

Analysis:
Can Local Authorities
Deliver Housing for Sale or
Market Rent in Scotland?



1 Introduction

The past few years have seen a significant expansion in the number of Local Housing Companies being set up and operated by local authorities in England. While their roles vary widely, many Local Housing Companies are now delivering a mix of affordable housing tenures and homes for sale or market rent.

The Scottish Futures Trust has discussed the direct development of homes for sale or market rent with a number of local authorities in Scotland.

This paper provides an overview of this model and examines the potential for similar activity to take place in Scotland. In doing so, this paper aims to support our discussions with interested local authorities and their considerations.

2 Council as Housebuilder – English Experience

Local Housing Companies (LHC) are an increasingly common feature in the housing sector in England. These companies are owned by local authorities and engage in housebuilding in a variety of ways.

Research undertaken by UCL Bartlett School of Planning on behalf of the Royal Town Planning Institute in 2019 found that 78% of all local authorities in England had a housing or property company comprising a wholly owned or joint venture company focussed on either, housing delivery and development, or acquiring property for investment or other purposes.

Furthermore, their survey of 142 English local authorities found:

- > 69% of respondents were directly engaged in the delivery of housing;
- > 42% had a Local Housing Company;
- > Of these, 83% were wholly owned housing company and 34% of authorities had a joint venture housing company. 7% had both.

In the last year, these local authorities and their companies had delivered 8,992 homes - 3,803 affordable (42%), 2,079 social (23%), 943 intermediate (10%), 1,428 for sale (16%) and 739 PRS (8%).

A **study by the Smith Institute** in 2017 found that the impetus for setting up LHCs were varied, but included:

- > A worsening housing crisis with many areas suffering from acute shortages of affordable homes, especially for those on low-to-medium incomes.
- > Desire to be an example of an 'entrepreneurial council' taking the initiative and innovating to meet local housing needs.
- > The need to react to government constraints on the Housing Revenue Account (e.g. borrowing caps, rent controls and the RTB), as well as to cuts in housing budgets.
- > The desire to intervene in the housing market, often because of a frustration with the pace, scale and cost of delivery by the private sector and housing associations.

An earlier phase of research commissioned by the Royal Town Planning Institute also looked at motivating factors for engaging in the direct provision of housing¹. These are influenced by circumstances that differ from those in Scotland, however the reasons provided are below, ranked in order of importance by survey respondents:

- 1 Meeting housing requirements
- 2 Tackling homelessness
- 3 Income generation
- 4 Estate regeneration
- 5 Private sector build out rates too slow
- 6 Frustration at unimplemented planning permissions & Place regeneration (e.g. town centre)
- 7 Improving quality of design
- 8 Because local authorities should be building housing
- 9 To deal with problem sites
- 10 To change public perceptions of place
- 11 To support small business

The 2019 update to this research subsequently found that a desire to improve the quality of design had become a more significant factor in delivering housing directly.

3 Fortior Homes & Stoke on Trent Council

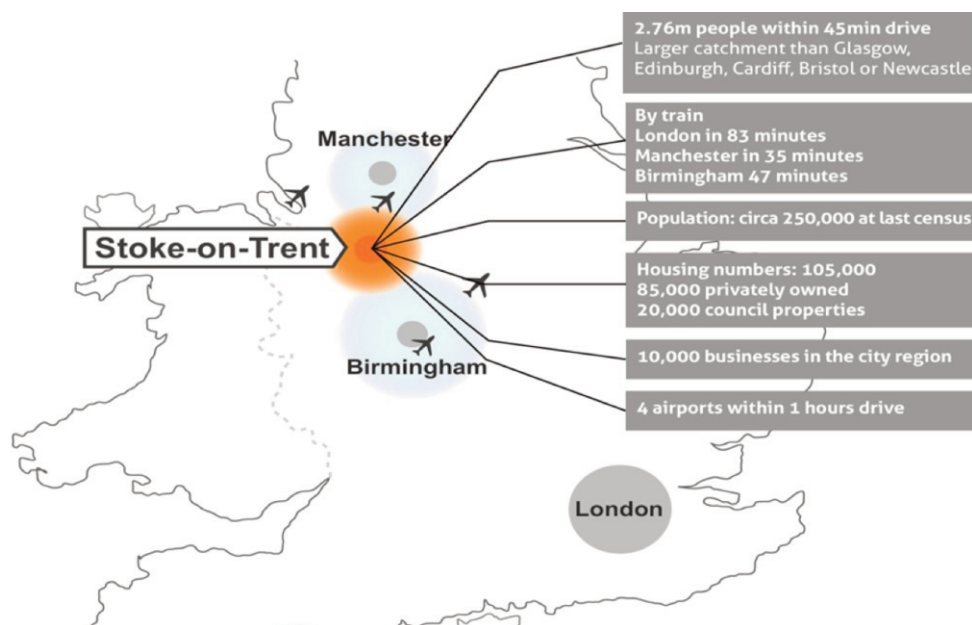
Stoke on Trent Council has recently become active in the housing market in the city of Stoke. The housing market issues faced by the Council, and which were the basis for the decision of the Council to take an active role in the housing market, are likely to resonate with many Scottish local authorities.

Scottish Futures Trust shared a platform with Stoke on Trent Council at the CIH Housing Festival in 2020 to discuss their experiences with their Local Housing Company, called Fortior Homes. The Council's experiences are outlined briefly in the case study below.

¹ https://i.emlfiles4.com/cmpdoc/3/8/5/5/7/files/516134_local-authority-direct-provision-of-housing.pdf

4 Case Study - Stoke on Trent & Fortior Homes

Stoke on Trent Council



Challenges Faced by Local Authority

- > Low land values;
- > High levels of deprivation;
- > Challenging brownfield sites – former industrial land throughout the city; with high costs due to remediation requirements;
- > Slow Housing Association delivery due to high costs;
- > Difficult to obtain funding to build in city;
- > Sales of Council properties through Right to Buy; and
- > Waiting list pressures due to lack of new stock being built.

Council Response

Decided to intervene in delivery of affordable homes and private sector homes, using Council mechanisms to make unviable sites work and increase confidence of private sector.

Actions

Set up **Fortior Homes** in 2016 as a private housing company wholly owned by the Council. It develops, lets and manages homes. Its overall goal is to stimulate and ‘make’ a market, by building confidence in the city. It will deliver a first phase of development, but steps back from sites if private sector interest comes forward, therefore avoiding displacement. Council provided finance to Fortior Homes via on-lending. It receives a yield on this investment. This is the main commercial benefit to the Council from Fortior Homes. It delivers £1m annual return to the Council. In addition, Fortior can also access some of the Council’s £9m finance package from the Housing Infrastructure Fund, which is targeted at enabling infrastructure for housing sites. Fortior is seeking to develop a

£92.5m programme to deliver 860 new homes for private rent and open market sale in the city on sites that are not viable for the private sector to deliver. It is developing Stoke's first Build to Rent development at the Clayworks, to address the lack of purpose built BTR developments in the city. The Council is also delivering a programme of over 1300 affordable homes on sites across the city, working with Homes England, MHCLG and an institutional investor to deliver these. HRA to borrow £125m to accelerate its development of affordable homes in the city (approved January 2020). Finally, following a deal in January 2019 that secured £40m from Cheyne Capital's Social Impact Property Fund, Stoke is setting up a new Registered Provider of affordable housing. Cheyne will fund the purchase of the land and the construction at the two sites, with the council leasing-back the properties over 40 years.

5 Council as Housebuilder – Scottish Experience

All but six local authorities in Scotland deliver homes directly. This is largely done through their Housing Revenue Account in order to provide homes for affordable rent or specific needs in accordance to their Housing Needs and Demand Assessment and the Local Housing Strategy.

Local authorities have also entered into Limited Liability Partnerships (LLPs) in order to support the delivery of homes for Mid Market Rent, notably through the **National Housing Trust** initiative, which has resulted in the creation of 28 LLPs across Scotland being established, which to date delivered 1731 homes for Mid Market Rent. Some of these LLPs do not include a private sector partner, for example Steadfast Homes LLP, which is comprised of Stirling Council and the Scottish Futures Trust.

City of Edinburgh Council has also recently established Edinburgh Living LLP, which currently aims to provide approximately 700 homes for Mid Market Rent in the city. It also aims to deliver approximately 700 homes for Market Rent. These homes will be offered for a rent that will sit above Mid Market Rent but below a typical Private Rented Sector rent for an equivalent property in Edinburgh. The Market Rent homes to be delivered by that LLP are not classed as affordable homes.

We are not aware of any other examples of local authorities directly delivering homes for non-affordable tenures – such as Market Rent, private rent or homes for sale - with the exception of Fife Council, as set out below.

6 Legal Basis for Local Authorities to Develop Homes for Sale or Rent in Scotland

In order to establish the legal basis for Councils to develop homes for non-affordable tenures in Scotland the Scottish Futures Trust sought legal advice from Burness Paull LLP. They provided the following opinion to the Scottish Futures Trust:

- i. The Local Government in Scotland Act 2003 part 3 gives statutory power to local authorities in Scotland to do anything which they consider likely to promote or improve the wellbeing of its authority or people within the area, commonly referred to as *the power to advance wellbeing*.
- ii. The power to advance wellbeing is a permissive power, in other words it only confers power on an authority where it does not conflict with other legal restrictions.
- iii. 2004 guidance published by the Scottish Government states that the broad power to advance wellbeing was provided to encourage innovation and that authorities should regard it as a “power of first resort”.
- iv. However, Burness Paull goes on to note that the Courts have applied a restrictive interpretation to the power in relation to its interplay with the *ultra vires doctrine*, which restricts local authorities to do only what they are specifically empowered to do. Unless a clear power can be identified, a Court may hold that a local authority’s actions are *ultra vires*.
- v. Burness Paull highlights the risk that there is no specific power conferred on local authorities to build homes for sale. Therefore, reliance solely on the power to advance wellbeing to do so may expose a local authorities to this activity being considered *ultra vires*.
- vi. In addition, there are very limited circumstances in which, under the Local Authorities (Goods & Services) Act 1970 can undertake trading operations, defined in section 1(1P) of that Act as “a trading operation which is carried on for the purpose of enabling a local authority to raise money, by borrowing or otherwise”. Burness Paull is of the view that if the development of homes for sale or market rent is driven by regeneration priorities and not from the need to generate an income, it should not be considered to be a trading operation.

To help ensure that developing homes for sale or rent falls under Scottish local authorities’ power to advance wellbeing, Burness Paull advises that any project or programme justification:

- i. Refers to Scottish Government guidance on the power to advance wellbeing when making the case to develop homes for sale or rent; and
- ii. Clearly determines why the initiative will contribute to the wellbeing of the area and how it will benefit from the regeneration of specific sites through the development of homes for sale or rent. These benefits should be set out clearly and specifically. This reflects the fact that, as stated within the guidance, it is for local authorities to determine what factors contribute to their area’s wellbeing.

Please note that the advice provided by Burness Paull was for the Scottish Futures Trust only. Any local authority considering building homes for sale or market rent should seek their own legal advice.

7 General Power of Competence v Power to Advance Wellbeing

There is a difference between the legislative basis under which English and Scottish local authorities can act.

Until 2011, English local authorities also had the broad power to advance wellbeing. However, the Localism Act of 2011 introduced a general power of competence, which superseded the power to advance wellbeing.

The general power of competence provides that a local authority has **power to do anything that individuals generally may do unless specifically prohibited**. In addition to dealing with the potential *ultra vires* issues, the substantive difference between the power of general competence and the power to advance wellbeing is that with the general power of competence, there is **no requirement to identify a specific benefit**.

The general power of competence is seen as a wider statement of local authority powers than the previous wellbeing powers. Its introduction was in reaction to cases such as *R v Risk Management Partners Limited ex parte The Council of the London Borough of Brent and the London Authorities Mutual Limited and the Council of the London Borough of Harrow* which saw courts apply a narrow definition of vires powers². These decisions were seen as introducing uncertainty around the scope of the wellbeing powers. The general power of competence was also a response to the 33% cut in local authority grant from central government between 2011-2015³.

Also notable is that the general power of competence allows local authorities to carry out commercial activities but, critically, this must be done through a company. Since the 2011 Act does not apply to Scotland, the choice of vehicle to deliver local authority services in Scotland can be determined by a range of other factors.

The introduction of the Localism Act in England, combined with the lifting of the borrowing cap on English local authorities' housing revenue accounts in October 2018, has enabled the proliferation of Local Housing Companies in England.

8 Council Developing Homes for Private Sale – Fife Council

Despite the absence of a general power of competence, the power to advance wellbeing has been relied upon to develop homes for sale by local authorities.

In December 2016, Fife Council approved a proposal by their Head of Assets, Transport and Environment for the development of 4 homes for sale by Fife Council on a site at Raith Drive, Kirkcaldy. The circumstances for this were specific, as set out in a paper submitted to the Council's Executive Committee:

- > Fife Council had approved the development of residential accommodation for looked after children at Raith Drive, Kirkcaldy in 2014. The development would occupy 2,140sqm of the site, with 5,400sqm remaining undeveloped.

² For an analysis of this case, see summary here.

³ The Local Government Authority paper on the GPC is here

- > It was felt that leaving the site vacant would result in the children's home being isolated, but selling the site to a developer would mean the Council could not control what is built and would expose vulnerable children to living beside a building site. The preferred alternative was a comprehensive development of the site, with all construction being undertaken by a single contractor in a single phase. Due to economies of scale being achieved, this would represent best value to Fife Council.

Noting that there is no specific legal provision that allows Scottish Councils to build out new homes for sale on the open market, the report sets out the basis for delivering homes as follows:

- > Section 20 of the Local Government in Scotland Act 2003 gives Councils power to do anything which it considers is likely to promote or improve the well-being of its area, or persons, within that area.
- > Proposals put forward under the above power to advance of wellbeing must still be in line with other legal provision.
- > Fife Council stated that the power to advance well-being was being utilised to benefit the young people living in the new homes, to encourage a safer community, equality of opportunity and to provide a benefit to their social and mental health.
- > Fife Council stated that the development for homes for sale in this instance did not comprise a "trading operation" as defined under the Local Authorities (Goods & Services) Act 1970 due to the specific circumstances outlined above.

Fife Council went on to **develop and sell the homes** without the use of an arm's length organisation.

9 State Aid Compliance & Development of Homes

The European Commission and courts have determined that the construction of social housing is an economic activity that can benefit from state funding by virtue of it being a service of general economic interest (SGEI). Where, however, the Council is *not* building "social" housing, such as housing for sale or market rent, then the Council would need to have regard to the requirements of State Aid law.

Any local authority in Scotland should seek advice on State Aid compliance in relation to any proposals for the development of homes that do not fall into the categorisation set out above.

10 Use of Arm's Length Organisations

If a local authority in Scotland is seeking to develop homes for sale or for market rent, it may consider following the examples of local authorities in England and do this via an Arm's Length Organisation (ALEO).

In relation to activity in the private rented sector, to execute a letting at Mid Market Rent or market rent, a Private Residential Tenancy is required to be in place with a tenant. Current legislation prevents local authorities from directly offering tenancies other than Assured Tenancies. Therefore, an ALEO is required if a local authorities wish to offer Private Residential Tenancies.

An ALEO is not required for the development of homes for sale, as demonstrated by Fife Council. This is because no tenancy is issued. Therefore, the properties can be developed under the General Fund. In this situation a local authority could also benefit from its VAT and Land and Building Transactions Tax shields. The use of these shields would need to be tested for State Aid compliance if the homes were not considered to be affordable and the homes were sold on the open market. The use of an ALEO in developing homes for sale could also offer additional legal and financial transparency.

In England, as set out above, most local authorities have sought to set up ALEOs and have used these to deliver a broad range of property types and tenures. They are restricted by legislation in terms of the type of ALEOs they set up.

In Scotland there are two primary types of ALEOs that can be set up by a local authority:

- 1. Limited company, wholly owned by a local authority; or**
- 2. Joint Venture Limited Liability Partnership with developer or funder as external partner.**

Each have different characterisations and any local authority would need to select one that best suits its purpose.

Any on-lending from a local authority to an ALEO requires consent from the Scottish Government.

11 Conclusion

There seems to be an opportunity for Scottish local authorities to directly deliver homes for sale on the open market or for market rent. The Local Government in Scotland Act 2003 part 3 gave statutory power to local authorities in Scotland to do anything which they consider likely to promote or improve the wellbeing of its authority or people within the area, commonly referred to as *the power to advance wellbeing*.

In the absence of a specific power to build homes for sale or for market rent, there would be a requirement for authorities to establish and demonstrate that they are progressing such a proposal under the power to advance wellbeing in Scotland.

There appears to be further merit in examining direct delivery of homes, particularly in areas where the following are factors:

- > Depopulation or aging population – where a local authority is seeking to attract or retain a higher proportion of working age population through the provision of more or better family homes.
- > Slow housebuilding rates – where there is an inactive private sector housing market, with large sites remaining vacant or derelict as a result.
- > Where the nature of the site fails to attract market activity due to prohibitive cost of enabling infrastructure or remediation required.
- > Land in Council ownership – where Councils have control of land but are struggling to attract suitable private sector investment or want a different kind of housing product in a settlement to support regeneration or potentially placemaking and low carbon policies.

The Scottish Futures Trust is keen to advance this discussion to explore new ways to support the delivery of homes across Scotland.

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