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**Differential grant rates - unpicking the rational**

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**Background**

1. Grants to support Council house building were reintroduced around 2008 as one of a number of actions aimed at encouraging house building generally and social housing building in particular. A simple flat rate of £30,000 was available for qualifying schemes. Grants to Housing Associations continued to be calculated by an entirely separate method based on benchmark rents and scheme costs until 2010 when a flat rate £40,000 grant was introduced. The grant for Councils remained unchanged at £30,000. Grants for RSLs were revised upwards in 2011.
2. The 2011 change was based in part on the results of a study commissioned by the Scottish Government from Glen Bramley and others[[1]](#footnote-1) that concluded that both Councils and RSLs had the capacity to a continuing significant programme of new supply at the proposed flat rates. The balance of costs was to be provided largely through borrowing funded from rents. Rents were assumed to rise at CPI+1% over the medium to long term.
3. The study didn’t include any detailed assessment of borrowing costs, land supply or affordability but nevertheless concluded that a lower rate of grant for councils was justified based on the existence of their own land bank and access to borrowing at a lower rate than that for RSL.
4. This approach was carried through into the work of the first Housing Subsidy Review Group that reported in 2013. Its report included the following:

**“**However, there are often tighter financial constraints on RSLs than on councils, given their need to raise funding from private lenders. Many councils also have a greater pool of resources they can draw on, eg in the form of land.”

1. These assumptions have remained unchallenged. The 2015 report of the reconvened Housing Subsidy Review Group made no reference to them, it simply continued to recommend lower rates of grants for local authority house building.
2. This short paper presents the available evidence around these two issues and other differences in the financing of new homes provided by Councils and RSL based on published information from the Scottish Government, the Scottish Housing Regulator and returns from a brief survey of ALACHO members.

**Borrowing costs**

**Councils**

1. Whilst the details of the calculations can vary, all Scottish councils account for borrowing costs on the Housing Revenue Account (HRA) on the basis of a “pool rate”.

1. Pool rates are published each year as part of the HRA financial return. The most recently available figures are for the year ending 31 March 2020[[2]](#footnote-2) and show rates ranging from 2.58% to 5% (note East Lothian is shown as reporting a pool rate of 0% but borrowing cost and debt figure included in the published tables suggest an interest rate charge within this range).
2. Overall, Councils paid a total of £143.9m in interest and £126.7m capital repayments on a total debt as at March 2020 of £4.026 billion. These figures suggest an overall interest rate of 3.57% and a total time remaining to repay of just under 32 years. It should be noted that these figures are estimates, they will vary from year to year to reflect the underlying structure of borrowing across the 26 HRAs.

**Housing Associations**

1. Identifying actual borrowing costs for housing associations is a little more complicated but the Scottish Housing Regulator does collect and publish some information. The most recent publication was dated December 2019 and related to the previous financial year.[[3]](#footnote-3)
2. Figure 16 in this report provides details of the number of loans, their value and the basis for the interest charged. It shows a total debt portfolio of £4.15b across 1,317 loans. The two most significant elements are:
* 511 loans totalling £2.75b on fixed rates with a median of rate of 4.78%; and
* 492 loans totalling £1.05b on short term lending with a median rate of 0.75%.

1. This data clearly covers all the long- and short-term borrowing across the sector and reflects the details of the wider treasury management function rather than just the core costs associated with borrowing to support new developments. To that extent staff at the SHR have confirmed that it is difficult to make a direct comparison or to identify a “typical” rate.
2. However, figure 15 in the report provides details of new borrowing during 2018/19. 157 Loans totalling £673m were taken out during the year of which 57 loans totalling £386.3m were on fixed rates with a median cost of 3.72%. The next largest group of loans totalling £227m were on short term rates with a median value of 1.4%.
3. The figures for 2019/20 for new borrowing by RSLs show 37 fixed term loans totalling £583m at a median rate of 2.8%
4. Overall this suggests that the costs of borrowing for RSLs is at broadly similar rates to those of local authorities. In both sectors the cost of borrowing has fallen in recent years but there is no evidence to suggest that Councils are paying significantly less overall.

**Other sources of funding for new homes**

1. The More Homes Division outturn report for 2019/20 includes some details of the way councils and RSLs finance the development of new homes[[4]](#footnote-4). These details are set out in table 11 and include:

 SG funding: Grants from the Scottish Government.

 Private finance: Borrowing by either RSLs or councils.

 Public Finance: Including 2nd Homes Council Tax Income; Developer Contributions through commuted Sums; Public Sector contributions and; Capital Funded from Current Revenue (CFCR)

1. The published figures do show some apparent differences. In particular Councils appear to have access to higher level of “public finance”.
2. In 2019/20 “Public finance” provided £21,975,663.95 or £6,695.81 (4.65%) per house for the Council house programme. For RSLs the equivalent figures were a total of £8,526,651.31 or £1,437.4 (0.9%) per house.
3. The published information isn’t sufficiently detailed to state definitively what the balance is between 2nd homes Council tax, developer contributions, public sector contributions or CFCR in “public finance” element of either part of the programme.
4. However, in the same year councils reported that their overall housing capital programme finance package included:
	* CFCR of £252,920,000;
	* £50,862,000 from “other” sources; and
	* £32,917,000 from capital receipts.
5. The conclusion from this is that greater part of the “public finance” element of the Council new supply programme was derived directly from rents, mainly through CFCR but also including an element from the sale of HRA assets. It does not represent a significant additional source of finance not available to RSLs or reduce the burden on rents in a way that advantages Councils over RSLs.

**Land costs**

1. The issue of land costs is probably the hardest to put any clear figures on. There appears to be no published data on land costs in the affordable housing supply programme or recent academic studies on the subject. Which is odd given how important land supply is to the overall programme. The land market as a whole has been the subject of some more detailed work.
2. The Scottish Land Commission’s 2017 paper “The Housing Land Market in Scotland” concluded:

“The way the land market operates depends largely on the laws, institutions and political history of particular nations, and so varies widely. In Scotland, the key characteristics are a reliance on the private sector operating on a speculative model to deliver new house building; a legal framework that allocates the uplift in the value of land resulting from planning permission to landowners rather than public authorities; a liberalised mortgage credit market; a taxation system that is highly favourable to land and property; and a paucity of publicly available information on land values and ownership.”[[5]](#footnote-5)

1. The York/Herriot Watt study previously cited opened its discussion of land availability and cost with the following:

“While new municipal housebuilding schemes have so far mainly involved council owned land, the availability of sites in housing department ownership (and therefore potentially available for development at nil cost) is very limited in some areas.”

1. But nowhere in the report is there any attempt to quantify the extent of the landbank held by local authorities either on the HRA or General fund. To the extent that it offers any evidence in this respect it is based on a limited number of case studies. The report goes on to say:

“However, while many local authorities will have held substantial HRA landholdings in the past, much of this resource has been used for RSL new development over the past 10-15 years (including under schemes associated with the local authority-sponsored RSLs established under the New Housing Partnerships programme). In many areas, RSL building programmes have for many years relied largely on formerly council owned land.”

1. The report concludes that:

“in many authorities a continued municipal housebuilding programme on any appreciable scale and over any appreciable period will call for land acquisition exactly as is true for RSLs.”

1. Given both the lack of evidence and this final conclusion it is perhaps a little odd that access to free or reduced cost land should continue to be used as justification for lower grant rates.
2. In the light of this we have made an effort to provide some direct evidence on the subject. A very brief survey of ALACHO members carried out in January 2021 resulted in 15 returns (out of 26 stock holding councils). Most of those responding indicated that an existing land bank has been used in the current AHS programme and will feature in investment over the 2021-26 period. The details included:
* Two of the 15 had no landbank and relied exclusively on land being acquired commercially or through the planning system.
* One council indicated that 100% of its programme over the past five year and for the period to 2026 would be on land already owned by the Council.
* For the remaining 12 councils their existing landbank has provided between 5% and 70% of the land required with a median value of 31%.
* Looking forward to the 2021-26 programme these same 12 councils provided a range of estimates of from 8% to 30% of the future programme to be developed on council owned sites with a median value of 21%.
* Six councils expected their land bank to provide a smaller proportion of development sites over the next five years. Four reported that they would use more council land.
1. This is, to be fair, a relatively unsophisticated study but it is probably safe to conclude that:
* A substantial part of the historic HRA landbank was provided free or at below market value to RSLs to support their development programmes in the period between 1980 and 2010;
* Most Councils have access to some land to support their house building programme;
* Council owned landbanks have provided a significant, if locally variable proportion of the land used in local authority house building programmes over the past five years; and
* Council landbanks will continue to provide some of the land required but at a lower level than in the recent past.
1. There is, however, a big difference between having access to developable land and land that is “free”. Most of the councils made comments on the nature of the landbank, its origins and cost associated with development. These included:
* Some council owned sites have to be acquired at value from the General Fund;
* Much of the previously undeveloped land still held on the HRA was “left for a reason” and often comes with significant access, drainage or ground condition costs;
* All of the sites held on the HRA were previously acquired at value at the time of purchase and represent an asset rather than a “free” resource;
* Many of the sites held on the HRA have been created as the result of demolition of unfit or unpopular stock. Lost rent, rehousing, demolition, and decontamination to prepare these sites for development all come with significant costs;
* Council house building programmes are required to meet the cost of essential infrastructure required as a consequence of developments.
1. In the light of this it is difficult to conclude that council landbanks are likely to make a significant contribution to reduced costs in future whatever role they may have played in the past.
2. One option for resolving this issue has, however, already been suggested, that is separating out the funding of land and infrastructure from house construction for the purpose of grant calculation.

**Conclusions**

1. The purpose of this paper is to unpick the suggestion that lower land cost and cheaper borrowing available to councils are a sound justification for lower grant rates compared to RSLs. It has also looked at other differences in the published information on the financing of Council and RSL development programmes.
2. Part of the problem in drawing conclusions from the evidence is that RSLs and Councils operate in quite different financial and regulatory environments. The funding of the new supply programme has to be seen in that light and, most importantly in the light of the overall impact on rents. but the following conclusions can be drawn:
* On the question of borrowing costs it is not demonstrably the case that they are lower for councils than they are RSLs.
* On land costs:
	+ Much of the best development land previously held on HRAs was used by RSLs in periods between 1980 and 2010 usually at nil or below market value;
	+ Some of the Council owned land that has been made available over the past five years has been acquired at full value from the General Fund;
	+ Many, perhaps most development sites currently held on the HRA have been created through the demolition of existing stock at significant cost to tenants; and
	+ These sites often come with significant abnormal costs and requirements to fund essential infrastructure, for example school capacity and transport schemes.
* There is also some evidence that both Councils and RSLs are accessing other “private finance” resources including commuted sums and second homes council tax income to support new supply but there is no convincing evidence that these other sources of income are higher for councils than RSLs.
1. In the light of this it is the view of ALACHO members that the current lower grant rates for the provision of new Council housing as compared with, not just RSL social rent but RSL LCHO/NSSE as well, is unjustifiable.
2. To the extent that the decisions taken in 2010, 2013 and 2015 were based on the notion that borrowing costs were lower and a significant supply of cheap or free land was available for councils there is no current evidence to support this view.
3. If any doubt remains in relation to land costs a more appropriate and proportionate way to address this would be to separate out land and infrastructure cost within the grant calculation.
1. Housing, Regeneration and Planning: Research Findings No.53/2010: A Study into the Capacity of Registered Social Landlords and Local Authorities to Build Housing across Scotland [↑](#footnote-ref-1)
2. <https://www.gov.scot/publications/housing-revenue-account-hra-statistics-scottish-local-authority-housing-income-expenditure-1997-98-2019-20-near-actuals-2020-21-budgeted-estimates/> [↑](#footnote-ref-2)
3. https://www.housingregulator.gov.scot/landlord-performance/national-reports/financial-analysis/annual-loan-portfolio-returns-at-31-march-2019-technical-appendix-16-december-2019 [↑](#footnote-ref-3)
4. https://www.gov.scot/publications/affordable-housing-supply-programme-out-turn-report-2019-2020/ [↑](#footnote-ref-4)
5. https://www.landcommission.gov.scot/downloads/5de1a716b632b\_Land-Lines-Discussion-Paper-Housing-Land-Market-Dec-2017.pdf [↑](#footnote-ref-5)