



Non-Housing Revenue Account Private Finance Initiative – cost of new build social rented housing



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Summary

In August 2006 the Department for Communities and Local Government began a review of the cost of delivering new build social rented housing through non-Housing Revenue Account Private Finance Initiative (non-HRA PFI) and Social Housing Grant (SHG). Initial findings indicated that while non-HRA PFI costs were generally significantly higher than SHG costs, non-HRA PFI housing could be delivered at an acceptable cost compared to SHG housing. This was confirmed by findings from Stage 2 of the review which focused on capital build costs and demonstrated that non-HRA PFI can show acceptable capital build costs compared to SHG schemes.

The findings from the first two stages of the review provide a sound basis for moving forward with outstanding non-HRA PFI new build schemes, subject to ongoing work to ensure that the costs on which these proposals are based are reasonable and justifiable. Stage 3 of the review will consider the impact of operational, financing, risk and procurement costs, in addition to capital build costs, as these non-HRA PFI schemes move through development and into procurement.

The review is ongoing, however this paper provides a summary of the findings and conclusions from the first two stages.

Stage 1: Assessment of total scheme costs

Stage 1 of the analysis looked at total costs from 20 schemes. It included both general needs and supported/extra care housing schemes funded through non-HRA PFI and SHG. The findings from this work indicated that, in most cases, the cost of non-HRA PFI was significantly higher than SHG. However the analysis also indicated that, in some circumstances, non-HRA PFI housing could be delivered at an acceptable cost compared to some SHG housing.

This work provided Communities and Local Government with a broad understanding of the comparability of costs between non-HRA PFI and SHG schemes and identified variations across the component costs of schemes. Some of the cost difference could be explained by the nature of PFI eg funding regime differences, specified contractual commitment over the life of the schemes also reflected in risk pricing, but other costs eg build costs would have been expected to show greater comparability. There was also some uncertainty over the robustness of non-HRA PFI and SHG data used in the initial analysis.

As a result, Communities and Local Government decided that a further examination was needed of proposals from a number of local authorities from Rounds 4 and 5 of the non-HRA PFI programme to better understand cost drivers and to enable robust decisions to be made as to the acceptability of costs included in the proposals.

Stage 2: Assessment of capital build costs

The second stage of work focused only on the capital build costs of schemes. This was to test whether the base capital build costs rather than PFI financing, risk pricing and procurement costs might be the major determinant of cost differences between non-HRA PFI and SHG schemes. Capital build costs include all elements of scheme build costs except for financing, specific risk and procurement costs.

In April 2007, seven local authorities that had either submitted bids to the 5th Housing PFI Bidding Round or were still developing their Outline Business Cases following Round 4 for non-HRA PFI schemes to deliver new build social rented housing were invited to take part in this work. They were asked to review and benchmark their scheme capital build costs and resubmit them using a pro-forma developed by Communities and Local Government and agreed with the local authorities. The Housing Corporation provided similar data for 21 SHG schemes in the same regions as the non-HRA PFI schemes – South East, London, West Midlands and the North West – and also aggregated sets of regional data for these four areas.

Methodology

The capital build cost data obtained is open to extensive analysis given the range of schemes, dwelling archetypes and size of units. In order to facilitate this stage of the analysis and provide a reasonable basis for comparison, weighted average dwelling capital build costs were developed for all schemes. We focused on capital build cost including land as this gives a fuller and truer reflection of all the capital costs of providing a dwelling. This allowed a relatively simple and transparent comparison across a range of non-HRA PFI and SHG schemes.

To enable a judgement to be made on the acceptability of capital build costs of non-HRA PFI schemes compared to the SHG schemes within the sample range, the mean SHG capital build cost was calculated. Any non-HRA PFI capital build costs equal to or below this figure were considered acceptable (subject to meeting any other relevant criteria).

To establish an upper limit for the range of acceptable variation from the mean – and so recognise the spread of capital build costs in both non-HRA PFI and SHG schemes – we took the SHG mean plus one standard deviation, based on the sample range. Any non-HRA PFI capital build costs above this figure were considered unlikely to be acceptable.

Two further cost ranges on the 'cost benchmark' scale were set based on market feedback which indicated that capital build costs for PFI procured units may include up to 10 per cent additional cost for the transfer of general build cost risk to the private sector. Non-HRA PFI capital build costs between the SHG mean and SHG mean + 10 per cent were considered to be within an acceptable range. Between the SHG mean + 10 per cent and SHG mean + standard deviation, non-HRA PFI capital build costs were considered 'possibly acceptable' subject to further scrutiny.

There are a number of limitations and qualifications to the analysis undertaken. These include:

- land, which is an important cost driver, can also be a distorting cost for analysis purposes. This is because non-HRA PFI schemes should include local authority land at nil cost while SHG schemes tend to rely on both market purchase of land and s106 agreements to reduce land costs. Land values and costs therefore vary significantly across both non-HRA PFI and SHG schemes. We have not adjusted the data to control for different land costs
- capital build cost data varied in the level of detail available and also cost certainty in respect of scheme development and procurement timing between non-HRA PFI and SHG schemes; and
- the limited number and range of non-HRA PFI and SHG schemes for comparison purposes.

However it is considered that the methodology adopted and range of non-HRA PFI/SHG schemes and data used still provide an acceptable and meaningful basis for the comparative assessment and drawing conclusions.

The table in Annex A contains a summary of the findings from Stage 2.

Conclusions

The comparison of non-HRA PFI and SHG capital build costs demonstrates that, based on the data sample, although non-HRA PFI capital build costs are generally higher than those for SHG schemes, both general needs and supported/extra care non-HRA PFI new build schemes can show acceptable capital build costs compared to SHG schemes.

It is also clear that there is no one right 'single point' benchmark for comparing non-HRA PFI and SHG capital build costs.

The analysis provides a benchmark range of costs which may be acceptable in new build non-HRA PFI schemes based on the sample range and an indicator of where costs may be outside the normal range of acceptability. Where costs are outside the normal acceptable range, we need to fully understand why costs are high, and though there may be circumstances in which these may be justified, they will require additional scrutiny and review.

The work undertaken so far provides the basis for:

- developing a set of standard non-HRA PFI scheme cost data sheets that will facilitate future comparison and benchmarking
- building and maintaining a non-HRA PFI and SHG benchmark database; and
- Stage 3 of the non-HRA PFI and SHG comparative cost analysis.

Stage 3: Assessment of operational, financing, risk and procurement costs

It is intended that as schemes progress through development and into procurement, additional cost comparison work between non-HRA PFI and SHG housing will be undertaken and further analysis carried out, including considering the impact of operational, financing, risk and procurement costs.

The establishment of the new Homes and Communities Agency, which will bring together the delivery functions of the Housing PFI and the SHG programmes under the same body, will support this work and facilitate the ongoing benchmarking of both non-HRA PFI and SHG scheme costs as a matter of routine.

Annex A

Weighted average dwelling capital build cost, including land, and showing the number of PFI and SHG schemes in each range

Acceptability ranges	General Needs			Supported/Extra Care		
	Capital build costs range	No of PFI schemes	No of SHG schemes	Capital build costs range	No of PFI schemes	No of SHG schemes
May not provide acceptable comparability: costs greater than SHG mean plus standard deviation	Above £176,339	0	1	Above £158,215	2	1
Possible acceptable comparability (subject to further scrutiny): costs between SHG mean+10% and SHG mean+standard deviation	£166,640 – £176,339	0	0	£129,551 – £158,215	1	1
Acceptable comparability: costs between SHG mean and SHG mean+10%	£151,492 – £166,639	1	2	£117,775 – £129,550	1	0
Good comparability: costs at or below SHG mean	£151,491 or below	2	2	£117,774 or below	0	6

Note 1: Weighted average dwelling capital build cost = total capital costs for scheme divided by average dwelling unit size for each scheme.

Note 2: The SHG scheme numbers exclude individual schemes where land costs were not provided but include the sets of aggregated regional data.