be threatened with financial covenants and ratios compromised with the effect that RSLs will be viewed as a higher risk to lenders in an environment when we need to be securing more attractive funding terms to deliver more housing.

## **4.0 Alternative Approach**

We accept that changes need to be made to deliver affordable housing more efficiently whether this is through competition by Regional Developers or some other mechanism. With this in mind a more radical review needs to be undertaken in relation to funding models whether this is by way of the introduction of Grant as a fixed percentage of construction cost or based around the benchmark system on an amount per unit.

With the potential introduction of competition for grant in 2009/10 we would question the relevance going forward to have standard assumptions as detailed in appraisal mechanism.

If 2008/09 is an interim year we would suggest that the current appraisal methodology is not reviewed. A more traditional approach should be taken to cover what appears to be a one year period until such times as the Scottish Government can undertake a meaningful review of the approach to delivering affordable housing during 2008/09.

We would suggest that consideration is given to updating the standard assumptions as normal and the introduction of an efficiency factor of a 5% reduction in grant on the standard grant calculation for all tender approvals in 2008/09.

### **3.0 Summary**

In summary we would suggest that:

- A more traditional approach to the appraisal assumption review should be undertaken in the short term.
- A more radical review of funding mechanisms needs to be undertaken with allowance for proper consultation and consideration of the issues during 2008/09.

In relation to the appraisal proposals themselves we would suggest:

- Standard rents should be adopted in respect of development appraisal rather than introducing differential inflation assumptions for costs and income.
- Management, Maintenance and Major Repairs costs should be increased by inflation as an absolute minimum.
- Communities Scotland should provide an indication as to how value for money assessments will be affected by the proposals.

The above would go some way towards meeting the Governments short term aspirations whilst due and proper consideration can be given to developing longer term delivery solutions to meet their objectives set out in Firm Foundations.

REFERENCE:  
ORGANISATION:  
CATEGORY:

030  
CASTLE ROCK EDINVAR HOUSING ASSOCIATION  
REGISTERED SOCIAL LANDLORD