

REFERENCE:
ORGANISATION:
CATEGORY:

011
KINGDOM HOUSING ASSOCIATION
REGISTERED SOCIAL LANDLORD

Our Ref: BB/LS

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Communities Scotland
Highlander House
58 Waterloo Street
GLASGOW
G2 7DA



Direct Dial: 01592 632521

FAO Aileen Piacentini

Dear Ms Piacentini

**Comments on Consultation Document:
Better Value from HAG – Changes to Grant in 2008/09**

With regard to the above, please find below my comments on this Consultation Document:

1. Introduction

The following provides comments on the above.

2. General Methodology

The appraisal methodology is fundamentally flawed, using a mix of appraisal assumptions and actual costs.

The proposed methodology will increase the Private Finance requirement by over £10,000 per unit and this level of financing is not sustainable.

The appraisal model does not recognise variations in house types, sizes or location and the base rental income is the only actual cost to be factored into the appraisal methodology, with all other costs being based on assumptions.

An alternative appraisal model should be agreed, either based on a more realistic methodology, which recognises actual capital and revenue costs, with variation factors to allow the development of different location factors and variations to allow a mix of house types and sizes.

Other Value for Money assessments are also carried out by Communities Scotland when assessing HAG and, although also flawed, to a certain extent, the Benchmark HAG levels recognise the above and could be developed to provide a more appropriate methodology. An alternative could be to fix HAG at a fixed percentage of costs, hence recognising variations in Capital Costs due to house type, size and location. Both these alternatives would need developed; however they would be more acceptable than the unrealistic, unreasonable and unacceptable assumptions being proposed.

The following provides comments on the specific changes proposed.

3. Rents

The appraisal model uses actual rent levels being applied by RSL's as the base rent figure. This is the only revenue element of the model to be based on actual costs, with all other costs being based on assumptions. If median assumptions are used for revenue costs, are median rent levels not being used to assume the rental income. This would address the anomalies which exist between RSL's rental policies.

The present system awards higher grant levels to RSL's who have lower rents and this adds additional pressure on RSL's who have slightly higher affordable rent levels.

The proposed changes also apply a 1% above inflation increase assumption on actual rent levels. This proposal is based on forecasts identified in RSL's financial projections; however these forecasts cover the next 5 years, whereas the proposed methodology applies this assumption over 30 years. The reason RSL's are forecasting this level of increase is due to the increases in costs and this has not been recognised when proposing the 1% above inflationary increase over 30 years.

The impact of the above will result in rent levels having to increase significantly in the future and this raises concerns associated with affordability. This also raises the need for the Government to provide an undertaking that they will not attempt to restrict future rent increases or cap Housing Benefit levels.

The proposal to apply the 1% above inflation assumption to rental income should not be implemented, and the following should be considered:

- Adopt a median rent level assumption as part of the appraisal model
- The same percentage increase assumption should be applied to rents and costs

4. Voids

It is proposed to reduce the voids level from 2% to 1%. Whilst the 1% void level may be representative of median void levels reported by RSL's, this median figure does not however recognise the following:

- RSL re-lets are currently 10%
- The median re-let time is 26 days
- Non technical arrears are currently 4% of rental income
- No recognition is taken in the appraisal model for serious arrears where bad debts need to be written off

All of the above represent factors which potentially result in a loss in rental income and the impact has not been recognised when proposing voids at 1%.

Rather than proposing a reduction in the current voids level, the above would suggest the 2% figure should be higher, it is therefore proposed the 2% voids figure should not be reduced until an accurate assessment of the loss of rental income is carried out and this factor is incorporated into the appraisal model.

5. Management, Maintenance and Major Repairs

It is proposed to freeze the current allowances for the above, however there is no evidence presented in the consultation document to justify this proposal.

To assume the management and maintenance of new stock costs less may be an accurate assumption when comparing the relative costs associated with older stock; however this assumes the base allowances are realistic and there is no evidence to suggest this is accurate.

On the contrary, comparisons between the allowances and actual costs confirms the allowance levels are significantly lower than actual costs.

Even if it were accepted that the allowances were comparable with actual costs, the allowances should still be increased by at least inflation to recognise increasing costs.

The BMI Public Housing Maintenance Output Price Index (February 2008), identifies a 7.2% increase in maintenance costs during 2007, therefore to propose no inflationary increase to the base cost assumptions is failing to recognise the impact of rising costs.

The model also proposes no change to the major repairs provision at 0.8% x works or capped at £510 per unit. This assumption is also fundamentally flawed, for the following reasons:

- The capped figure of £510 is not comparable with actual expenditure required, which is £20,000 - £30,000 per unit over 30 years, which would equate to an annual unit cost between £666 - £1000 per unit.
- The proposed guidance also identifies average capital works costs at £95,000 per unit. Using Communities Scotland's 0.8% assumption this would equate to £760 and therefore further demonstrates that virtually all projects will only be able to assume the lower capped rate, whereas even Communities Scotland's standard 0.8% assumption clearly identifies the need to increase the capped rate.

Rather than introduce the proposed changes which freeze the allowances, the following should be recognised:

- Management and Maintenance base allowances should be increased to more realistic levels.
- Inflationary increases should be applied to the base allowances for maintenance; therefore a minimum 7% increase should be recognised when considering the 2008/09 allowance.
- The capped figure, for major repairs, should be abolished and the minimum assumption for major repairs should be 0.8% for all stock, alternatively a revised capped level should be applied which is significantly higher than the £510.
- There is no evidence to justify that Management and Maintenance cost will increase at RPI and this is not an appropriate index to recognise the increasing costs associated with these elements. As a minimum, the inflationary increase, for costs, should at least equal the inflationary increase on income from rents.

6. Inflation

The model assumes inflation based on RPI; however RPI is an average inflationary factor and is not appropriate when considering housing costs. In support of this view the following can be highlighted:

- Earnings indices show that labour costs rise at around the same rate as GDP, which recently has been RPI plus 2%
- The maintenance indices are reflective of the true cost increases, as shown above, at 7% during 2007
- Communities Scotland's own statistics, from the Financial Digest, confirms costs increasing at above RPI, an example being unit maintenance costs at around RPI plus 10%
- The real inflation on costs is resulting in the downward pressure on valuations provided by Valuer's, who are assuming that high inflation on costs will persist in the long term, resulting in low EUV-SH values.

7. Private Finance Factors

This element is the most concerning. The Private Finance factor used in the model has been changed and the methodology now uses different factors for costs and rental income. It is also particularly concerning that Communities Scotland should issue a consultation document on proposed changes to the model, without specifically identifying the proposals in respect of the Private Finance factor.

The Private Finance factor is largely determined by the inflationary assumption and to set income inflation at 1% above cost inflation is the fundamental issue and should be removed from the proposed changes.

8. Implications

The proposed changes will impact on a RSL's capacity to develop and will have consequences in the following areas:

- The future viability of RSL's could be threatened
- Financial covenants and ratios will be compromised and RSL's will be viewed as higher risk borrowers by Lenders
- Rent levels will be forced to increase in the future, raising concerns related to affordability
- RSL's capacity to develop projects will be severely restricted

The proposed assumptions are being introduced as an interim measure pending the proposal to introduce regional competitions for subsidy in 2009. The proposed changes to the 2008/09 will compromise the capacity of RSL's to undertake any proposed Lead Developer role and will compromise the ability of partner RSL's to receive stock from Lead Developer RSL's, where the Private Finance requirement is unsustainable.

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9. Conclusions

The proposed changes should not be introduced and alternative amendments should be considered for 2008/09, which recognise the following:

- Future inflationary increases on costs and income should at least be equal
- The current base Management and Maintenance allowance should not be frozen and should be increased to a realistic level which recognises actual cost increases impacting on the sector
- The capped figure for major repairs should not be applied and 0.8% should be the minimum provision allowable for all projects
- The Private Finance factor should not be set higher for income when compared to costs.

The model is fundamentally flawed and the above can still be introduced and achieve HAG efficiencies. It is proposed less radical changes should be introduced, for 2008/09, as an interim measure pending further consultation as an alternative methodology to calculate subsidy.

If the proposed changes are introduced as suggested this will restrict RSL's from developing next year and in the future, this is a position that is already being considered by Management Committees and the impact on the delivery of affordable housing will suffer as a consequence of this. In the longer term the capacity, ability and desire of RSL's to undertake a lead developer role will also be jeopardised and I would urge the Government to seriously consider the implications of the proposed changes.

Should you require clarification on any of the above points, or wish to discuss this further, please do not hesitate to contact me.

Yours sincerely

Bill Banks
Development & Property Services Director

Email: b.banks@kingdomhousing.org.uk

Enc

cc David Stewart, SFHA