

## REFLECTIONS ON PHASE 1 QUESTIONNAIRE



### Respondent information:

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### General comments and observations:

#### Point 1:

**Please record any general comments and observations that you may have on the content of the discussion paper:**

#### It is 'affordable' housing

The feedback we have had from our members reiterates the message that you have stated clearly in 4.7 regarding affordable housing contributions. As you indicate this is a 'do' or 'don't' deal breaker for most home builders and must be considered by Local Authorities in future rounds of NHT. As you rightly point out, Scottish planning policy lists a number of options for affordable housing provision to meet the housing needs and demands of an area and mid-market rent is clearly one of them.

Whilst it remains at the discretion of Local Authorities to decide if the initiative meets the requirements of their Local Housing Strategy/Affordable Housing Policy, we would urge for continued engagement from the Scottish Government with each of the 32 Local Authorities to increase understanding of the initiative in the context of delivering much needed affordable homes.

Local Authorities who are keen also have a responsibility to ensure that they engage internally as early as possible and ensure that Committee approvals are obtained prior to the outset of the bidding process. This would reduce the risk of abortive tendering for home builders.

Where the initiative is thought to be unviable for some Authorities, thought should be given to flexing the model to maximise delivery within their area, while at the same time ensuring the scheme is attractive to home builders. A change which would be particularly attractive to smaller companies, would be to allow the affordable housing provision delivered on one site to be offset or banked against future development within the same housing market area.

#### Bureaucracy, Bureaucracy, Bureaucracy

In summary, it is imperative that the tiers of prequalification are streamlined and the suites of documents involved are simplified and made available from day one. We would urge you to consider in detail the feedback we received from our members in our June 2011 survey.

#### Legal fees

We are pleased that the feedback on the detrimental impact of associated high legal costs has been understood by the Scottish Government (as described in 3.6). While considering the scope for streamlining the legal documents we would urge the Scottish Government and the SFT's legal representative to engage fully with the legal firms that represented the development industry in the first round. We do not accept that this streamlining could be

counter-productive as is suggested.

#### Risky Business

We note that this discussion document does not address the re-balancing of risk as an issue for potential revision. We accept that this is because the current model has proven to work with home builders signing up to the terms outlined. We are not convinced that the levels of risk involved for the home builder are fully understood by our Local Authority colleagues.

It is clear from the suggestions outlined in the discussion paper that some authorities are keen to see what else they can get out of the private sector through this initiative and we would urge the Scottish Government to continue to remind those who lack understanding that maintaining the attractiveness of this initiative to the private home building industry is also a prerequisite for its delivery.

#### Disconnecting Service delivery from equity

We accept that the terms here have been amended by SFT already but felt it important to point out that any revision to the model must not reverse this change. The original ultimate default position in the event of the Management and Maintenance contractor failing was grossly unfair (i.e. assets can be seized for £1).

#### Increasing interest rates

Public Works Loan Board (PWLB) rates were modelled at 4% but are now increasing. What impact will this have on the scheme terms? Interest rates on private borrowing are also increasing. The 70/30% equity split will therefore need to become the norm and not an upper limit as currently noted.

We note from within the discussion document that the Scottish Government plan to consider this matter in detail, with alternative funding sources pursued where possible. An early outline of the alternatives, their limitations and any impact on cost modelling would be helpful to our members.

#### Unfair costs fall home builder

Currently home builders are asked to cover the full costs for the LLP Project Monitors. Home builder output is already carefully monitored by Bank Development Funding Monitors, Warranty Bodies, internal quality systems and all statutory consent inspections so are these necessary? To reflect the interests being monitored, a more equitable split would be 70% paid by the Local Authority and 30% by the home builder.

#### Other models

Homes for Scotland welcomed with open arms the innovation displayed by the Scottish Government in developing the NHT. We appreciate that the speed in which it was delivered has resulted in some teething problems and identified issues for refinement in future rounds. We also appreciate the parallel development of similar schemes in Scotland, one in particular which addresses many of the concerns raised with NHT including risk, early sales opportunities and affordability in perpetuity. Exploration of alternative models should be welcomed to increase the options, or number of 'tools in the box', available to home builders and Local Authorities for the delivery of affordable homes.

### Discussion points:

#### **Point 2 (please refer to section 4.3 of the discussion paper):**

**What should be the basis for setting NHT rents in future phases? How closely should these track the 30<sup>th</sup> percentile Local Housing Allowance rate?**

Homes for Scotland would support the introduction of a slightly greater degree of flexibility on local rent setting to allow market affordability and housing need considerations to be taken into account.

The Local Housing Allowance areas are sometimes currently too generic to account for local detailed circumstances. To make this tenure an attractive option while meeting housing needs, Local Authorities should have the ability to more precisely benchmark rents where this would allow marginal development to become viable.

In addition, where a Local Authority feels they could charge a higher rent than the benchmarked target in an area of high demand, this may increase the scale of uses for NHT and the supporting of prudential borrowing in a certain area more promising.

A wider concern worth noting is the security of rent payments with forthcoming proposed changes to housing benefit driven by the UK Department of Work & Pensions. Where a household becomes eligible for support, housing benefit payments directly to the LLP would better protect the LLP and the Scottish Government guarantee.

#### **Point 3 (please refer to section 4.4 of the discussion paper):**

**How could tenants be better supported to purchase homes through the initiative? How could tenants who require to be re-housed be better supported at the end of the initiative? Are there ways in which homes could be retained in perpetuity as affordable housing?**

The NHT initiative was welcomed by Homes for Scotland and many of our members took full advantage of the opportunity to ensure continuity in their businesses. Feedback overall suggests a positive experience, with home builders pleased with the innovative approach offered for the delivery of much needed new homes. In some ways, however, more could be learned from those who chose not to participate in the scheme. The main reason being the high risk involved for developers.

We appreciate the reasons for considering 'better' exit strategies beyond the life of the mid-market rental period, but it is important to state that if the Scottish Government chose to impose further requirements on home builders without reshaping the nature of the risk involved, the scheme would immediately become unviable to many.

Our preferred approach upon 'exit' would be for the mid-market tenants to have first refusal on a time limited basis to purchase the home. It is widely accepted that the main blockage to this 'new' category of need, in which the mid-market rent caters, is lack of mortgage finance due to banks current risk averse attitude. This means that households now need to save large deposits and have a whiter than white credit history.

A strong positive for the mid-market tenure, in comparison to traditional private renting, is that the rents are set at a level where saving for a deposit should be more manageable. At the end of the tenancy, the tenants will also have a rent payment history to assist them in demonstrating to banks their ability to service a mortgage. The house holds therefore

would be in a much stronger purchasing position than they were from the outset.

Although it is impossible to predict the home builders financial capacity and associated cash flow to support shared equity in five years' time, it is nevertheless possible that some home builders may be in a position to offer residents the opportunity to step up to home ownership through the use of shared equity or deposit save schemes.

These arrangements will vary largely from company to company, they are not universally available across the industry, and so should continue to be offered only at the discretion of the developer.

Furthermore, we would be interested in exploring a model which allows the sitting tenant to buy at a time that suits them, after say 3 years, rather than having to wait until the timeframe picked by the LLP for asset sales or the end of the ten year period. Tenants having this opportunity would have the potential to assist home builders with their cash flow with funds released earlier.

We appreciate that it is unlikely that every resident will be in a position to purchase upon 'exit'. Therefore, home builders are unlikely to have objections to a Local Authority, or a partnering RSL, engaging with them to explore the opportunity to bulk purchase a selection of the units at the end of the mid-market rent period. This would allow an authority to continue to offer mid-market rent to meet demand or where appropriate to convert a proportion of the units to social rent. This would be subject to negotiations with the home builder in the run up to the 'exit' date.

Given the high levels of risk already invested by the home builder in entering the initiative, and a business model likely to depend on future increases in values, it would not be advisable for the purchase prices of the units to be pre-determined at the outset.

**Point 4 (please refer to section 4.5 of the discussion paper):**

**Is the current IRR cap to the private sector of 20% appropriate? If not, what level would you suggest in order to balance the interests of both the public and private sectors going forward?**

We understand that there have been calls for profits at the point of sale to be invested back into affordable housing. The home builder is already last in the pecking order when the money is paid back and we would argue that the IRR cap should actually be increased to the benefit of the home builder to better reflect the weight of the risk that has been taken.

We note that this discussion document does not address the re-balancing of risk as an issue for potential revision. We accept that this is because the current model has proven to work with home builders signing up to the terms outlined. We must be clear however; that our members would not accept a revision that would impact negatively on their businesses and a reduction in the IRR cap is not an option if NHT is to remain a mode of housing delivery in Scotland.

**Point 5 (please refer to section 5.3 of the discussion paper):**

**Are there ways to better reach and support smaller-scale house-builders in order to increase their participation in future NHT rounds?**

The initiative involves locking a high volume of investment into the homes for the mid-market rent duration of five years and this unfortunately automatically excludes many small scale home builders due to the impact on their cash flow.

The obvious way to increase the participation of smaller home builders would be to decrease the minimum size of a project or group of projects from 15 units. We appreciate however (as stated in the discussion paper) that you have carried out analysis against the costs of setting up/participating in individual LLPs and accept that the minimum has been set for that reason. It would be useful however to give consideration to an LLP that could be set up on an incremental basis, allowing home builders to deliver in phases across housing market areas, rather than insist on project specific delivery.

One thing we can do is raise awareness of the opportunities of NHT so it is better understood amongst smaller home builders. We would encourage the Scottish Government to hold well publicised bidder conferences and to ensure early notification of the next round. Homes for Scotland would be happy to assist the Scottish Government with the promotion of such events on a joint platform.

**Point 6 (please refer to section 5.4 of the discussion paper):**

**Do you have any suggestions on what more could be done to support bidders to improve the quality of their procurement responses?**

We believe that the quality of procurement submissions were an inevitable consequence of the short time scale bidders had to respond. The bulk of criticism we received from members who had participated in the scheme was the levels of unnecessary, often repeated information and bureaucracy involved. We would like to see this streamlined in future phases, potentially with the removal of the mini-bid process which our members did not feel added anything substantive to the experience.

We also support the suggestion that SFT continue to issue checklists and provide clear guidance on what is expected throughout the stages of the process. Consistency on submission requirements at a national level from NHT would greatly assist home builders participating in the initiative in more than one council area.

A supplementary suggestion would be to include more detail within the 'bidder's days'. If SFT was able to publish all the necessary documents, agreements and supporting models from day one, this material could be clearly explained in line with the procurement process increasing the benefit to home builders in attending the workshops. Developers should continue to be encouraged to field their appropriate supporting advisors at these sessions and Homes for Scotland can assist in the promotion of such bidder events amongst our associate members within developers supply chain.

**Point 7 (please refer to section 5.7 of the discussion paper):**

**Do you have any suggestions on how lenders could be encouraged to bring forward non-performing sites in future phases of the initiative?**

Given how risk-averse financial institutions are at the moment we would like to assume that their potential to bring forward non-performing sites into the NHT would increase in future rounds. They now have a tried and tested delivery model to present to their Risk Managers as opposed to an 'innovative concept'. The Scottish Government/SFT should continue to actively engage with the lending institutions directly on this basis.

To date engagement from banks in the process has been disappointing. Our members have raised issues with the following which we also hope can be improved in future rounds:

- High arrangement fees,
- Expensive interest charges,
- Ludicrous exit fees for presold stock,
- Extended periods of time taken to grant credit approval,
- Costs of monitoring surveyors,
- Costs of legal overviews,
- Requirement for cost overrun personal guarantees from Directors of small firms

When engaging with lenders, we would encourage the Scottish Government to secure better terms for development finance for home builders participating in NHT. Better terms would go far to bring additional home builders to the table, particularly smaller ones.

**Completed questionnaires should be returned to [nht@scotland.gsi.gov.uk](mailto:nht@scotland.gsi.gov.uk) by Friday 19 August 2011.**