Removing the Housing Revenue Account Borrowing Cap

While the government's decision to lift the borrowing cap on councils' Housing Revenue Accounts was a welcome move for councils keen to build more affordable homes, it is only piece of a complex picture. This briefing explores the opportunities and constraints on building more affordable homes in London.

Background

Historic restrictions on councils' funding options have been a contributing factor in London's growing shortage of affordable homes. This has led to a situation where today there are more than a quarter of a million Londoners on housing registers with waiting times of up to 25 years, and 87,000 children in temporary accommodation.

With this crisis in mind, London Councils warmly welcomed the Prime Minister's announcement on 3 October that the government would lift the 'borrowing cap' levied against councils' Housing Revenue Accounts (HRA). We further welcome the speed with which government reacted to enact the policy change (28 October), and the freedom it gives councils to move to use of the prudential code without further restrictions.

HRA caps on councils' borrowing were originally imposed when council housing became self-financing in April 2012. Although they were set by a formula, they bore no relation to individual councils' need to build more homes: some were given more capacity ('headroom') than they needed; others were given none.

We know that we need to build more than 66,000[1] homes a year in London if we are to have any hope of providing a decent, affordable home for everyone who needs one. The last time we achieved that level of housebuilding was in the 1960s and 70s, when councils were playing a major role.

London Councils - along with other stakeholders such as the National Federation of ALMOs, the Association of Retained Council Housing and the LGA – have consistently argued for the abolition of the cap to allow councils to build more homes. The lifting of the cap may be seen as a recognition by government that councils will once more need to play a significant role if we're to build new homes at the level required to address London's housing crisis.

The appetite and ambition to meet the needs of residents is certainly there. In a recent round of bidding for an additional £500 million of borrowing made available by the treasury, London

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Boroughs submitted bids totaling £1.4 billion. This has been noted as a key determinant in demonstrating the ambition of councils to finance building programmes, and subsequently government's decision to remove the borrowing cap.

While the lifting of the borrowing cap is a significant and welcome move, on its own it is not a panacea to the restrictions on councils' ability to build homes. Some of the barriers to local government ambitions - and the next steps to unlocking their full potential - are explored below.

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Analysis

Barriers to building

Estimates of how many new homes the HRA borrowing cap removal will allow councils to build vary. Savills predict an additional 15,000 homes a year.[2] Considering councils across the whole of England built just 1,870 homes in 2017/18 (670 in London) this is a significant increase.[3] The Office for Budgetary Responsibility (OBR) estimates an additional 20,000 homes by 2023/24. Although this is a more modest prediction, it still equates to a more than doubling of councils' current annual home building. In reality, there are many other factors which contribute to councils' ability to build.

Limitations of the HRA borrowing capacity
Recent research by London Councils illustrates some key facts on the limitations of the HRA borrowing headroom:

- London authorities expect to generate £2.8 billion of HRA income in 2018/19, of which £722 million will be spent on servicing existing HRA debt (26 per cent).
- Initial modelling suggests that additional rents generated from new housing stock would be insufficient to cover additional financing costs over the 30-year duration of an HRA business plan. For example, 15,000 additional homes would generate £4.5 billion of additional HRA income over 30 years (through rents) while creating additional debt servicing costs of £8.5 billion.
- As new stock would not be self-financing over a business plan period, any additional borrowing would need to be serviced by reducing spending on other areas (e.g. repairs, supervision etc.). For example, the financing costs of 15,000 additional homes would mean that aggregate 30-year expenditure on non-financing costs would need to reduce from £84 billion to £81 billion.

The corollary is that the relatively high level of existing HRA debt and the very long time period for a new house to 'pay for itself' suggests that the removal of the HRA cap would be relatively modest in terms of additional housebuilding in London.[4]

Land availability
In a 2017 study, 90 per cent of councils who were not engaged in house building cited land shortage as the primary reason.[5] Local councils face a land shortage for two main reasons. Firstly, there has been a consistent pressure on local authorities over the past few decades to sell land. Secondly, the requirement that public sector bodies achieve market value when disposing of public land puts housing associations, local authorities, community organisations and other under-resourced actors at a disadvantage when bidding against commercial, for-profit institutions such as developers.

Right to Buy (RtB)
The failure to replace social housing sold through RtB has played a major role in a 20 per cent fall in social rented homes over the last decade.

In 2016/17 3,138 homes were sold by councils in London under RtB while just 1,445 replacements were started or acquired using receipts from the scheme. Moreover, the parameters of the scheme are particularly punitive for councils; for example, only 30 per cent of RtB receipts can be used towards the cost of a replacement home, all receipts must be spent within 3 years; failure to do so incurs a 3 per cent interest charge across the full term the funds are held. London Councils has made its position clear on these aspects of the policy in a recent government consultation on RtB submitted in October 2018.

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Grant funding
Funding currently available for affordable homes is below the levels we saw in 2008-2010, with much of that available already being allocated to ongoing activities.[6] This means that councils may not be able to take full advantage of new borrowing opportunities without additional grant finance.

Skills shortage
While setting targets is a desk exercise, building new homes requires skilled construction workers of which there is a limited supply. Interestingly, the OBR notes that as councils seek to draw in building expertise this could have the unintended consequence of driving down output in the market sector, illustrating the competition for scarce resources in the construction sector.

The existing skills shortage is also in danger of worsening in a post-Brexit Britain, given that early half of London's construction workers are non-UK workers; 27 per cent from EU.

Commentary

While London local government is extremely pleased that government has heeded its calls to remove the HRA borrowing cap, this is just one piece of the jigsaw. To truly unpick the burdensome financial constraints that prevent councils from realising the potential of local building capacity other actions need to follow. For example:

1. Complete flexibility over how long RtB receipts can be retained, and how they can be used to deliver homes. This means no cap on what proportion of RtB receipts can contribute to new homes, no time limit on their use, and no punitive interest charges that penalise councils for proper long-term planning of sustainable housing developments. This would empower councils to help satisfy London's housing demand (and to fulfil the policy objective of one for one replacement).
2. An injection of an extra £1 billion a year from the chancellor would bring funding back up to 2008-2011 levels, and build an estimated 12,500 additional social rent homes across England each year.
3. Government should recast its policy on social rent increases and make a 30 year commitment to increase rents by CPI + 1 per cent starting immediately. Furthermore, that flexibility of rent rises should be granted to councils that can demonstrate a positive correlation on additional house building and reductions in housing benefits.

While we should temper our optimism for the impact of the HRA borrowing cap removal, the onus is on the sector to make the case, as we did with the HRA borrowing cap, for a complete suite of progressive policy changes that can free Local Government to build at the level of its ambitions.

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Endnotes

[1] **London plan 2018**

[2] **ARCH, NFA, Savills - Raising the Roof**

[3] **https://www.gov.uk/government/statistical-data-sets/live-tables-on-house-building**

[4] Detailed knowledge of individual HRA business plans would be needed to make a robust judgement about sustainable levels of additional debt.

[5] Professor Morphet and Dr Ben Clifford - Local authority direct provision of housing. Available at: **https://www.rtpi.org.uk/media/2619006/Local-authority-direct-provision-of-housing.pdf**

[6] **https://www.resolutionfoundation.org/media/blog/lifting-the-lid-on-the-hra-cap-is-a-new-era-of-council-housing-about-to-dawn/**