THE SMITH INSTITUTE

Delivering the renaissance in council-built homes:

The rise of local housing companies

Summary report

Local housing companies (LHCs) are independent arms-length commercial organisations wholly or partly owned by councils. They can develop, buy and manage properties within and outside of a local authority area. The homes LHCs provide sit outside of the local government housing financing system (Housing Revenue Account) and are not subject to the Housing Act and most of the social/affordable housing regulations.

Over the past few years the number of companies has increased dramatically among councils across the whole of England. This study of LHCs shows that the vast majority are engaged in the provision of affordable housing, as well as market housing for rent and sale.

Although the number of LHCs has risen rapidly, there have been few studies on their evolution or impact on meeting local housing needs. There is no official register or database of LHCs and few case studies. This report is an attempt to fill that information gap and better understand the extent to which LHCs are developing as alternative providers of affordable homes.

The research, including an on-line poll of councils, roundtable meetings and interviews with practitioners and experts, has attempted to document the emergence of LHCs, in all their shapes and forms.

Main findings

- Our findings suggest that LHCs offer councils a "triple dividend" in the form of much needed extra housing, a greater stewardship role in place-shaping and a financial return to the council.
- There are now probably as many as 150 LHCs in England, most formed in the past few years. On the current trend, this could increase to 200 by 2020 – covering more than half of all councils in England.
- LHCs have been established by all kinds of councils, across the size spectrum, including, in some cases, with participation by counties. The largest concentrations are in London and the South East.
- Most LHCs have modest ambitions to build (averaging around 50 units a year), although there are larger housing companies in urban areas with major build programmes.
- Collectively LHCs could increase completions over time from 2,000 homes a year to 10,000-15,000 homes each year by 2022, with perhaps a quarter of the total in London.
- We estimate that around 30%-40% of new LHC homes are likely to be 'affordable', with a minority at the equivalent of social rented levels.
- Councils are attracted to LHCs because they want more control and influence, and greater freedoms and flexibilities (especially over rents, borrowing and the Right to Buy).
- LHCs can generate income and cross-subsidise new private affordable and sub-market housing at social rents.

Background

The affordable housing crisis in England has worsened, with more and more people unable to buy or rent in areas where they live and work. New supply continues to fall short of demand and, in many areas, there are now acute shortages of homes for those on low and medium incomes. The "broken housing market" has also made it difficult for cash struck councils to meet specific local housing needs, especially for the elderly and homeless.

Hopes of stock holding councils building again under a reformed HRA in the early years of the Coalition government failed to materialise. Alongside budget cuts and welfare reforms, councils faced tough new restrictions on their ability to build. National housing policy was focused on private development and home ownership, largely ignoring the contribution that councils could make.

Although there are now welcome signs of a shift in government policy with councils being spoken of as part of the solution, rather than part of the problem, the main constraints on local government's capability to deliver through the HRA system remain in place (including the RTB, rent cuts, borrowing caps and limited government funding for new social housing). Furthermore, councils continue to complain that despite all the housing and planning reforms the housebuilders and private developers are still failing to provide enough affordable homes.

We believe that there is an opportunity for government to support the scaling up of LHCs to be significant contributors of additional homes

Frustrated by national policy-making and critical of the performance of other registered providers, a growing number of councils, large and small, have "gone it alone". Under the banner of localism, councils of all types have sought to use the new general freedoms and flexibilities that they have been granted to establish their own housing companies, mostly on council land. These council owned companies, which reflect the new entrepreneurial ethos of many councils and mirror the trading companies some councils had already established, are home grown, developing in-spite of government intervention, rather than because of it.

The rise of local housing companies has occurred fairly quickly and with little controversy. The vast majority of LHCs have secured local cross-party support and appeal to both councillors and council officers. In fact, LHCs are fast becoming a "must have" for councils wanting to pro-actively intervene in their local housing market, albeit often initially on a small scale.

The growth of LHCs has attracted little attention in either Whitehall or Westminster. There has been little political discussion at the national level about the future of LHCs and what they might contribute going forward. We believe that there is an opportunity for government to support the scaling up of LHCs to be significant contributors of additional homes, particularly new affordable homes.

Form and function

Many councils have long harboured the chance to play a more pro-active role in housing and place-shaping. The tight constraints on the HRA system and the Right to Buy (RTB) has made that extremely difficult for stock holding councils. Non-stock holding councils have meanwhile been largely side-lined by the government's strong support for private sector-led development.

Providing new homes "commercially" using council assets and public borrowing (with no capital grant) effectively frees the council from Whitehall control. It also gives councils a much-welcomed degree of flexibility to offer a mix of housing tenures, rather than just council housing, and exemption from the RTB and rent controls. Councillors often spoke passionately about this, arguing that their LHC gives them some "skin in the game".

In some places, the LHC is also seen as a viable alternative or complement to delivery by the private sector and housing associations. In others, the LHCs purpose is primarily to kick-start development or to change the tenure mix on existing estates. Several LHCs are also providing specialist housing for older people and students, as well as temporary accommodation. Some also offer self-build and eco-homes. Councils claim that LHCs are not just filling gaps in the local housing market and making budget savings, but also driving up standards in the PRS. In some instances, such as Newham in East London, the LHC aims to be the major market provider of PRS homes.

This "quiet revolution" in councils building again is adding to the diversity of supply of affordable homes. There are several main themes that the research revealed:

- LHCs provide a mix of housing tenures, with the focus on renting (at equivalent affordable rent and market rent levels) and to a lesser extent at social rented levels. Some LHCs provide homes for sale and to meet specialist housing needs (e.g. for temporary accommodation and homes for older people) and several are involved in estate renewal and regeneration schemes.
- The majority of LHCs are wholly owned by the council, which typically provides loan finance and land. Most are governed by a mix of Members and officers and partly staffed by the council and external consultants.
- A few LHCs are multi-council and some are subsidiaries of a council-owned regeneration or property company. Some of the larger LHCs have attracted private finance and established 'revolving investment' funds.
- Councils have been careful in setting up their LHC, taking outside legal and financial advice. With some exceptions, there appears to be little antipathy towards LHCs or evidence of "reckless" lending. There are some concerns over a council's multiple roles – as owner/co-owner, funder and planning authority.

The ethos and social purposes of many LHCs are arguably similar to housing associations, operating where they can a cross subsidy model for funding sub-market housing. However, unlike most housing associations, the LHCs, by virtue of being new housing providers, have higher concentrations of market housing for rent and sale. As mentioned, the proportion of housing at social rents for most LHCs is much lower.

This "quiet revolution" in councils building again is adding to the diversity of supply of affordable homes

Most LHCs generate income directly from their market housing, as well as through on-lending and from other sources, like the New Homes Bonus. However, there is little evidence to suggest that the LHCs are making hefty profits or that they are diverting large surpluses into the council's General Fund, rather than re-investing them back into the LHC. However, as our survey showed the financial return is still a key motivation for establishing a LHC. There is a risk that government could intervene to change the way LHCs can generate surpluses. Equally government could seek to fund LHC directly via the HCA, although this may create regulatory problems. Overall on LHC finances, the report found that:

- Most councils expect their LHC to generate a profit, which can be re-invested into the housing company. Besides income from rents and sales, LHCs attract funds from the New Homes Bonus, additional council tax, and planning gain.
- Councils are also generating income from 'on-lending' to the LHC (borrowing long term at below market rates from the Public Works Loan Board and on-lending at a market-rate premium).
- Councils claim that LHCs are there for the long term and are more resilient to market and financial risk than private developers and that the LHC can 'flip tenures' and defer dividend payments if needs be.

With a few notable exceptions, there appears to be little public antipathy towards LHCs. Although public awareness of LHCs is fairly low, most of the local media coverage has been generally positive. Where there has been protest and criticism it is usually centred around proposed schemes, rather than the LHC itself (although there has been criticism of some joint-venture LHCs in London). However, it should be noted that not everyone agrees that LHCs are the right route for councils to provide "genuinely" affordable homes.

Recommendations

The extent to which councils and their LHCs can realise their plans will largely be determined by the state of the local housing market and the wider economy. Nevertheless, central government has a critical role and there are actions that it could take alongside council and other stakeholders that would help LHCs. To support additional housing delivery through LHCs, the report recommends:

- The Department for Communities and Local Government (DCLG) and local government, perhaps through the Local Government Association, should consider establishing a high-level commission or task force to consider how best to maximise the potential of LHCs as alternative providers of affordable housing.
- The government should give unambiguous support to LHCs and remove the caveat that "we want to see" LHCs offering tenants the RTB. It appears that LHCs are not subject to the RTB or Right to Acquire, but the prospect that they might be is confusing and undermines investor confidence in LHCs.
- Councils should be able to retain all their RTB receipts and be able to choose whether to invest them via their LHC or HRA as they wish.
- The government should revise upwards the regulations which restrict the number of HRA-properties that a council can transfer to its LHC.
- The government should move ahead with its promised compulsory purchase order reforms and examine the potential benefits to LHCs.
- Local government, perhaps through the LGA, should offer a centre of excellence or learning hub on LHCs.
- Both central government and local government could do more to raise awareness of LHCs, particularly among other agencies which can support housing growth (e.g. local enterprise partnerships, Homes and Communities Agency, NHS Estates, National Infrastructure Commission).
- DCLG should monitor the growth of LHCs and seek to keep an open register or database on the homes they are providing.
- Combined authorities and the GLA should consider the case for supporting wholly owned or joint venture LHCs as well as multi-authority LHCs.

Top tips for Local Housing Companies

The following top tips derive from the interviews and roundtable discussions with councils and LHC staff

- Don't reinvent the wheel – talk to others about their experience
- Listen to Members and share the strategic vision
- Think always about the residents and keep them informed
- Be clear about governance and management structures – "keep it simple"
- Makes sure the capacity and capability is there from the start
- Don't get distracted by RTB and talk of more housing reforms
- Be thorough and diligent, especially on market appraisals
- Get good external legal and financial advice
- Think and plan long term

Further information

The full report can be downloaded at www.smith-institute.org.uk. The report, which includes over 20 case studies of LHCs, was produced by the Smith Institute and based on interviews with practitioners, councillors and professional advisers, an online survey of local councils in England, and seminars and roundtable discussions. The research was supported by the Nationwide Foundation: www.nationwidefoundation.org.uk

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