

The Highland Council

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| Agenda Item | 13 |
| Report No | HC/21/24 |

Committee: Highland Council

Date: 27 June 2024

Report Title: Declaring the Highland Housing Challenge and Identifying Solutions to Resolve it.

Report By: Chief Executive

1. Executive Summary

- 1.1 Members are asked to approve the formal establishment of a Highland Housing Challenge, in recognition of the issues facing Highland Council and its strategic partners in meeting the current and anticipated future demand for housing in the area. This is based on an updated ten-year Housing Needs Demand Assessment, which incorporates economic modelling based on potential increases in jobs connected to the development of the Inverness and Cromarty Firth Green Free Port.
- 1.2 It is anticipated that an additional 24,000 or so houses will be required in the next ten years. This is around double that which would normally be built. This paper looks at what the challenges are in increasing the supply of housing and potential solutions that can be brought to bear to meet these challenges. Providing an effective supply of housing and an effective and energy efficient housing stock is important to the people of the Highlands, both current and future. The evidence base for what we need to do is based on population and economic modelling.
- 1.3 A number of strategic objectives are proposed through the Highland Housing Challenge that are designed to be explored in a future summit with partners, following which a Housing Challenge Action Plan will be developed. It is expected that this action plan will be complete by the end of 2024. These strategic objectives relate to the following:
 - sourcing finance from different means;
 - finding varied mechanisms to build new housing required;
 - being flexible regarding the ownership of housing; and
 - finding new ways to maximise the supply of land.
- 1.4 Importantly, some solutions to future housing supply are shown in a separate paper to Council on a Social Value Charter from Renewables. The Highland Housing Challenge is part of the Highland Investment Plan, which seeks public/private sector solutions and describes a route-map to a sustainable future estate, as part of our delivery plan.
- 1.5 Highland Council and its partners are on course to meet the challenge of building 24,000 houses but over 20 years. To accelerate this will require additional investment

of around £2.8 billion. While this is a large number, the Council's financial contribution to this is manageable within anticipated, planned budgets. Importantly, the challenge of building this number of houses in ten years, can be met if a number of strategic objectives are achieved.

2. Purpose / Context

- 2.1 In October 2023, Highland Council approved the Outline Business Case for the Inverness and Cromarty Firth Green Free Port. The Final Business Case was provisionally approved by the Economy and Infrastructure Committee (June 2024). Meeting the housing demands of a future workforce for the development is a major challenge identified by partners.
- 2.2 In December 2023 Highland Council reported on its population challenges based on recent census information showing change over time and future population projections – an ageing population and decreasing rural population were key factors identified.
- 2.3 At the same Council meeting, a separate report on strategic capital, stated that 'of a c£62 million per annum Housing Revenue Account revenue budget, circa £28 million per annum in excess of 42% is spent servicing this debt.'
- 2.4 This shows the challenge Highland Council faces in meeting the needs of current and future occupants of social housing. Therefore, our ability to accelerate our new build programme and ensure that our stock meets required standards and is low carbon / energy efficient is constrained.
- 2.5 In January 2024, the Strategic Housing Investment Plan was approved by the Housing and Property Committee, giving information on current performance in new build of housing (social, affordable, and private).
- 2.6 At the Housing and Property Committee of May 2024 a range of plans were progressed as part of the Housing Strategy 2023-2028. This detailed work to increase affordable housing supply and to provide secure and sustainable housing for Highland households with an identifiable housing need. It also commented on plans to make the housing stock more sustainable and able to support planned work to achieve Net Zero targets. This was based on previous reports outlining a longer-term rent strategy for Highland to improve provision and the engagements with tenants that had taken place on this issue.
- 2.7 Separately, an independent piece of research was commissioned by the Council to consider the impact of the Green Free Port on existing housing need by Arneil Johnson which identifies an overall need future need for circa 24,000 homes to be built over the next 10 years, considering the additional requirements at the Green Free Port.
- 2.8 There are parallel reports to this committee on: the Final Business Case for the Inverness and Cromarty Firth Green Free Port; an update to the Highland Investment Plan; and our Social Values from Renewables Charter.

3. Recommendations

3.1 Members are asked to:

- i. **AGREE** the establishment of the Highland Housing Challenge as described in the report;
- ii. **NOTE** the illustrative financial position and initial modelling regarding the strategic approach to developing the HRA;
- iii. **AGREE** that further modelling work be done to identify options for future rent modelling for the HRA;
- iv. **NOTE** the challenges faced in developing meeting the Housing Needs Demand Assessment, as described in Appendix 1;
- v. **AGREE** the strategic objectives, which can be converted into a future Highland Housing Action Plan, as described in Appendix 3 in draft form to be shared with key partners in a consultation exercise; and
- vi. **AGREE** the establishment of a summit to mobilise partners to support our work in meeting the Highland Housing Challenge.

4. Implications

4.1 Finance and Resource:

- 4.1.1 The current level and costs of HRA debt are significant. Options available to the Highland Council to produce affordable and sustainable plans for the HRA depend on finding solutions to the historic debt.
- 4.1.2 Section 6 of this report details a financial modelling exercise which sets out illustrative financial modelling on rent options and potential outcomes in relation to new build and funding of existing housing stock. The modelling illustrates that, even with sustained rent increases year on year, above inflation levels, this would only allow for modest increase in HRA new build housing levels and would still leave the underlying issue of high levels of HRA debt and costs of repaying that debt. Rent levels are clearly one aspect to consider, but addressing the Housing Challenge will require a broader range of measures. Furthermore, detailed financial modelling will be undertaken to support future reports to Members.
- 4.1.3 Any future additional General Fund support towards the Housing Challenge, whether that be direct financial support (revenue/reserves/capital/borrowing), or guarantees / underwriting, will need assessment in relation to financial risk and implications, and being mindful of the General Fund's own financial capacity and sustainability, and other investment priorities and demands (roads, schools, etc.).
- 4.1.4 Pre-devolution historic debt still totals £81.5 million and costs £6.7 million in annual loan charges against the revenue budget. If that pre-devolution historic debt was supported to remove that burden from the Housing Revenue Account, that would reduce the proportion of the revenue budget meeting debt costs from 41.8% to 31%.

4.2 Legal:

- 4.2.1 The Housing (Scotland) Act 2001 places a statutory duty on local authorities to produce a Local Housing Strategy which sets out its priorities and plans for the delivery of housing and related services over a 5-year period, and which should be supported by an assessment of housing provision and related services. This is interlinked with the Housing Need and Demand Assessment which the Council provides to the Scottish

Government, and which evidences the demand for housing across Highland by tenure and type.

4.2.2 The supply of housing continues to be a priority for both the Council and the Scottish Government. The Local Housing Strategy sets out our approach to delivering high quality housing and housing-related services across all tenures, to meet identified need in its area. The detail around the delivery of affordable housing supply is included in the annual Strategic Housing Investment Plans which are also submitted to the Scottish Government as part of their governance process.

4.2.3 It should be noted that there is no statutory duty on local authorities to fund or facilitate house-building. However, increasing housing supply will assist Highland with meeting other statutory duties such as those relating to homelessness.

4.3 **Community (Equality, Poverty, Rural and Island):**

The paper on addressing future population challenges in the Highlands, placed before Council in December 2023, made the link between sustaining communities and providing a housing supply in rural areas. An action plan for increasing housing supply needs to factor in finding solutions to increasing supply, enabling development and reducing the costs of construction of housing in rural areas. The paper can be viewed by clicking this [link](#).

4.4 **Climate Change/Carbon Clever:**

4.4.1 Increasing the energy efficiency of HRA stock has been a priority investment area and there have been improvements, but historic debt is a barrier to progress.

4.4.2 The financial modelling at section 8 of this report is based on a number of scenarios and includes modelling year-on-year increases in the HRA Capital Programme to support investment in existing housing stock, which year-on-year increase in the HRA Capital Programme which – combined with external funding – could provide the Council with a funding mechanism for increasing the energy efficiency of our stock as far as is technically feasible.

4.5 **Risk:**

4.5.1 The wider challenge is that there are pressures on the Council (and its wider local and national public and private sector partners) to not only increase the number of new buildings added to the stock, but that it also ensures that its existing properties are improved to the required decency and efficiency standards. Given the current condition of the HRA finances as narrated above, there will require to be a compromise between the rate at which new build can affordably be delivered whilst addressing the challenges of the existing stock, not all of which necessarily will have an economic justification to be retained.

4.5.2 The risk of not having enough housing supply is managed through the construction of the draft action plan.

4.6 **Health and Safety (risks arising from changes to plant, equipment, process, or people):**

There are no specific Health and Safety issues.

4.7 **Gaelic:**

While there are no direct Gaelic implications, it is nonetheless the case that if population issues are not addressed in certain areas of the Highlands, this are also likely to work against the purpose of strengthening Gaelic communities, due to the drift of people away from areas where there is a concentration of Gaelic speaking people.

5. **Background**

5.1 **The Local and Housing National Challenge**

5.1.1 The Scottish Parliament declared a national housing emergency on 15 May 2024. This formally recognises the problems with the country's housing system and specifically the lack of affordable, quality housing supply. This declaration is not legally-binding and does not guarantee specific actions or funding measures. This is similar to housing emergencies declared by a number of local authorities in 2023 and 2024.

5.1.2 Many of the issues nationally – the lack of affordable new build supply, the rent rises in the private rented sector, pressures from homelessness demand – are also evident in Highland. However, the challenges faced by and within Highland need specific actions. These issues are further explored in Appendix 1.

5.2 **Local Assessment of Housing Demand**

5.2.1 The latest figures forecast a requirement for circa 24,000 new homes over the next 10 years. Based on current completion rates around 12,000 new homes will be built, leaving a shortfall of 12,000 new homes.

5.2.2 These figures exclude any additional pressures from the huge investment in transmission reinforcement and the five new hydro storage schemes proposed to be built over this period. A recent onshore wind skills analysis report estimates that to 4000 new temporary jobs will be required in the Highlands by 2027. New solutions to this are required and lessons should be learned from other parts of the country where urgent schemes have been established (like the Commonwealth Games village in Glasgow).

5.3 **Meeting Statutory Housing Standards**

5.3.1 Legislation requires the Council to maintain existing stock to relevant standards. This involves additional requirements in relation to ensuring energy efficiency and enabling the move to a Net Zero Council.

5.3.2 To achieve these standards, Highland Council requires substantial resources from, Scottish or UK Governments, Salix or retrofit / low carbon funding, partner investment and joint venture opportunities and, where appropriate, private institutional funding options such as bonds may need to be considered.

5.3.3

We will consider and utilise all possible sources of external funding but need to be proactive in addressing the Housing Challenge rather than reactive to external funding opportunities. This will ensure timing, tenure and place making are within our control.

5.4 Recent Track Record in Delivering New Build Housing

5.4.1 The Highland Council has a proven track record of delivery of affordable homes with an average of over 500 new affordable homes delivered annually over the past 10 years and is recognised as a proactive council nationally.

5.4.2 The Highland Council has taken a positive partnership approach in forward planning and resolving development issues with our housing, planning and private developer partners, continuing to work constructively to overcome constraints. The Highland Housing HUB, which was established in June 2016, meets weekly. HUB membership includes officers representing:

- The Scottish Government's More Homes Scotland
- Highland Council
- Developing housing associations and other housing partners.

5.4.3 Its value to date has been that it has exceeded its annual targets and delivered more housing than would otherwise been achieved. It delivered 4,000 new, affordable homes over the period of its existence.

5.4.4 The Council was the first local authority in Scotland to set up a recyclable land bank fund to secure strategic sites, unlock constraints and deliver mixed tenure schemes whereby the private housing cross subsidised the affordable housing. However, various barriers remain to be overcome.

5.4.5 The Highland Council is the only council in Scotland to be given devolved infrastructure funding to open constrained housing sites and has been developing and piloting new forms of construction including modular and passive housing.

5.5 Delivery of Affordable Homes

5.5.1 Currently Council housing is delivered through a mix of funding:

- HRA Borrowing repaid through rental stream and the HRA budget.
- Scottish Government Grant
- Land bank contributions.

5.5.2 Our target number of units over the past 5 years has been 500 affordable units per annum of which on average the council house build programme has been 180 with the remainder delivered through our housing partners.

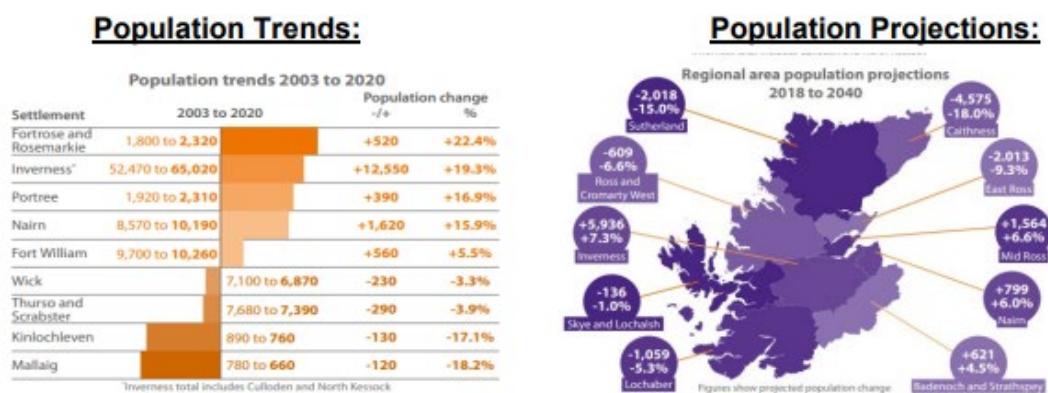
5.5.3 Due to overall public sector financial pressures the Scottish Government has reduced the overall level of housing from approximately £48 million per annum in 2023/24 to approximately £35 million in 2024/25 (a reduction of over 25%). Whilst future year levels of investment have not been confirmed if investment levels remain around this figure there will be a corresponding reduction in the number of affordable homes delivered to around 350 new affordable homes per annum and this could be less due to construction cost inflation.

5.6 Economic Benefit of New Social Housing

- 5.6.1 UK wide research from Shelter and the National Housing Federation (2023), carried out by CEBR, shows building 90,000 social rented homes would add £51.2 billion to the economy.
- 5.6.2 Most of this impact would happen quickly – £32.6 billion would be generated within a year of building the homes, supporting almost 140,000 jobs. Within three years, the programme would break even, with the wider economic benefits surpassing the upfront cost of building, largely by boosting the construction industry.
- 5.6.3 The economic benefits continue over the longer term, through the management of more social homes, savings on housing benefit, and wider benefits including reduced homelessness, increased employment, and improved healthcare.
- 5.6.4 Within 11 years, the initial government funding to build the homes would be fully paid back. Over a 30 year period, building 90,000 social homes results in a £12 billion profit for the taxpayer.

5.7 Sustaining Communities

- 5.7.1 The graphic below shows the changes of population over time from 2003 – 2020 and projects further changes over the period 2018 – 2040. It describes the continual movement of population from the rural Highlands to more urban contexts, mirroring patterns seen in other European countries.



- 5.7.2 Future strategic approaches to housing need to incorporate a structured approach to community engagement on housing priorities. This can be wrapped up in placed based planning for the Housing Investment Plan.

5.8 The Funding Gap

Based on the current development programme in the Highland of 1200 per annum the total investment housing investment in the Highlands would be approximately £2.83 billion (including public subsidy, private and public investment e.g. HRA) over a 10 year period. If we are to build an additional 12,000 houses over the same period to meet projected demand years, the overall investment level would need to increase to approximately £5.5 billion, of which approximately an additional £2.1 billion would come from private investment from a variety of sources (see appendix 4).

6. Identifying Potential Solutions to the Highland Housing Challenge

6.1 Increasing Finance for Housing

6.1.1 Strategic Use of Housing Revenue Account

Appendix 2 provides illustrative financial modelling for the HRA over a 20-year period. It uses similar assumptions and principles as underpinned the Highland Investment Plan considered by the May Council, to model different HRA scenarios and in particular the levels of rent increase needed to fund those scenarios.

6.1.2 Historic Debt Write Off

The Council's outstanding housing debt as of 31 March 2023 was £365.2 million. A significant element of this is historic debt which was inherited from former district councils at local government re-organisation in the 1990s and was associated with the Council house-building programme to support local economic development in the hydro and oil industries.

The Scottish Government announced the Scottish Housing Quality Standard in 2004 and the following decade was marked by historically high capital investment in Highland Council stock. In the period 2010-2016, Highland invested £143 million in capital improvements to over 9,000 Council houses. As detailed at section 7 of this report, further significant investment in Highland has taken place in the last 20 years through the new build housing programme.

Housing debt is repaid as loan charges to the Council's Housing Revenue Account, funded from Council tenants' rents. In 2023/24 annual loan charges were £26.291m which equates to 41.8% of budgeted expenditure. Loan charges are projected to increase from £26.291m in 2023/24 to £35.126m in 2026/27 based on current Capital Plan investment, and therefore a greater proportion of rent income will be required to fund repayment of debt.

The Council Leader wrote to Michael Gove, Secretary of State for Levelling Up, Housing and Communities on 20 May 2024 to request a meeting to discuss the UK Government partial write-off of the housing debt. A similar letter has been issued to Angela Raynor, Deputy Leader of the Labour Party. Any debt write-off will be essential in freeing up investment which can be directed towards increasing the supply of affordable new build housing to meet the demands of communities particularly those which will be affected by the anticipated increase in workers as a result of economic initiatives.

6.1.3 Accessing Support from Pension Funds

Pension fund managers are very keen to invest in housing, it is a low risk, long term sustainable investment and there are various models currently on the market which are worth further consideration. Officers have had initial discussions with one private sector pension investor to understand their investment approach and appetite, and further follow up discussions are planned. Initial discussions indicate that typically the level of return a Pension Fund would look for exceeds the comparable Public Works Loan Board (PWLB) borrowing rate that the Council could access to support investment. Such an investment model could however be attractive in scenarios where PWLB may not be an available borrowing source, for example where Registered Social Landlords (RSL) or the Private Sector are the lead developer not the Council.

Some local authority pension funds are investing directly in the delivery of affordable housing both in England and Scotland. There are of course significant regulatory and governance matters which are a particular factor as the Pension Fund must always act in the best interests of its members and beneficiaries. Of particular note is that it is the Pensions Committee, acting in the interest of scheme members and fulfilling the fiduciary duty, who determine Highland Pension Fund investment matters, not the Council. The current economic context and investment strategy for the Highland Fund is perhaps the most relevant consideration, with the Fund's current projected investment return and investment strategy at a level which is significantly higher than current PWLB borrowing rates i.e. borrowing from PWLB may well be cheaper than Pension Fund return expectations. Mid-market rental properties (with rent levels normally around 20% less than market rents) are a popular form of investment to private pension funds (often with a local authority guarantee). Private Pension funds have invested over £1 billion in local authority projects and initial discussions have been very positive.

It is recommended that officers should prepare a future report to Members on the various options available.

6.1.4 **Use of Non-Domestic (NDR) Rates Concession: Green Free Port**

One of the key financial investment benefits arising from the Green Free Port is the retained NDR that will be derived from the Free Port, estimated at £550 million over 25 years, and the mechanisms available to utilise that for investment, including in enabling activity and infrastructure to deliver Free Port outcomes.

The governance process for use of that retained NDR is joint Council/Freeport consideration of investment business cases, with the Council retaining right of veto as accountable body. The Green Free Port FBC makes clear that one potential use of retained NDR is for enabling infrastructure including support for housing.

Potentially the retained NDR could be part of a range of options and strategies to address the Highland Housing Challenge. Further work would be required to consider options for retained NDR, across both public, mid-market and private sector housing solutions.

There are a number of key considerations around use of NDR:

- It will be some years before retained NDR is derived whereas the case for housing need and housing investment will be expected to pre-date that.
- The expected level and phasing of retained NDR will depend on a number of factors and assumptions.
- There will be a range of expectations and business cases for use of retained NDR, and housing will be but one. There will be competing demands across the spectrum of other public sector investment needs (schools, roads and other infrastructure) as well as the private sector's own investment cases within the Freeport area. Consideration of business cases would need to be as per the joint Council/ICFGFP governance process within the FBC.
- Any forward funding of investment, ahead of retained NDR being realised, would carry a range of risks and financial implications that would need detailed modelling and consideration.
- Any borrowing by the Council to support enabling infrastructure, even if backed by retained NDR, will represent additional capital and borrowing beyond that

currently planned, and would need to be considered affordable, prudent and sustainable and within the agreed limits for borrowing and loan charge costs agreed by the Council.

6.1.5 **Infrastructure Developers**

Council officers have had positive discussions with SSENT regarding legacy housing. SSENT is changing the way it approaches the challenges of housing its workers. A Housing Strategy is in development, a collaborative exercise with input from across the company, its contractors, workers, councils, and local and national housing stakeholders.

We are working with SSENT on various Legacy projects including:

- **Serviced Sites:** Sites for worker accommodation identified in collaboration with housing stakeholders, serviced and left behind for future housing development. SSENT to have a policy on additionality, no displacement.
- **Empty Homes:** Long term leases creating extra capacity in Council “empty homes” initiatives, in collaboration with housing stakeholders.
- **Unlocking Housing Developments:** Long term leases on RSL new build (policy allowing), unlocking investment. Policy on additionality, no displacement, in collaboration with housing stakeholders
- **Making Use of Disused Property:** Upgrading near-site SSENT purchased homes for staff use, in collaboration with housing stakeholders

SSENT will set guidance on this to their principal contractors through development frameworks.

One potential model would be - to deliver projects which could be utilised and leased to Infrastructure developers temporarily and transferred to the council or community after a set period for permanent housing as an alternative to workers camps. If agreement can be reached with SSENT these solutions can be replicated with other infrastructure developers.

Agreeing housing provision for workers which will transfer to HRA at a later date for local housing is a really positive and innovative approach, creating a positive legacy from development which directly supports local communities, particularly if the housing is ring fenced for some form of social rent and not sold.

6.1.6 **Attracting Future Funders**

Both the Scottish national Investment bank and the UK infrastructure Bank are keen to work with Highland Council to open up constrained strategic housing sites. Officers will continue to work with these banks and report back to Members.

Importantly, at the recent UK Real Estate Investment and Infrastructure Forum (UKREIIF) conference feedback from other local and national public sector partners and private developers and sources of private investment suggested that this was an issue that is a shared challenge for partners and that there is an opportunity for this to be progressed positively.

6.2 Increasing the Number and Variety of Developments

6.2.1 Developing the Mix of Housing Tenure

The type of housing required to be delivered over the next few years include Private housing for sale, private rented housing, mid-market rented properties, lower cost home ownership (shared equity) and social rent, whilst self-build homes are popular in rural areas. The challenge is in the Highlands, in particular rural areas is the cost of building a new home is significantly higher than the value and therefore subsidy - is required to attract private investment. This has resulted in market failure in some areas in the Highlands.

6.2.2 Building a Council Guarantor Model

In order to attract more private investment, we need to access subsidy funding or act as guarantors for properties which do not sell. The delivery of new housing at scale will require a public sector / private investor partnership. This may involve a council or preferably Scottish government guarantee. Public sector guarantor models attract significant institutional investment and lowers interest rates as risk is substantially reduced.

6.2.3 Encouraging Existing Developers to Commit to Projects

Housing developers, particularly in the Highlands, are conservative by nature and tend to monitor second hand property sales prior to building new and only at our rate which maintains profit margins. The Council has to work with existing and new developers to streamline processes, reduce risk and maximise confidence in the market.

This might involve Highland Council undertaking actions in relation to specific developments, such as:

- Preparation of sites to ensure that they can be readily developed
- Shared investment and development schemes
- Council pre-purchasing units to support start-up costs
- Shared equity models
- Mid-market rent development schemes

The first objective will be to move the projects which are already committed and land banked.

6.2.4 Increasing Construction Sector Capacity and Reducing Construction Costs

As is the case with local authorities Housing Associations are facing significant challenges to develop new affordable homes. RSLs' business plans need to consider prioritising their limited resources between repairs and improvements to their existing stock and delivering new build properties. Some housing associations have stopped developing new affordable housing altogether or significantly reduced their development programmes.

In order to increase the number of new affordable homes in the areas we need to attract new housing partners to the area recently, two national housing associations are now operating in the Highlands for the first time. Link HA are developing 82 homes in Fort William and Places for People are developing 175 new homes in the Inverness

area replacing some of the existing RSLs who have reduced their development programmes.

Given the limitation on the number of new Council houses we can deliver because of the impact on HRA we require more affordable home developers to meet our overall targets by proving that the council is proactive in delivery of new sites and open to new funding models. One way to address this is to provide a partnership vehicle to offer a guaranteed market for new build homes if they meet our needs in each area. This can provide the baseline funding to ensure site preparation and viability and derisk developments in the initial phase where cash flow is the issue.

6.2.5 **Developing Housing Projects for Rural Communities**

Delivery of housing is particularly challenging in rural areas, with far higher construction costs, no private developer interest and very limited contractors. To reverse rural depopulation this issue has to be addressed strategically. We have successfully built bespoke housing solutions to meet individual rural housing needs with partners e.g Staffin, Skye and need to develop more innovative solutions including:

- Joint projects utilising local trade contractors and the council's own maintenance department.
- Joint projects with local businesses to deliver mixed tenure schemes.
- Local construction training programmes with UHI/HIE to develop and retain workforce in rural areas.
- Support through HIE and Business gateway to promote new construction businesses.

6.2.6 **Build To Rent**

The build to rent (BTR) market where homes are built specifically to rent rather than sale is proving extremely popular in England with over 150,000 new homes in management or in planning. BTR is at an early stage in Scotland but has potential to meet the needs of many people currently seeking housing in the Highlands particularly in the Inner Moray Firth.

Informal feedback from international investors has shown that they may be nervous about investing in BTR in Scotland due to their perception of current regulatory requirements. Further discussions and agreement are required at a national level to provide reassurance to such investors.

Investors are calling on the Scottish Government to incentivise investment in the BTR stock by:

- Creating a stable policy environment that removes the risk of ongoing intervention in the market.
- Positive Planning Policy
- Working with the sector to foster confidence.
- Consider rent guarantee models.

The recent development in relation to Masterplan Consent Areas areas is an important step towards meeting this ask of investors.

6.2.7 **Other Public Sector Partners**

As part of the public sector asset rationalisation plans more land and properties need to be released for housing projects. The current public sector disposal procedures are too slow and inflexible.

Where public services have a housing requirement for key workers on their organisations, they could contribute to the capital cost of the housing or alternatively revenue fund through leases and guarantees. This type of arrangement has already been successfully introduced in Sky and Lochaber with the NHS.

Public agencies need to define their housing need requirements in order that these can be clearly identified in the Council's strategic housing investment plan.

There is an opportunity for land transfer as part of the community benefit of any public sector investment – options regarding this will be brought to a future committee after further work is done. The issue for Highland Council is, can we get Public Sector partners to agree to land transfer at nominal cost to support particular housing needs and reduce unit cost?

6.3 **Increasing Land Supply**

6.3.1 **Consolidating and Strengthening Our Land Supply**

Based on the recent housing and economic analysis we require a land supply to deliver 24,000 new homes in the Highlands over the next 10 years. The Council's approved Local Development Plans allocate sites with capacity for over 20,000 homes. However, the most recent housing land audit, which includes the collective input of developers and housebuilding industry, estimates a likely build out rate of 8,757 over 10 years.

An assessment of the of sites, land ownership and control, and viability for delivery would help estimate how the pace and scale of delivery can be increased and to ensure that sites are in the right locations to address need. To help enable and activate sites a clear understanding of the essential infrastructure requirements and the means to fund and deliver these will also be crucial. The Council will also need to consider how additional sites can be developed in areas of greatest housing need.

6.3.2 **Developing Masterplan Consent Areas**

A number of other tools are also being investigated to aid proactive delivery. As reported to the E&I Committee on 2 May the Council is supportive of the introduction of masterplan control areas (MCAs) subject to the detailed guidance. The revised Inner Moray Firth Local Development Plan includes a reference to the potential use of MCAs for both economic/employment and housing development in circumstances where there is a need to accelerate delivery to support measures such as the Green Free Port.

6.3.3 **Highland Development Plan**

The new Highland Development Plan evidence gathering stage is underway and will consider the new projected housing demand figures based on economic forecasts for the area.

6.3.4 Changes to Pre-development Service

In order to deliver new housing to meet projected demand it is important that we speed up the pre-development service through a proactive practice including key agency partners and training of applicants and their consultants to deliver new housing proposals as diligently as possible whilst adhering to the regulatory process.

6.3.5 Land Audit

The Planning Service has carried out a detailed housing land audit of the Inner Moray Firth area breaking the land supply figures from under construction right through to allocated and approved local development plan but with significant consultations. The figures project that 7500 units could be delivered by 2034.

The Council may need to consider new allocations of housing land to meet the projected demand. This needs to be built into future local development planning processes.

6.3.6 Terra Tracker

The Terra Tracker project is mapping title deeds for land owned by Highland Council to secure our existing, known land boundaries and to identify additional sources of land that we may have lost track of historically.

6.3.7 Utilising Compulsory Purchase Order Powers

The Council will be heavily reliant on the private sector to meet the overall targets for the area. The Council will need to attract private housing developers to build new homes ahead of perceived demand potentially with Guarantees.

Major employers in the area will need to work with the Council to invest in housing for their workers in partnership with private and affordable housing developers. Private landowners also need to release land for housing in areas of housing pressure and the Council will need to use its CPO powers where it can be shown that landowners are not releasing land when market values are being offered. We will only use CPO where appropriate and necessary to support a strategic housing need where all other options have been exhausted.

7. Declaring the Highland Housing Challenge

7.1 Purpose of the Challenge

The purpose of creating a Highland Housing Challenge is mobilise all partners towards the same goal, which is the rapid expansion of housing development across the Highland area, focusing on addressing current and future housing need and clarifying the role that Highland Council and other partners needs to play in this process.

7.2 Strategic Aims and Objectives

7.2.1 The aim of the challenge is to meet the current and future housing demand, by bringing a new approach to Highland of sustained public/private sector investment, supported by UK and Scottish Governments, bringing renewal and regeneration to help us sustain communities.

7.2.2 Our key strategic objectives are to:

- Increase social housing build rate by 40% etc in first 10 years
- Increase local Housing Association build rate in rural areas
- Increase external investment in housing in target areas
- Improve existing stock to maintain progress to net zero and sustainable living standards.

7.3 Mapping Demand and Aligning Supply

The overarching principle is one of ascertaining our current and future demand and aligning supply side solutions to meet it through structured partnership interventions. The purpose of this is to clarify the gap we need to fill and working out the best ways to proceed towards closing it.

7.4 Incorporation within the Highland Investment Plan

The Operational Delivery Plan for Highland Council already incorporates future affordable and social housing solutions, committing to:

- Review affordability of the new build housing programme including maximisation of external funding streams.
- Partnership work to address themes such as provision of key worker accommodation, veterans housing and accessible housing.
- Work with private sector investors to explore new Finance model for increasing delivery of new housing.

This paper unfolds with more clarity and detail the ways in which this will be done.

7.5 Summit to Formally Launch the Highland Housing Challenge

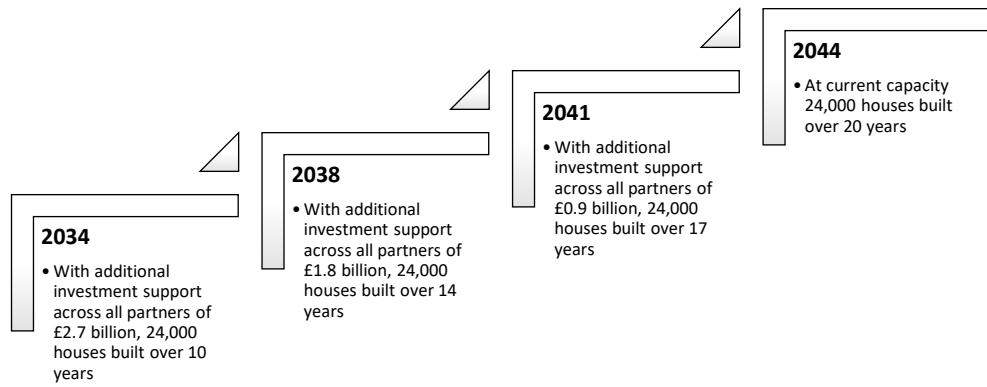
It is proposed that the Highland Housing Challenge will be formally launched with partners later in the year, following a highland conference with all key stakeholders represented, and with the purpose of developing a clear action plan to underpin partner commitments to support the challenge.

7.6 Highland Housing Challenge Strategic Objectives for a Future Action Plan

Appendix 2 shows the list of strategic objectives which can become an action plan in time, for which approval is sought to share with key partners, as part of the process of building important alliances to enable the achievement of the plan.

Any action plan would need to be constructed in such a way that it can be flexed to adapt to changing circumstances and to ensure that we meet the Highland Housing Challenge as fast as possible, allowing opportunities to be seized.

The graphic below shows that the challenge of building 24,000 houses will be met by Highland Council, but that we are currently on course to achieve it in 20 years. To accelerate this will require additional investment, as shown in Appendix 3 of around £2.8 billion. While this is a large number, the Council's financial contribution to this is manageable within anticipated, planned budgets.



Designation: Assistant Chief Executive - Place

Date: 16 June 2024

Author: Malcolm Macleod – Assistant Chief Executive – Place
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Appendix 1: The Challenges of Meeting Highland's Housing Demand

Introduction

The Local Housing Strategy 2023-2028 sets out a Housing Supply Target for new house building across tenure. This sets out the estimated level of additional housing required and informs the definition of the Housing Land Requirement within Local Development Plans (LDP). The figures did not include projections from the impact of the Inverness and Cromarty Green Free Port as the successful announcement of the bid came after this.

Stakeholder consultation and evidence gathered through community housing surveys, as well as housing analysis of housing need and affordability data, have all highlighted an acute shortage of housing across tenure. The consensus from partners and stakeholders is that a step change in housing delivery is required to support and drive economic growth in the Highlands. This needs to be balanced against the resources available as well as effective land supply, infrastructure and other constraints.

Balancing all of these factors the Housing Supply Targets (HST) set out in the Local Housing Strategy are detailed in the table further below. The supply targets are categorised in terms of affordable and market delivery and indicated a significant uplift on the housing required through the HNDA.

Independent Analysis of Future Housing Demand

The 2021 HNDA estimated that in the first 10 years of the 20-year projection period, just over 9,000 homes would be required (9,039) with 6462 affordable homes required (71%) and 2577 market homes (29%)

Housing estimates produced by the 2021 Housing Need & Demand Study are based on demographic projections, which use historic trends in the Highland household population as the basis for projecting future housing requirements. In recent years housing completions in Highland show significantly higher numbers (on average 1,200 units per annum) than the "newly arising need" figures within the HNDA (on average 300-400 units per annum). These estimates of new need are based on the 2018 household projections produced by NRS and which do not reflect the impacts of wider economy development strategies.

Furthermore, whilst a local estimate of existing housing need was used to measure the number of households in unsuitable housing who need to move in Highland (2,236) this falls far short of the 8,600 households who are currently applicants on the Highland Housing Register.

To address these issues, the Council's approach to setting Housing Supply Targets focused on assessing not just the demographic but the economic factors that will influence future demand for housing. This approach assumes that the current output of the construction industry should continue at least at the same rate as the last decade and making assumptions about the potential impact of the Highland Growth Deal. This approach resulted in an uplift from HNDA estimates of 9,093 over 10 years to 16,964 with 6,462 affordable homes required (38%) and 10,500 market homes (62%).

In 2024, Housing Supply Targets have been further adjusted to take into account the economic modelling associated with the delivery of the Inverness and Cromarty Firth

Green Freeport and the creation of roughly 8,400 direct jobs in the Inverness and East Ross Housing Market Areas. Revised Housing Supply Targets now stand at 24,235 over the next 10 years with 7,078 affordable homes required (29%) and 17,157 market homes (62%).

The methodology applied to derive the updated Housing Supply Targets therefore shifts away using demographic projections as the basis of forecasting future housing need to using principles associated with the English approach where planning authorities produce a HENA (Housing and Economic Needs Assessment) to create future housing estimates aligned to economic forecasts. This approach enables land-use planning and housing delivery strategies to reflect the economic development agenda for the Highland region.

The Social Housing Context in Highland

Social rented housing provides affordable homes for over 21,000 households across Highland. Compared to Scotland, Highland has proportionally less social rented housing. Social rented housing makes up around 18% of all housing in Highland while the national average is around 23%. The process for allocating social rented housing is bound by legal duties and informed by statutory guidance, including the Housing (Scotland) Act 1987; Housing (Scotland) Act 2001, Housing (Scotland) Act 2014 and the Council's statutory homelessness duties.

The Highland Housing Register (HHR) Partnership consists of the 6 main social landlords in Highland and maintains a shared single Allocation Policy. This has streamlined and simplified the process of accessing social rented housing in Highland.

There was a total of 8,618 applicants on the Housing Register at the end of 2023/24 compared to 9,247 at the end of 2022/23. As explained elsewhere, this does not necessarily indicate the total level of housing demand in Highland, rather it provides an indication of households who wish to be housed by a social landlord in a particular community and particular house type and size.

Many applicants on the Register have apply because of the difficulties they experience in sourcing affordable private rented or owned properties. Many households do not apply simply because they know they are unlikely to be housed in areas of extreme housing demand, where inevitably the available social lets are allocated to those in extreme housing need.

The pressure on housing varies across Highland. This means that applicants whose need for housing is less acute can receive offers of housing more quickly in some areas than applicants with more acute housing needs in other areas. Analysis of the number applying for each house being let indicates that the pressure on social rented housing is greatest in Wester Ross, followed by, Badenoch & Strathspey, Nairn, Inverness, Lochaber and Skye & Lochalsh. Housing pressure in these six areas is greater than the Highland average.

Across Highland, 1,738 households were housed in 2023/24. The represents a decrease on the previous year's number which stood at 1,962.

Social rented housing providers have a legal duty to give a 'reasonable preference' to priority groups when allocating housing. This includes households who have nowhere safe and secure that they can reasonably stay and so are homeless, and

households who are living under unsatisfactory conditions and who have unmet housing needs.

Highland Council's Challenges in Improving its Housing Stock

Highland Council will require to revisit the current ambitions for social housing new build rates to ensure there is the appropriate balance between our ambition to build out at a pace to address significant housing pressures, and Scottish Government requirements for us to maintain existing stock to relevant standards.

This is in the context of a highly constrained HRA with 42% of revenue income being allocated against historical loan charges. Reserves are extremely constrained. This will require a revised financial model to fund stock improvement and increase new build supply, linked to a sustainable rent policy and investment strategy.

As part of our Local Housing Strategy and our Investment Plan, work is ongoing to assess the viability of current stock and what is identified for retention and investment and that which may not be.

This net present value approach will identify investment requirements across the HRA over a 30year cycle, including identifying core stock and stock which will cost more to manage and maintain than it will ever bring in through rent.

The Increasing Cost of Housing

The Cost of delivery of affordable homes has increased significantly over the last 3 years This has led to an increase in subsidy required per unit which is not sustainable in the long term and may lead to fewer houses being delivered overall. The table below gives the average cost of build as it has changed over time from pre-covid to 2023/2024. The highest tender that the Council has received recently has been £400,000 per unit which is undeliverable.

| | |
|----------------------------|-----------|
| Pre- covid | £ 157,000 |
| projects impacted by covid | £ 182,000 |
| Projects completed 2022/23 | £ 205,000 |
| Projects on site 2023/24 | £ 226,243 |
| Projects committed 2023/24 | £ 227,627 |

The higher cost of working in rural areas is recognised and will continue to require additional subsidy **Constraints**

- There is a shortage of allocated, economically deliverable sites in areas of greatest housing pressure, and the issues raised are more challenging than ever. Construction tender price inflation (higher than any time in the last 20 years) has resulted in some projects no longer being viable. There is only a very limited pool of contractors willing and able to build affordable housing projects in the highlands particularly in West Highlands, and some open tender processes have resulted in only one or two tender returns. Contractors cite lack of skilled labour, lack of accommodation for their workforce, material price uncertainty and full order books as reasons for not tendering.

- Many large, allocated sites are dependent upon major infrastructure works e.g., the proposed East Inverness expansion area cannot be developed until the dualling of the A96 from the Smithton roundabout and the new East link are constructed. It is not anticipated that these works will be completed until at least 2027.
- In the Inverness area and in most of the Inner Moray Firth area the majority of the affordable housing is delivered through Section 75 agreements whereby developers must deliver 25% of these developments as affordable housing. We are dependent upon private developers progressing with their private developments to release the affordable housing sites; however, developers will only progress the private housing based on their business plans, cash flows and confidence in market conditions.
- Landowners often have high expectations of land values and do not fully understand the impact of constraints, abnormal costs and the impact of developer contributions on land value. Landowners do not need to sell,
- There can be significant delays in obtaining statutory approvals including planning permission (and purification of conditions), Road Construction Consents and Scottish Water consents. We are working closely with our planning colleagues and others to ensure that all consultants and contractors are fully aware of the statutory authority requirements to minimise these delays.
- Some identified potential site purchases are being aborted due to community concerns over loss of green space and other land in their areas and direct opposition to new affordable housing.

Significant infrastructure/abnormal costs on certain available sites have made sites unviable after full site investigations have been carried out e.g., very high decontamination costs, peat management, rock removal.

The Housing Supply Targets (HST) set out in the Local Housing Strategy 2023-2028 are detailed in the table below.

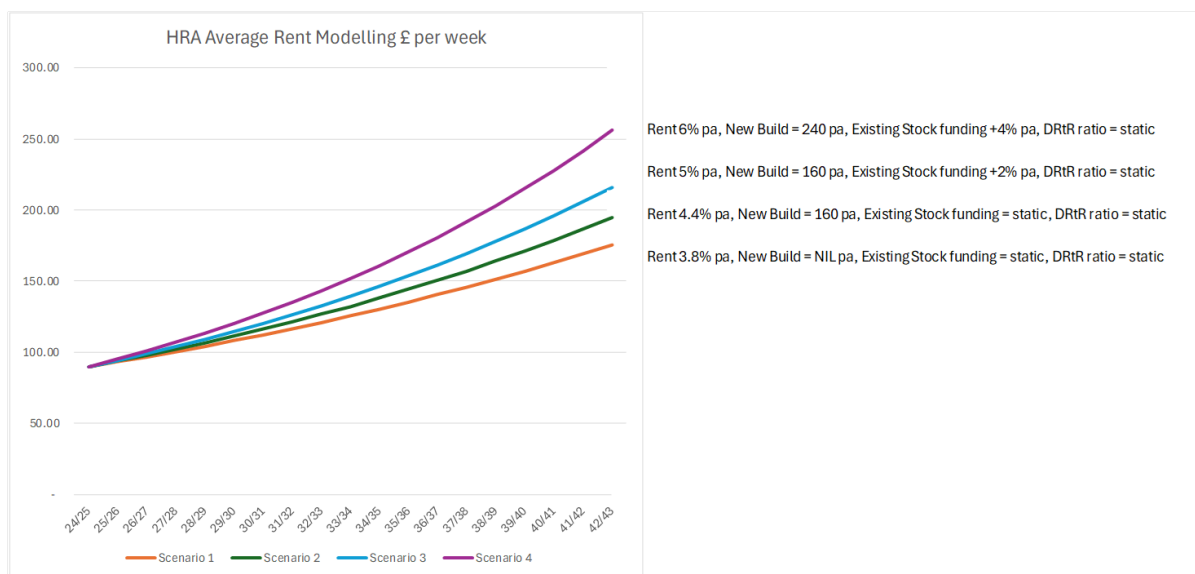
| | Affordable HST | Market HST | Total HST | % Affordable HST | % Market HST |
|-----------------------|----------------|--------------|--------------|------------------|--------------|
| Badenoch & Strathspey | 300 | 350 | 650 | 46% | 54% |
| Caithness | 100 | 300 | 400 | 25% | 75% |
| East Ross | 450 | 400 | 850 | 53% | 47% |
| Inverness | 1,200 | 2,400 | 3,600 | 33% | 67% |
| Lochaber | 250 | 400 | 650 | 38% | 62% |
| Mid Ross | 450 | 850 | 1,300 | 35% | 65% |
| Nairn | 150 | 250 | 400 | 38% | 63% |
| West Ross | 200 | 200 | 400 | 50% | 50% |
| Skye & Lochalsh | 200 | 450 | 650 | 31% | 69% |
| Sutherland | 100 | 200 | 300 | 33% | 67% |
| Highland HST | 3,400 | 5,800 | 9,200 | 37% | 63% |

Appendix 2: Strategic Use of Housing Revenue Account

This long-term model is an initial illustration and will be further developed, for example to look at a 'whole life' financial model for new build and to consider how such a model might influence future rent and new build rent premium approaches. The core assumptions behind the modelling are based on the following:

- **Scenario 1** - a base scenario to illustrate a status quo position.
- **Scenario 2** – modelling the current circa 160 new built units per annum, but no enhancement to funding for the existing housing stock.
- **Scenario 3** – the same 160 new build units but with enhancement of revenue and capital spend in existing housing stock of 2% p.a.
- **Scenario 4** – a higher 240 units per annum plus enhanced revenue and capital spend in existing housing stock of 4% p.a.

Across all scenarios, other than small year on year variations, the Debt Repayment to Revenue Ratio (DRtR ratio) is essentially static. I.e. the current 42p in the £1 of the budget remains broadly static and ranges from circa 41% to 45% over 20 years. By implication to materially address that debt burden, would require a rental level over and above those shown in the scenarios, and a planned strategy to use rental to reduce borrowing costs from what they would otherwise be. This will be addressed as the modelling is developed.



Footnote: modelling assumes current £15 per week new build premium applies, over and above average rent, and premium inflated as per average rent levels.

It is clear across all scenarios that very significant year-on-year rent increases over and above inflation or cost pressure levels would be required to make initial inroads to addressing the Highland Housing Challenge. Were interest rates or other factors to materially impact the financial model, compared to current assumptions, that would further impact on rents.

One particular action that it is proposed is taken forward, arising from this initial modelling, is more detailed assessment of the current rental assumptions relating to new build and an updated consideration of the appropriate level of new build premium on rent. To assess in relative terms how much of the cost of new build units falls on the average rent payer, versus new build tenants via the rent premium.

At present, it should be noted that Highland's average weekly rent is well below the national average for local authorities and significantly below that of housing associations (both Highland-based and nationally). Given that local authorities are also considering significant investment in their stock and in new build supply, it is anticipated that Highland will remain below the average national weekly rent for a number of years.

While the financial modelling and references in this section relate to the HRA budget, members may also wish to reflect on the role of the General Fund in regard to Housing. Any cost related to the HRA must be borne by the HRA and the rent payer. The General Fund cannot support or subsidise the HRA budget.

While there may be wider housing solutions, out with the HRA, that there could potentially be a role for the General Fund in, Members need be mindful of the General Fund's financial capacity and sustainability, and decisions already made in relation to capital investment and the Highland Investment Plan. Any further investment to be considered from the General Fund, into housing or related infrastructure more generally, would need be within the Highland Investment Plan principles and parameters as considered by the May Council. Scope for the General Fund to consider any role for it in housing investment needing assessed alongside priorities for investment in schools, roads and other assets and within the Highland Investment Plan funding principles agreed.

Further work will need to be undertaken to fully appreciate the implications of future debt levels for the council and what an appropriate level of rent increase over time would achieve, in terms of the ability we would have to upgrade existing housing stock and add in new stock to our portfolio. This would include an appreciation of the value of the mix of tenures we might require and a forensic analysis of the optimal locations in which this might be best directed.

Highland rents across the planning period, including comparisons against similar and neighbouring local authorities, and the national average will also be looked at. We anticipate that this will show that rents will increase regardless across the country, and it will be a choice for whether Highland Council in future wishes to take it further to provide a better stock.

Appendix 3: Outline Strategic Objectives (Initial Activity Towards a Housing Challenge Action Plan)

| Theme / Action | Contribution to Challenge | Timescale |
|---|--|----------------|
| 1. Increasing Finance for Housing | | |
| a. Strategic Use of the Housing Revenue Account | Potential to increase social housing supply | TBC |
| b. Historic Debt Write Off | Potential to increase social housing supply and investment in council stock | TBC |
| c. Accessing Support from Pension Funds | Release investment on build to rent and mid-market rent housing | March 2025 |
| d. Use of Non-Domestic Rates Concession: Green Free Port | Use of NDR funds to open up infrastructure on constrained sites and subsidise affordable housing | March 2026 |
| e. Infrastructure Developers | Joint funding of high-cost rural projects – permanent housing legacy projects | December 2024 |
| f. Attracting Future Patient Funders/ potential JV's | Increase funding for infrastructure. long term funding, increasing supply of housing | September 2025 |
| 2. Increasing the Number and Variety of Developments | | |
| | | |
| a. Building a Council Guarantor Model | Increase private housing investment in highlands | March 2025 |

| Theme / Action | Contribution to Challenge | Timescale |
|--|--|------------------|
| b. Encouraging Existing Developers to Commit to Projects | Release more land for affordable and private housing | September 2024 |
| c. Increasing Construction Sector Capacity and Reducing Construction Costs | Increase skills base to deliver more homes in the highlands | March 2025 |
| d. Developing Housing Projects for Rural Communities | Sustain rural communities by increasing homes in rural areas -increase local contractor capacity | March 2025 |
| e. Identifying and Securing More Affordable Housing Partners | Maximise affordable housing delivery and investment – increase capacity and skills base | March 2025 |
| f. Build to Rent | Meet unmet demand for rented accommodation | September 2025 |
| g. Collaborations with other Public Sector Partners | Release of surplus land and buildings – potential for joint funded projects | September 2024 |
| 3. Increasing Land Supply | | |
| a. Consolidating and Strengthening Our Land Supply | Identify constraints and solutions to unlock sites | September 2024 |
| b. Developing Masterplan Consent Areas | Speed up predevelopment process and identify additional sites | September 2025 |
| c. Highland Development Plan | Identify additional sites to meet demand | September 2026 |

| Theme / Action | Contribution to Challenge | Timescale |
|---|--|------------------|
| d. Changes to Pre-development Service | Speed up predevelopment process | March 2025 |
| e. Land Audit | Identify sites to bring forward – unlock constraints | September 2024 |
| f. Terra Tracker | Identify additional sites in council ownership | March 2025 |
| g. Utilising Compulsory Purchase Order Powers | Deliver sites where owners unwilling to sell | September 2025 |

Appendix 4

New homes required



Housing Investment Funding requirements

