

Housing, Homelessness and Fair Work Committee

10.00am, Thursday, 1 December 2022

Housing Land Strategy Report

Executive/routine Wards Council Commitments	Executive All
---	------------------

1. Recommendations

- 1.1 It is recommended that Housing, Homelessness and Fair Work Committee notes:
 - 1.1.1 The findings and emerging opportunities resulting from the Prior Information Notice (PIN) market engagement process; and
 - 1.1.2 That approval will be sought from Finance and Resources Committee for purchase of homes or sites with progress reported to this Committee via briefings and Business Bulletin updates.

Paul Lawrence

Executive Director of Place

Contact: David Cooper, Head of Development and Regeneration

E-mail: david.cooper@edinburgh.gov.uk | Tel: 0131 529 6233

Housing Land Strategy Report

2. Executive Summary

- 2.1 This report updates members on the findings from the market engagement exercise looking at more innovative ways of delivering affordable housing in order to accelerate delivery rates.
- 2.2 The market conditions have changed dramatically since this exercise began and this is reflected in the approach that is now proposed. Rather than move forward with lease based proposals, it is now considered better to focus on the opportunities being presented directly by land-owners.
- 2.3 The Council will explore delivery options with these potential partners and will also involve Registered Social Landlords (RSL) in these discussions as well as considering the role of the Council's Edinburgh Living LLPs. These opportunities are now included as part of an updated Housing Land Strategy and the sites are also included in the 2023-2028 Strategic Housing Investment Plan (SHIP).

3. Background

- 3.1 Edinburgh needs more homes of all tenures, with greatest demand being for affordable homes. The latest Housing Need and Demand Assessment (HNDA3) states there is demand for between 36,000 and 52,000 new homes in Edinburgh between 2021 to 2040; between 24,000 to 35,000 of these homes need to be affordable. Lack of affordable housing is impacting on the ability of the city to address homelessness and is also a barrier to economic growth.
- 3.2 The SHIP is reported annually to this Committee (with the latest report being presented to Committee as part of this meeting agenda). Previous reports highlight the main risk to the delivery of the plan is that affordable housing developers need greater control of sites in order to accelerate development of affordable housing. Funding is also a challenge and there is an important role that non-grant funded models play in delivering affordable homes and brownfield regeneration in the city.
- 3.3 The proposal to carry out market engagement was agreed by Committee on [4 November 2021](#) as a means of exploring new delivery options for the Council directly and through Edinburgh Living. A Parameters document was also agreed as

part of the pack to be provided. This document is attached in Appendix 1 for ease of reference (and the link to the full report is provided in the Background Reading section below).

- 3.4 Viability of affordable housing is now more challenging due to substantial increases to construction costs, increased borrowing costs and rents which have been frozen. Construction prices increased globally in 2022 and costs of construction materials such as timber, steel and particleboard increased by more than 40% in the last year due to rising energy prices, increased demand post the Coronavirus (Covid-19) pandemic, and reduced supply, due in part to the war in Ukraine. The average cost of building an affordable home in Edinburgh increased from just under £120,000 in 2012 to just under £160,000 in 2020. In 2021, the cost of building an affordable home rose to almost £185,000.
- 3.5 Most affordable rented housing is funded by a combination of RSL private finance or Council borrowing repaid from rental income and grant funding. Finance is usually based on the amount of rent that can be collected to repay the interest and borrowing. The amount of grant funding made available by Scottish Government for each affordable home increased in 2021, however, it still only represents around 41% of the cost of an affordable home. Whilst the average cost of an affordable rented home in Edinburgh in 2021 was almost £185,000, the average grant amount per home was only £76,000.
- 3.6 In September 2022, the Bank of England raised interest rates by 0.5% to 2.25% to try to curb inflation; this increases the cost of borrowing, including the cost of borrowing for housing. In September 2022, inflation was 10.1%, which is the highest for 40 years, and mortgage interest rates exceeded 6% for the first time in 14 years. The number of mortgage products available fell from almost 4,000 in September 2022 to just over 2,000 in October 2022.
- 3.7 High development costs coupled with high interest rates are expected to impact on delivery of market and affordable housing. There is an increased risk of insolvencies and developers may choose to delay site starts or sell sites. Whilst this may create opportunities for the Council and RSLs to purchase sites or completed homes, affordable developers are facing increased financial pressures and are unlikely to be able to scale up their development programmes without additional grant funding from Scottish Government.
- 3.8 The Housing Revenue Account Budget Strategy 2023/24 report to this Committee in [September](#) set out the impact of rising costs on the Housing Service and the planned capital programme. The report highlighted that an increase in government funding and rental income will be needed to enable more homes to be brought into the Council's development programme.

4. Main report

Market Engagement - Findings

- 4.1 On 4 November 2021, agreed to carry out a market engagement exercise. A Prior Information Notice (PIN) was subsequently issued reflecting that new delivery approaches may require to be formally procured.
- 4.2 A direct approach to funders was also made. The Council received a good response from the market with 21 parties engaging with the process. This included investors, developers, and landowners as well as intermediaries who have developed delivery models that are designed as a full service to the Council.
- 4.3 Appendix 2 provides a list of all the respondents along with a brief analysis of their proposals. This document is being treated as commercially sensitive in order to ensure best value for the Council moving forward should it choose to move to a competitive process. Engagement with funders was also undertaken on the basis of confidentiality for those participating.
- 4.4 All of the parties who responded have provided proposals for the Council to consider. In some cases, this has been more generic and has been an offer of services or finance but without there being a defined project or development site identified. Other respondents have come forward with more site specific proposals.
- 4.5 In general terms, the findings of this exercise reaffirm the position that was set out in the previous report to Committee: that access to land is one of our biggest challenges and that the typically strong housing market in Edinburgh means that securing land or opportunities for affordable housing comes at a premium. The key points are as follows:
 - 4.5.1 There are a number of investors, intermediaries, developers and landowners who have responded and are keen to work with the Council;
 - 4.5.2 The Council's covenant is attractive to investors and the level of security it provides means that the Council can achieve competitive rates;
 - 4.5.3 The specificity of the Council's housing requirements – quality, zero carbon, rents at or below Local Housing Allowance (LHA) levels mean that project viability is challenging particularly when working to deliver units in addition to those delivered through the Affordable Housing Policy (AHP) and where land or buildings need to be purchased at market-value;
 - 4.5.4 In terms of lease-based delivery models, these are shown to be available and broadly feasible, but they are inflation linked and involve lease terms of 50 years or longer. These models also have to be assessed in the context of delivering sustainable mixed-tenure communities as they tend to offer mono-tenure solutions and do not support the delivery of social rented housing;
 - 4.5.5 The Council may be an attractive development partner on larger sites where a 'place premium' has not yet been achieved and this may also mean that the

Council can secure better deals in these circumstances involving more than one delivery route; and

4.5.6 In a typically strong property market, the ability to act quickly to seize opportunities when they do arise, is fundamental to success.

4.6 The leasing model featured strongly in the responses received from both intermediaries and investors. Under this model the Council would sign up to a lease or an agreement to lease completed units. In order to meet the cost of land, construction, services and finance while still being able to deliver affordable homes, the lease terms required were generally 55 years or longer.

4.7 These offers are inflation linked and generally come with a collar and cap. At the time of reviewing the proposals, these were generally at 1% and 5% meaning that the annual lease costs would automatically increase by between 1% and 5%, dependent on the actual rate of inflation. Rents paid by tenants would need to increase annually at the same level to avoid creating a gap in the financial model and to ensure that the Council can meet its future lifecycle requirements and overheads. It is also unlikely that the terms stated in the proposals would still be held in the current economic climate.

4.8 While these offers are appealing from the perspective of being a complete end to end service, the key challenge with this approach is financial risk. The Council's analysis of these proposals is that if there was around nine years of consecutive inflation running a 3% per annum then we would arrive at a position where either the Council would be in a loss making position or the rents would need to be set at levels no longer considered to be affordable. As such, these opportunities are not considered to stand up to sensitivity analysis and it is not recommended that they are taken forward at this time.

4.9 Scottish Futures Trust (SFT) is establishing a lease-based delivery working group to further assess the risks and opportunities of these models. Council officers will take part in this working group, which will be an opportunity to share experience and set out where further support is required to improve the viability of these models. This work will help to inform any future consideration of lease-based models as well as potential procurement routes.

New Approach

4.10 There are ways in which the Council could work more with the private sector to increase affordable housing delivery although, as stated above, this comes at a cost. Entering into such arrangements will need careful consideration to ensure that the approach is procurement compliant.

4.11 In order to increase the number of affordable homes and Council owned homes, the following should be considered:

4.11.1 As previously stated, access to sites has always been a key challenge in delivering more affordable homes. It is proposed that where landowners and developers come forward with housing sites, the Council and RSL partners

explore whether affordable homes can be delivered above and beyond the affordable housing policy requirement. Where it is not possible to secure additional homes, it may be possible for the affordable development to be brought forward in advance of market housing. In some instances, delivery of market homes will also be required to cross subsidise the affordable homes. Any such engagement with landowners would only be made on sites specifically identified as housing sites in the local development plan (LDP), or other sites in the urban area, provided they are considered to be suitable for housing development. It would not extend to land in the green belt or sites specifically identified in the LDP for other purposes.

4.11.2 Where sites are suitable, the Council would offer to either buy land, completed homes, or work in partnership with the landowners and RSL partners to develop sites and additional affordable housing. A key challenge will be that funding and additional grant from the Scottish Government will be required. In addition, a more commercial approach may need to be taken so that we can cross subsidise affordable homes with market homes for rent or sale.

4.11.3 With less certainty around mortgage lending and availability, more “Off The Shelf” (OTS) house purchasing opportunities may be presented to the Council and RSL partners. In the past this has been homes sold at completion with a bulk purchase discount offered. Developers and House Builders may prefer to work with the Council or RSLs to sell homes direct rather than offer homes for market sale in a period of mortgage lending uncertainty and instability. However, as the homes were designed and built as market homes for sale, they may not fully meet the energy efficiency and accessibility standards expected from affordable housing. The Council will open dialogue with Scottish Government to explore the option of grant funding in case OTS opportunities start to be offered.

4.11.4 The Council is likely to have to pay market value, or very close to market value, in order to secure land or homes above and beyond the affordable housing policy. Any proposals coming forward will be carefully assessed to ensure they are financially viable and can be accommodated within the HRA budget. Careful consideration will be given to the choice of tenure and the vehicle in which units will be held, having regard to the ability to fund the purchase and development of the homes and also the desire to have mixed tenure communities. Any Edinburgh Living acquisitions would require to be funded from General Fund borrowing repaid from future rental income.

Live opportunities

4.12 Through the procurement exercise, landowners have been identified who are willing to work with the Council to explore options for increasing the levels of affordable housing on their sites. The detail of these opportunities is set out in Appendix 2 along with a description of the likely commercial requirements. These are all the subject of live negotiations.

- 4.13 It is envisaged that all of these opportunities, if progressed, will be moved forward as property transactions and are unlikely to require any formal procurement processes to be undertaken. The Council will remain open to approaches from other landowners. Such opportunities will be assessed on their own merits.

5. Next Steps

- 5.1 Council officers will continue to seek new opportunities to secure land and the delivery of affordable homes in line with this revision to the Housing Land Strategy while also having regard to the challenges regarding budget constraints.
- 5.2 Any new proposals to acquire land or take forward new projects will be considered on their own merits and taken to the Finance and Resources Committee for approval as is current practice.

6. Financial impact

- 6.1 There is no direct financial impact arising from this report. The recommendations are in relation to a strategic approach that will sit within the wider budget strategy that will be considered separately by this Committee.
- 6.2 As stated above, any new proposals will be reported to the Finance and Resources Committee where the direct financial impacts can be fully assessed.

7. Stakeholder/Community Impact

- 7.1 This work has been focussed on market engagement to explore new funding and delivery models. Alongside this work officers will continue to work closely with RSL partners who are fundamental to the continued delivery of affordable homes in the city.
- 7.2 The HRA Budget Strategy, which will dictate the availability of funding for new homes and land acquisition is the subject of consultation with tenants and will be reported to Finance and Resources Committee as part of the annual budget setting process.
- 7.3 Any individual projects will be the subject of community and stakeholder engagement during planning and delivery stages.

8. Background reading/external references

- 8.1 Land Strategy Update and Private Sector Engagement, Housing, Homelessness and Fair Work, [4 November 2021](#).

- 8.2 Strategic Housing Investment Plan (SHIP) 2021-2026, Housing, Homelessness and Fair Work, [14 January 2021](#).
- 8.3 Land Strategy to Support Delivery of Affordable Housing and Brownfield Regeneration, Housing, Homelessness and Fair Work, [14 January 2021](#).

9. Appendices

- 9.1 Appendix 1 – Parameters document.
- 9.2 Appendix 2 – PIN Responses and Analysis (B Agenda)

Appendix 1

PROPOSED PARAMETERS FOR INVITING INTEREST FROM PRIVATE SECTOR TO DELIVER AFFORDABLE HOUSING FOR PURCHASE OR LEASE BY THE COUNCIL

The Invitation to Market is open to landowners, investors and developers and recognises that opportunities will be at different stages in the design, development and construction process. These parameters have been agreed by the Council's Housing, Homelessness and Fair Work Committee for the purposes of the Prior Information Notice and are intended to challenge the market in terms of the outcomes sought.

PARAMETER CATEGORIES	DETAIL
KEY REQUIREMENTS AND OUTCOMES	<p><u>Generally</u></p> <ul style="list-style-type: none"> • Provides access to land or homes that are not in Council ownership • Presents a viable business model and meets a five-case business case for approval by the Finance and Resources Committee • Preference is for a mix of 1, 2 and 3 bed flats and houses (with limited 3 bed flats) • Proposals of between 50 and 250 homes per development is preferable but proposals will be assessed on their own merit and higher numbers will be acceptable on developments where there is a clear business case for this approach <p>Provides opportunity for rapid delivery in areas of the City where there is high demand for affordable tenures</p> <p><u>Where leasing structures are proposed</u></p> <ul style="list-style-type: none"> • Homes will be considered for social rent, mid-market rent and market rent. • Lease terms should be appropriate with respect to risk level, rent affordability and financial viability • The Council proposes to set mid-market rents at or below 80% of Local Housing Allowance where lease models are being considered and rents will remain within 100% of Local Housing Allowance for the duration of the lease. • Rent increases will be capped at CPI annually. • Full details of partners within the funding structure and discussions with funders will be required directly in addition to transparency of funding structure • Sufficient financial headroom, over and above expected operating costs and built in risk for void and rent loss, will be required to allow for (i) adverse economic conditions, (ii) making buildings more sustainable in line with future technology and regulations and (iii) lifecycle replacement of key capital components (e.g. roofs, windows, kitchens, bathrooms). Contingency should be sufficient to ensure that there are no unexpected revenue pressures for the Council and the long-term affordability of the homes is protected. • Homes that are leased to the Council must transfer into Council ownership at the end of any lease term (asset reversion) • Market rents will be assessed based on scale, typology, location and relative affordability.
QUALITY AND SUSTAINABILITY	<ul style="list-style-type: none"> • Focussing on the Council's ambitions in delivering highly efficient new homes, developments should be designed to high standard of sustainability (minimum silver standard, EPC - B) with a preference for new zero carbon homes and all business cases should include full costs to meet our net zero carbon target of 2030. • Where homes are already completed or nearing completion a high standard of sustainability will be expected with additional headroom to allow funding for net zero carbon • Suitable on-site quality assurance and input into acceptance of practical completion and making good defects in line with the defect rectification period • NHBC/warranties should be made available • Delivery of social value benefits from the construction are to be evidenced, including adoption of fair work practices, use of local SMEs within the supply chain and delivery of local community benefits • Method for benchmarking heating costs to tenants to be demonstrated for proposals featuring communal systems, to ensure long term affordability to tenants • Proposals will be assessed against a quality standard to ensure that designs align with the Council's expectations
MAINTENANCE RESPONSIBILITIES	<ul style="list-style-type: none"> • All maintenance responsibilities and any shared maintenance apportionments to be set out clearly in the Heads of Terms and costed as part of business case • Maintenance responsibility for shared heating and hot water plant to be capped • Where homes are being leased, the cost of maintenance to be benchmarked in relation to similar properties