

ORKNEY HOUSING ASSOCIATION

Response to HAG Consultation – changes to grant from 2008/09

1. Financial Strength
Comments on the cash holdings of RSLs imply that these reserves are regarded as being available for investing in the house building programme. This simplistic view fails to acknowledge the extent to which RSLs must provide for the future maintenance of their housing stock. When Local Authorities failed to do this and their stock deteriorated due to lack of maintenance and upgrades, their stock had to be transferred to RSLs. No such option will be available to an RSL that fails to adequately provide for future stock maintenance. RSLs must not be forced to rob their reserves for short term gain
2. Rents
RSLs have been obliged to raise rents by more than inflation in order to ensure they are viable in the long term. This is almost certainly as a result of the management and maintenance allowances (including major repairs allowance) in HAG calculation having been well below real costs over many years. If this level of rise was not necessary RSLs would not have applied it. If it was necessary then altering the assumptions in the HAG calculation will simply push RSLs into even higher rent rises with the predictable effect on affordability.
3. Voids
The allowance in HAG assumptions should be set to cover voids and bad debts.
4. Cost of borrowing
It is not clear what the proposals are for the cost of borrowing assumptions. The consultation document suggests that no change is proposed but SFHA advice is that there is an intention to increase the private finance factor to 21.76458. This is therefore what has been assumed in this response.
5. Management, Maintenance and major repairs allowances
The assumption that because all properties are new and will therefore require lower than average maintenance is flawed because the properties begin to age as soon as they are handed over and this needs to be allowed for over the long term.

A better indication of the true cost of managing and maintaining the properties comes from the APSR tables which show the average across a range of different aged properties. They show the following unit costs:-

	Management	Maintenance (excl major repairs)
OHAL	671	460
Rural peer group	775	574
Scottish ave	681	674

As regards major repairs allowances, costs year on year will fluctuate according to when major component replacement is required making the APSR figures unsuitable for setting an annual allowance. It would be better to base it on the annual contribution to sinking fund as calculated in the SFHA Planned Maintenance Kit. For our current stock this amounts to an average £720 per unit.

6. Impact on HAG levels

Running the new assumptions through an existing 6 unit rented development the impact is to reduce the HAG level by £48,890 (-8.04%) and increase the private finance by 37.56%. This increase in borrowing has a marked impact on viability.

7. Impact on viability

To assess viability a discounted cashflow is used to calculate the Net Present Value (NPV) over 30 yrs for this sample development. The results are as follows:-

	<u>NPV</u>
Per CSGN2007/06, rents RPI	-£27,676
Per CSGN2007/06, rents RPI , OHAL unit costs	-£30,910
Per CSGN2007/06, rents RPI+1 , OHAL unit costs	£5,293

The above shows that under the old assumptions when true unit costs were used it was necessary to increase rents by RPI+1 in order to make the scheme viable.

	<u>NPV</u>
Per new assumptions, rents RPI + 1	-£23,921
Per new assumptions, rents RPI + 1.6	£990
Per new assumptions, rents RPI + 1, OHAL unit costs	-£27,155
Per new assumptions, RPI + 1.5, OHAL unit costs	-£6,579

The above shows that using the new assumptions even with CS unit costs the scheme is in deficit over 30yrs. Using CS unit costs, it is necessary to use a rent increase of RPI + 1.6 before a positive NPV is achieved. When true unit costs are used, rent increases of RPI + 1.66 are required if the scheme is to be viable.

8. Summary & Conclusion

Unit costs in the old HAG assumptions were inadequate and as a consequence RSLs were obliged to increase rents by more than RPI in order to be viable long term. If this is taken into the HAG calculation and if unit costs continue to be understated (as compared to APSR results) the situation will be much worse. It is difficult to see how RSLs will be able to make these grant levels stack up while still keeping rents at an affordable level.

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