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REPORT BY THE
COMPTROLLER AND
AUDITOR GENERAL

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Department for Communities
and Local Government

The New Homes Bonus

Key facts

£1.3bn

paid to local authorities, through the New Homes Bonus, 2011-12 to 2013-14

326

local authorities in England responsible for residential planning

5%

average Bonus allocation as a proportion of spending power¹ for district councils, 2012-13

£699 million allocated in grant over three years, 2011-12 to 2013-14, to fund the Bonus

£599 million additional Bonus over that period, funded by a deduction from the local government Formula Grant

232,000 estimated additional households requiring homes annually, to 2033

115,600 homes built in 2012

160,400 number of homes² added to the council tax base between October 2011 and October 2012 and resulting in payment of the Bonus

14,000 the Department's midpoint estimate of the average annual number of additional homes that would be attributable to the Bonus over its first ten years of operation

82 per cent average local authority approval rate for major residential planning applications (ten or more homes) in 2011-12

1 Spending power is the combined total of a local authority's central government grants and council tax. The Department excluded the Bonus from its calculation of spending power in 2011-12 and 2012-13, but later decided to include it in the calculation from 2013-14 to recognise the Bonus' increasing proportion of local authority funding. The Department therefore recalculated spending power for 2012-13 to include the Bonus. Our analyses are based on the recalculated spending power for 2012-13 that includes the Bonus.

2 Includes newly built homes, conversions and long-term empty homes returned to use.

Summary

Shortfall in the supply of new homes

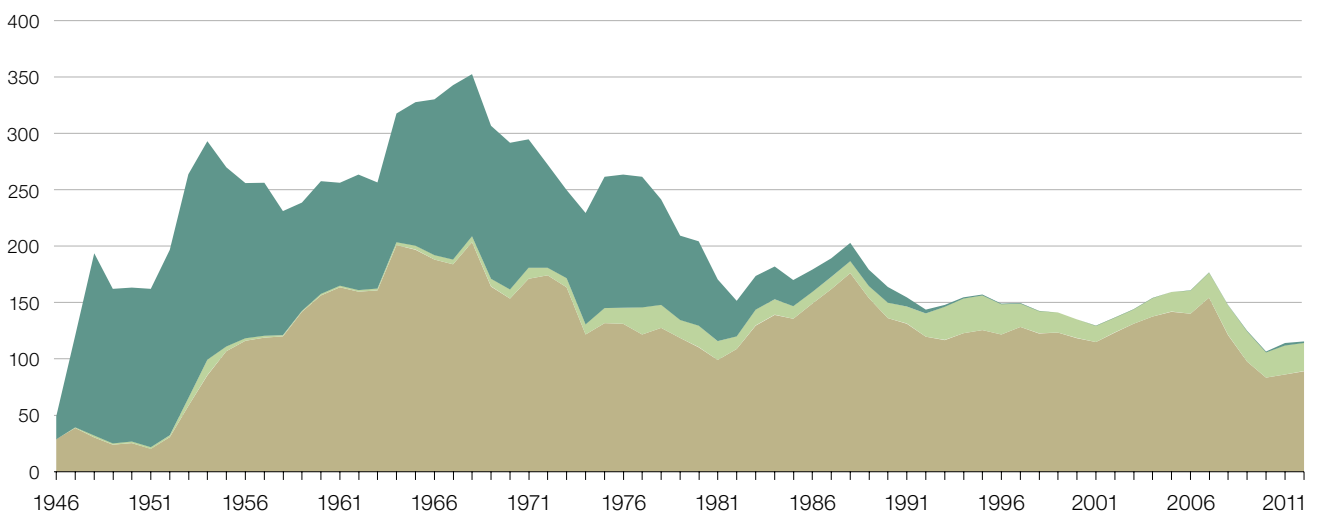
1 The government estimates that 232,000 additional households could require homes each year to 2033. In 2012, only 115,600 new homes were built in England. Since 1970, levels of private housebuilding in England have shown no consistent growth (**Figure 1**). This is the background against which successive governments have tried to increase rates of housebuilding.

Figure 1

Homes completed in England, 1946 to 2012

The level of private housebuilding in England has shown no consistent growth

New homes built (000)



- Local authorities
- Housing associations
- Private enterprise

NOTES

- 1 Data for earliest years are less reliable than for later years. Definitions may not be consistent throughout the series.
- 2 Some data missing for October 2005 to March 2007.

Source: Department for Communities and Local Government, table 244, "Permanent dwellings completed, by tenure, England, historical calendar year series"

The New Homes Bonus

2 The New Homes Bonus (the Bonus) is strategically important in two ways, firstly as part of the government's economic growth agenda, and secondly as one of several major changes to local authority funding (unitary authorities, district councils, county councils and London and metropolitan boroughs). New housing is often unpopular with residents who may be concerned about pressure on local services, loss of amenity, traffic congestion, and disruption during building. The government set out the rationale for the Bonus in its impact assessment, which is to incentivise local authorities to encourage new homes locally by contributing to visible benefits for local communities and countering resistance to growth in housing.

3 The Bonus is a non-ring-fenced payment the Department for Communities and Local Government (the Department) has paid, since April 2011, to local authorities for every home added to their council tax register, after deducting recent demolitions. The extra homes qualifying for the Bonus may be newly built, conversions or empty homes³ returned to use. For each new home, the Department pays an amount equivalent to the national average for that home's council tax band every year for six years. For example, a local authority adding a band D home to its council tax base between October 2011 and October 2012 will receive £1,444 per year for the six years from 2013-14 to 2018-19, £8,664 in total. An extra £350 per year is paid for each home that is deemed an affordable home, and for affordable traveller pitches. For areas jointly governed by district and county councils the Bonus is split, with 80 per cent paid to the district council.

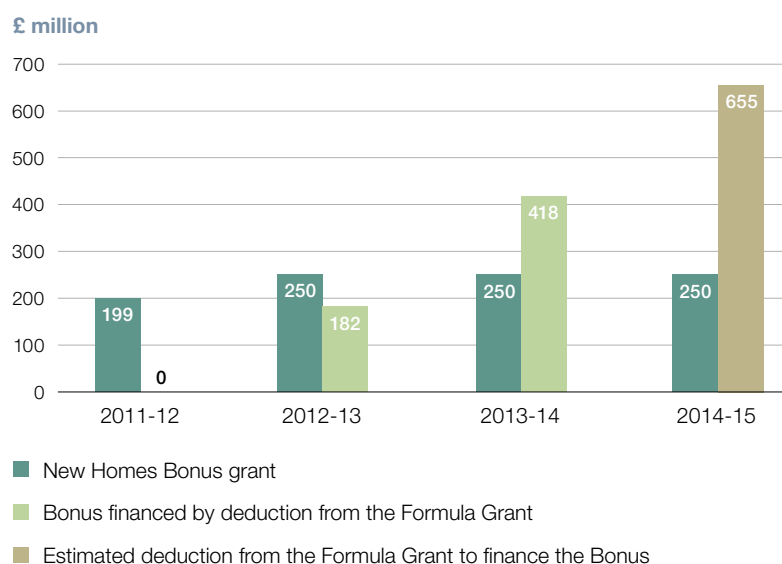
4 The Bonus is partly funded from a specific grant that replaced the Housing and Planning Delivery Grant,⁴ which the Department last paid in 2009-10. The Department has allocated £950 million in specific grant over the scheme's first four years. Each year the rising Bonus excess is financed by redistribution from the Formula Grant, currently the main departmental funding for local government. This redistribution totalled £599 million over the first three years of the Bonus (**Figure 2**). In our report, we use the term the Formula Grant, which is ending on 31 March 2013, to refer to the current Formula Grant and its successors.

³ 'Empty homes' have been unoccupied and substantially unfurnished for over six months.

⁴ The previous government's initiative to incentivise housing growth and improve local authority planning procedures.

Figure 2
Sources of New Homes Bonus funding

Each year the rising Bonus excess is financed by redistribution from the Formula Grant



NOTE

1 The estimated deduction from the Formula Grant to finance the Bonus in 2014-15 is obtained by rolling forward the 2013-14 allocation and was used by the Department as an illustration of spending power for 2014-15. Final allocations for 2014-15 will be based on the council tax base in October 2013.

Source: National Audit Office analysis of Department for Communities and Local Government's data on Bonus grants and allocations

Our report

5 This report examines whether the Department is meeting its objective for the Bonus to incentivise local authorities to encourage new homes locally. It is too early for the scheme to have achieved the full impact the Department intends. We have chosen to examine the Bonus now because it is an important part of the government's effort to use funding to incentivise growth. The report does not assess local authority decisions on housing development or how local authorities spend their Bonus allocations. Appendix One sets out our assessment criteria based on the following questions:

- Is the New Homes Bonus scheme well designed to achieve its objectives?
- What is the early evidence of positive influences on new homes creation owing to the Bonus?
- Have any wider consequences been identified and are appropriate actions being taken?

6 We have considered the Bonus in the context of wider efforts to stimulate economic growth, including housing growth, through funding incentives. This report draws on our programme of work examining issues relevant to local government, in particular, our recent report *Financial sustainability of local authorities*,⁵ and our insights from a study we have under way on local economic growth.

Key findings

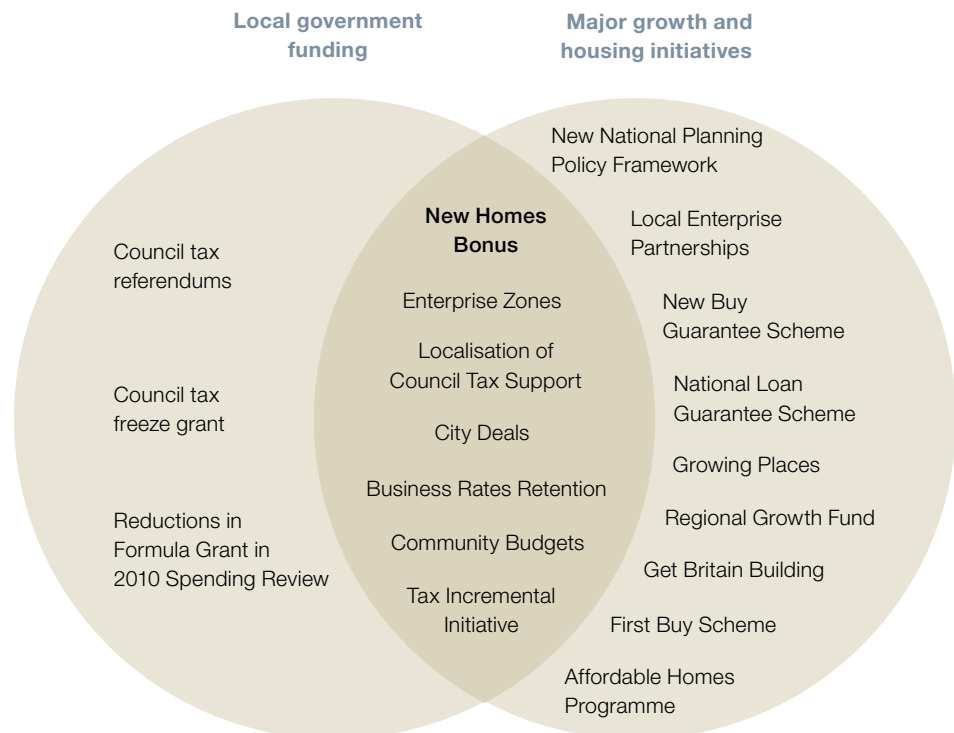
Design of the New Homes Bonus

7 The Bonus' main objective is clear: to incentivise local authorities to encourage new homes locally. The Bonus is one of several policies, many involving incentives through funding, that are designed to promote and support economic growth or growth in housing, or both (Figure 3) (paragraphs 1.1, 1.10 to 1.15).

Figure 3

Relationship between local government funding and major growth initiatives

The Bonus is among a range of policies that bring together local government funding and growth



Source: National Audit Office

5 Comptroller and Auditor General, *Department for Communities and Local Government: Financial sustainability of local authorities*, Session 2012-13, HC 888, National Audit Office, January 2013.

8 The main design features of the Bonus – an incentive payment per home, paid as part of local authorities’ funding – were set in advance as they were key to the policy aim to incentivise and reward housing growth. The Department consulted on other design aspects. It aligned features with wider housing objectives that were widely supported by local authorities, including a supplement for each new affordable home, and payment of the Bonus for empty homes brought back into use (paragraphs 1.1 to 1.6).

9 To work well, incentives need to be understandable, which the Bonus is. The simplicity of the Bonus calculation and how it is triggered makes it easy for councillors and local authority officers to understand and explain to communities. Stakeholders we consulted, and local authorities we visited, agreed that having the payment clearly relate to council tax, and the visibility of a ‘New Homes Bonus’ revenue stream, were potentially incentivising features (paragraph 1.23).

10 The Department avoided the risk of paying disproportionate rewards to local authorities that set relatively high levels of council tax. It did so by basing the Bonus payment to all local authorities on the national average council tax, rather than their actual council tax. The amount of Bonus does, however, vary with relative house prices, because higher priced homes fall into higher council tax bands. Therefore, on average, local authorities in areas with higher relative house prices receive higher payments for similar new homes (paragraphs 1.7 to 1.8, 2.11).

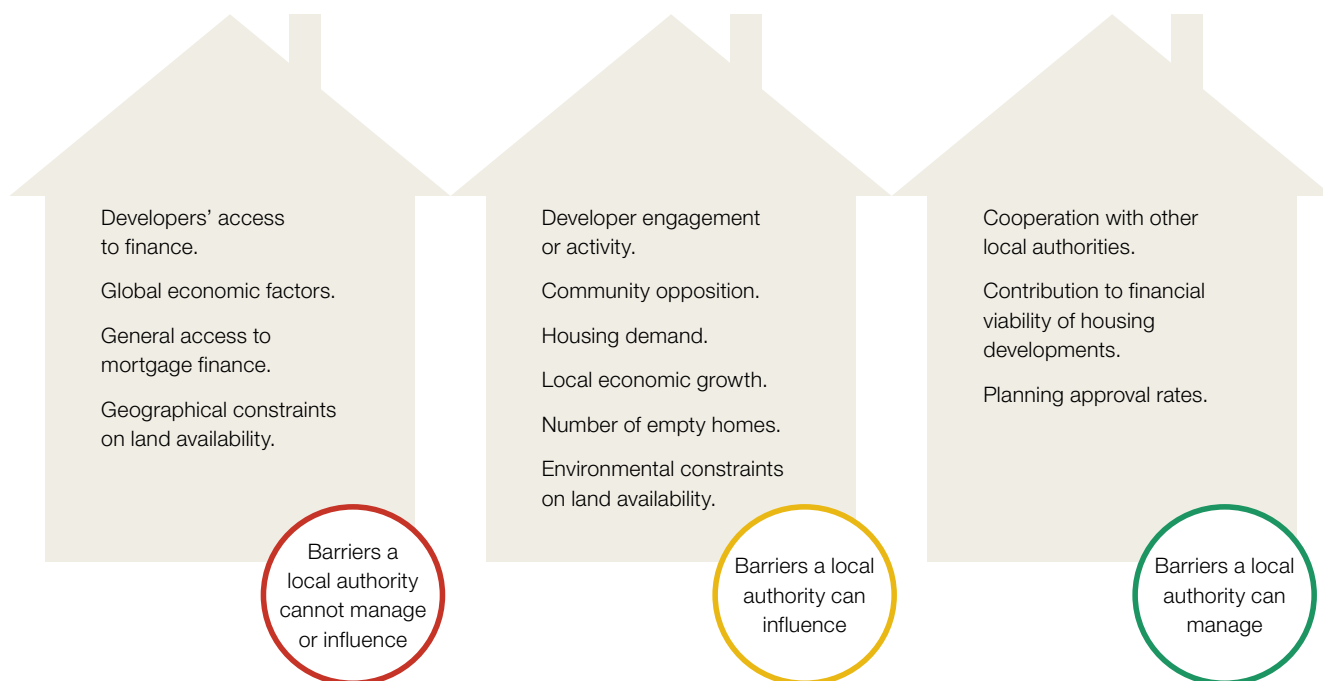
Monitoring and evaluating the impacts of the Bonus

11 Measuring the impact of incentives on local authorities to increase housing supply is complex because of the many influences (Figure 4 overleaf) that have differential effects depending on local circumstances. The Department concluded that it would be impossible to calculate definitively how far the Bonus is responsible for any change in the rate of creation of new homes because of the Bonus’ interplay with other policies (Figure 3), the long-term nature of housebuilding and the wide-ranging effects of barriers such as availability of financing for housing developers and whether there is viable land for housing. Such barriers can be powerful, and their influence varies widely depending on the local new-housing market (paragraph 1.25).

12 The Department’s estimate of the potential increase in new housebuilding that the Bonus might achieve is unreliable. The Department estimated that the Bonus would increase housing supply by 8 to 13 per cent over its first ten years, equivalent to around 140,000 additional homes. The Department produced the estimate using modelling for which the assumptions were unrealistic, being based on very limited evidence of local authorities’ actual behaviour. The calculation also contained a substantial arithmetical error which, when corrected, reduces the estimate by around 25 per cent (paragraphs 1.18 to 1.21).

Figure 4
Barriers to local authorities influencing housing supply

There are a range of barriers to local authorities' ability to influence housing supply



Source: National Audit Office

13 The Department is not currently systematically monitoring the impact of the Bonus. It plans to review performance in 2013-14 but has not yet determined the review's scope or approach. The Department did not consider impact monitoring in the early years of the Bonus to be justified because of the time lag between planning and completing new housing development. It undertakes general monitoring of indicators such as planning approvals for homes and trends in housing starts and completions, but not specifically against expectations for the effects of the Bonus. The Department did two annual surveys of local authorities' responses to the Bonus that it uses for its own internal monitoring. However, shortcomings in the survey design and application mean that the results, while having some use, must be treated as only broadly indicative (paragraphs 1.26 to 1.30).

14 By not monitoring the early impact of the Bonus more closely, the Department missed the opportunity to gain insights that might apply to other incentive-based funding that it is introducing from April 2013. For example, changes to business rate retention may have a more substantial impact on local authority budgets than the Bonus. The Department has not used experience from operating the Bonus to examine how these changes will combine to affect local authorities' funding, or how they might together influence local authorities' attitudes towards housing development and growth (paragraph 2.21).

Early evidence of impact

15 It is too early to tell whether the Bonus will increase new housing. The Department's impact assessment predicts a measurable increase in new homes from 2016-17. Bonus payments are triggered only once a new home is on the council tax register, and there is a gap of several years between planning and completing a new development. Overall we found little evidence that the Bonus has yet made significant changes to local authorities' behaviour towards increasing housing supply (paragraphs 2.16 to 2.21, 2.29).

16 The Bonus has so far mainly rewarded home creation that was not incentivised by the Bonus. The Department started to pay the Bonus from 2011 to mitigate the risk that local authorities would reduce their activities to stimulate new housing after local authorities' housing targets were abolished. The Department recognised that much of the £1.3 billion paid in the first three years would relate to local authorities' pro-growth activities and planning approvals granted before the Bonus started. Local authorities that have benefited from this see the Bonus as a reward for a pro-development stance, which recompenses some of the costs associated with new housing development and consolidates pro-growth behaviour (paragraphs 1.14, 2.23 to 2.24, 2.29).

17 We found little evidence that the influence of the Bonus is reflected in increased planning approvals for housing. The link between trends in planning applications and building is not straightforward as some developers hold land with planning permission for several years before commencing development. Local authorities we visited and stakeholders said that the main drivers for planning approvals were housing need, community views and the circumstances of a particular site. In the three years 2009-10 to 2011-12, the proportion of applications local authorities approved ranged between 35 and 100 per cent (paragraphs 2.25 to 2.28).

18 We found some evidence that the Bonus has given local authorities resources to allow them to protect activities relating to new and empty homes. The Bonus has, for example, been used to maintain local authorities' capacity to identify and bring empty homes back into use. Similarly, some local authorities have used the Bonus to continue to fund their work with developers on the viability of specific housebuilding projects, which can be resource intensive. Such services might otherwise have been cut or reduced as local authorities respond to reductions in funding (paragraphs 2.30 to 2.33).

Wider financial consequences of the Bonus

19 While an individual local authority can see the Bonus it receives, it can make only an approximate estimate of its overall gain or loss as a result of the scheme.

Our 2011 report *Formula funding for local public services* outlined the substantial complexity of the Formula Grant.⁶ The Department has confirmed that it is not possible to calculate an individual local authority's exact overall gain or loss because of the complex adjustments to the Grant after the Bonus element is deducted (paragraphs 2.2 to 2.4).

20 As with funding mechanisms in general, achieving a scheme that is simple to understand and operate is likely to involve risk to fairness. The Department's decision to fund a large part of the Bonus from a deduction from the Formula Grant is seen by some local authorities as unfair. Local authorities that earn only low levels of Bonus will not make up their share of the sum deducted from the Formula Grant. These local authorities are usually in areas where developers are less likely to want to build housing, which are more typically in deprived parts of the country or in areas where land can be more expensive to develop. As we described in our recent report *Financial sustainability of local authorities*,⁷ these authorities will need to find ways of managing the financial impact of their inability to make up the reduction of the Formula Grant from receipts of the Bonus (paragraphs 2.7 to 2.11).

21 The total Bonus increases as it builds towards an estimated payment of £1.4 billion in the sixth year. Some local authorities will gain substantially while others will experience further substantial net reductions in the Formula Grant. The Department was aware the Bonus could result in large cumulative losses for some local authorities, though this effect was not covered in the impact assessment and the Department has done no analysis of the position of individual local authorities. The Department's main mitigation of this impact is the general protection afforded by the Transition Grant.⁸ The redistributive effect will increase from April 2013 when the Formula Grant to local authorities will no longer be reduced to account for additional council tax collected on new homes (paragraphs 2.5 to 2.6, 2.12 to 2.15).

Conclusions

22 It is too early for the Bonus to have had a discernible influence on the numbers of new homes, in line with the Department's expectations. We have not found evidence that there has yet been measureable change in local authorities' behaviour. At the same time, with an estimated £1.4 billion to be paid out annually in the Bonus through the redistributed Formula Grant by 2016-17, some local authorities face substantial increasing financial risks from the overall reducing effect of the Bonus on their funding.

⁶ Comptroller and Auditor General, *Cross-government landscape review: Formula funding of local public services*, Session 2010–2012, HC 1090, National Audit Office, July 2011.

⁷ See footnote 5.

⁸ The Department allocated Transition Grant totalling £116 million over 2011-12 and 2012-13, which capped a local authority's overall annual reduction in spending power (defined at footnote 1) where it would otherwise have exceeded 8.8 per cent. From April 2013, it is renamed the Efficiency Support Grant.

23 The Department plans to undertake a post-implementation review of the Bonus in 2013-14, but has not yet decided its scope or methodology. Monitoring and evaluating the impact of the Bonus requires time to develop and explore with the local government sector, to get the most from the available data and intelligence. The Department's approach to monitoring and evaluating the Bonus and its effects is neither timely nor adequate. The Department's proposed review of the Bonus during 2013-14 is essential and urgent.

Recommendations

24 In our recent report *Financial sustainability of local authorities* we highlighted the uncertainties and risks of funding changes, and the consequent importance of timely assessment of wider effects. We recommended that the Department should better evaluate the impact of decisions on local authority finances and services, before and after implementation. We repeat this recommendation here with specific reference to the cumulative impact of escalating Bonus deductions from the Formula Grant. The Department should monitor the impact of the Bonus and other financial pressures on the spending power of local authorities, especially those most affected, so the pressures can be managed effectively.

25 In close collaboration with local government and consulting with the housebuilding sector, the Department should carry out its review of the Bonus to:

- a** identify and agree the many influencing factors that need to be considered and potentially adjusted for;
- b** identify the important indicators and work through realistic plans for collecting data to measure them;
- c** improve the design of the Department's annual monitoring survey of local authorities, and work with local authorities and representative bodies to help increase the response rate;
- d** determine those indicators and benchmarks that it would be worthwhile for the Department and local authorities to monitor in the future; and
- e** draw out the lessons and insights about what makes a successful incentive, and consider their application to other financial, incentive-based schemes being introduced.

26 The Department should review its quality assurance processes to prevent future errors in its analyses and publications.