

# Nottingham City Council - Audit of accounts 2019/20

## Selective Licensing Scheme

### Reason for this report

Under the Local Audit and Accountability Act 2014, local electors have a right to make objections to the accounts of local authorities, in which they can ask the external auditor to either produce a Report in the Public Interest on a particular matter or to apply to the High Court for a declaration that there is an unlawful 'item of account' (transaction or balance) in the Council's accounts. We received a purported objection to the Council's 2019/20 accounts in relation to the scheme for Selective Licensing of private landlords in the City.

In the event, the objection did not meet the statutory requirements for a formal objection as the would-be objector was no longer on the electoral register in the City at the relevant time. Given the nature of the allegations made, the interest of the Audit Committee on this matter and the would-be objector's indication that he knew of others who would object to the 2020/21 accounts on the same matter, we decided to carry out some work on the matters raised and this report has been produced as a result of that work.

This report does not prejudice the outcome of any future objection to the accounts on this matter, for which we would review existing and new evidence afresh in reaching our judgement, whilst also not duplicating any work already done in producing this report.

In summary, the concerns of the would-be objector are that:

- The scheme is highly bureaucratic and time-consuming for landlords to comply with
- The broad geographical spread and proportion of the private rented sector covered means that it is insufficiently focused on particular areas and adversely impacts on many good landlords
- The scheme provides very poor value for money in that the number of inspections carried out is very low
- The scheme has had an adverse effect on some tenants as licence fees have been passed on to them to pay and in extreme cases the requirements for applying for a licence have led to tenancies being terminated and an increase in homelessness
- Licence fees are disproportionately high

Overall, while implementation of Selective Licensing has not gone smoothly, partly because of the significant impact of Covid-19, we do not consider that any formal audit action is needed at this stage: officers have clearly identified lessons from the first scheme which are being addressed in the proposals for second, and indeed it is likely that further benefit will be felt from the first scheme in its remaining year now that a higher level of inspections can be carried out. We are also mindful that the overall framework for Selective Licensing is set out in legislation and guidance and is subject to approval by the Secretary of State, which was granted in February 2018. Under these circumstances, an auditor would need particularly compelling evidence before taking formal action.

### Background

Unitary and district councils were given discretionary powers under section 80 of the Housing Act 2004 to operate selective schemes to license private landlords operating in their areas. Originally, these powers were intended to tackle areas of low housing demand and of anti-social behaviour, but the assessment criteria were widened under new guidance in 2015 to include poor property condition, high numbers of migrants, deprivation and high levels of crime, and this resulted in many more councils implementing schemes. The guidance also required authorities to consider other ways of dealing with these issues.

Schemes are required to be entirely self-financing, but at the same time are not allowed to make a profit – all expenditure has to be financed from the licence fee. Where a scheme covers more than 20% of the Council's geographical area, or 20% of the private rented sector homes within that area, it is required to be approved by the relevant Secretary of State (for Communities and Local Government at the time of approval of the first Nottingham scheme).

A number of national reviews of the implementation of Selective Licensing scheme have been carried out, both before and after the 2015 changes. In general terms, these have recognised that Selective Licensing has helped to tackle poor standards but that evidencing the impact of it is problematic. It is widely seen as a 'blunt tool' which works best in combination with a range of other actions - unsurprisingly given the complex nature of the issues it is seeking to tackle and the range of external factors which impact.

## The Nottingham Scheme

The ruling Labour Group included the implementation of a licensing scheme as part of its manifesto for the 2015 local elections, and it was subsequently included in the Council Plan 2015-2019. The original commitment was to a scheme covering the whole of the City, in terms of both geography and the private rented sector, but this was scaled back during the design of the scheme as officers were clear that a scheme covering the whole City would not receive the Secretary of State's approval. The implemented scheme covered approximately 50% of the geographical area of the City and 90% of its private rented sector, with the main geographical areas which were excluded being areas with a high proportion of social rented and / or owner occupied housing and therefore lower proportion of private rented.

The budget for the scheme amounted to around £25m for the five years, and it involved employing 76 staff. The licence fee was initially set at £780 for non-accredited landlords and a reduced £480 for accredited, based on assumed application numbers of around 24,000 for 32,000 licensable properties (based on current estimates 25,000). The scheme set an inspection target of 50% of non-accredited and 10% of accredited properties over the five years.

The proposals for the scheme were supported by extensive research and analysis, including analysis of local demographic and economic data and visits to other authorities who had implemented schemes. A consultation process was carried out in accordance with the guidance and the outcome of the consultation was reported back in detail to members and appears to have been considered as part of scheme finalisation.

The scheme was implemented on 1 August 2018 and runs to 31 July 2023. Some changes were approved in November 2019, revising the fees and introducing block licences so that individual landlords did not have to make as many separate applications.

The Council is currently in the consultation phase for a new scheme to run for a further five years from 1 August 2023 – the legislation does not allow for schemes to be extended or rolled-over: instead, a fresh process of design, consultation and approval has to be followed and a new scheme put in place. The proposed new scheme was considered by Executive Board on 24 May 2022 prior to consultation.

## Practical implementation

The Council has carried out two reviews of the scheme during its existence, in accordance with the statutory requirement to carry out periodic reviews and also as general good practice. These have identified a number of issues with the implementation, many of which chime with the issues raised by the would-be objector. Issues were also identified in the Internal Audit review reported in February 2019 and subsequent follow-ups, which rated the service as 'limited assurance' and 'moderate assurance' respectively. They are also reflected in the reporting to members in connection with the implementation of the proposed new scheme.

As with many of the Council's activities in the past three years, the Covid-19 pandemic has had a major impact, particularly in terms of the Council's ability to carry out planned internal inspections of properties – all inspections were put on hold for a period, while for a lengthy subsequent period only external inspections were carried out in order to minimize Covid risk. This was in accordance with the relevant government guidance: 'Non-statutory guidance for local authorities on enforcing standards in rented properties during the COVID-19 outbreak'.

## Application process

The Council decided to use an online application process, but there have been a number of difficulties with the system which have clearly antagonized some landlords. These issues were primarily:

- Problems with the operation of the on-line portal, which was being used for the first time
- The extent of information required to be submitted as part of the application process
- The requirement for landlords of multiple properties, including in the same building, to make a complete separate application for each property.
- The time of year when the scheme commenced was unfortunate for many landlords as it coincided with, in some cases, holidays and, in others, major projects being underway in their properties.

In relation to the portal, the on-line application process used a newly-implemented system which proved to have a number of problems. There was extensive testing and landlords were invited to come and try the new online system and make comments on it during the planning phase of the online application development. The Council undertook a soft launch of the application form in June 2018, allowing selected landlords access to try and ensure a smooth introduction, but despite these efforts there were teething problems which did delay the issue of licences. These have since been rectified.

When designing the application process, the Council decided to include a range of information about the properties which would assist it with risk assessment for inspections and also compiling information on energy efficiency. Officers now acknowledge that this did place a significant additional burden on applicants.

In relation to multiple properties, the Council responded to feedback from landlords by implementing a block application process, but this was not available until over a year into the scheme, by which time many landlords had been adversely affected by its absence.

In relation to the timing of scheme commencement, having received feedback from landlords, officers agreed to extend the period in which portfolio landlord applications were expected to be made; arguably, at least, this issue should have been foreseen and avoided.

Whilst the Council sympathised with the commencement of the scheme being inconvenient for some landlords, officers have stated that they do not see how this could be avoided as once the legal designation is approved by Secretary of State the scheme is required to commence after a minimum of 90 days public notice and requires all private rented properties within the designation which qualify as selective to be licensed. This is a product of the scheme being the first of its kind in the City and not the timing of its commencement. The Council also made provision to allow landlords with large portfolios of properties a longer period of time to apply up to end of October 2018 (3 months).

### **Application numbers**

The scheme anticipated overall applications of 24,000, with the vast majority expected to be submitted in the first year of the scheme. While this was broadly correct, there have been difficulties in forecasting application numbers through the scheme, with an unanticipated continuation of applications to date. This is thought to be as a result of turnover of landlords, increases in purpose-built accommodation, and a complex market with a significant number of landlords who live outside Nottingham and were therefore less aware of the scheme. Clearly, this impacts on the workload of the administration team and has required adjustments to planned resourcing as the scheme has evolved.

In relation to application numbers these have been the split between accredited and non-accredited landlords, with the plans for the scheme envisaging 15% of applications coming from accredited landlords, whereas the reality has been that around 30% are accredited. This clearly has an impact on total fee levels, but this can be accommodated as it also impacts on the number of inspections required to be carried out.

### **Impact of Covid on inspections**

The plans for the scheme anticipated that the initial focus of efforts would need to be on dealing with applications, but that over time, once application numbers had tailed off, the focus would be switched to carrying out inspections of properties. Such inspections were intended to be both internal and external and are crucial to the stated aims of the scheme in terms of increasing standards within the sector, allowing specific issues to be identified and the necessary remedial action taken.

In the event, the first and most severe Covid -19 lockdown occurred at the time when resources were starting to be refocused on inspections, and no inspections were carried out at all from late March 2020 until July 2020. External inspections then commenced and 2100 were carried out by February 2022. While of value in identifying problems with rubbish, security, unsafe pathways, boundary walls and fences and external electrics, such external inspections are limited in impact compared with full internal inspections. In line with appropriate Covid guidance, internal inspections only recommenced in July 2021, and 1800 had been carried out by February 2022.

### **Recruitment**

The Council continues to struggle to carry out the planned number of inspections under the scheme because of difficulties in recruiting suitable staff. This is a country-wide problem as identified by the Chartered Institute of Environmental Health in the 'CIEH Workforce Survey', which found that '87% of local authorities are relying on agency cover and 56% have had vacancies unfilled for more than six months'.

Carrying out the inspections is much more of a specialist role than, say, managing applications, and a combination of this and wider recruitment difficulties for the Council means that inspection are still not being carried out at the planned rate. In response, the Council has implemented a 'grow our own' scheme funding the degree required to qualify internal staff as Environmental Health Officers (EHOs).

The Council envisages that 12,780 inspections will be undertaken by July 2023. This exceeds the projected 9500 inspections (10% accredited and 50% non-accredited) anticipated under the first scheme will still not have been carried out on expiry of the scheme in July 2023. These inspections will, however, continue after that date as funding from the licence fees will not have been spent. As the Council points out, continuing to carry out these inspections is also appropriate given the unexpected numbers of licence applications made in the latter half of the 5-year period, which means that the licences are also still valid for a few more years.

## Fee levels

As noted above, selective licensing schemes are required to cover all their costs from licence fee income, and to avoid making a surplus. This clearly requires accurate budgeting of both costs and likely fee levels, which in turn requires reliable information on property numbers and robust assumptions on take-up levels. There are a number of licensing schemes which local authorities operate which have similar requirements in terms of being self-financing including, for example, taxi (hackney carriage and private hire) licences.

The fees which Nottingham set for the scheme were within the range of fees set by other authorities at the time, albeit towards the upper end of that range. Officers based the fees on guidance produced by the Local Government Association, including in respect of the recovery of central overheads through the scheme. As fees are within the range set by other authorities, we have not carried out a detailed audit of the approach used by the Council.

Given the delays in the inspection process due to Covid, and subsequent recruitment difficulties, there have been no issues in terms of meeting all expenditure from fee income to date, but it is important that officers continue to monitor the situation closely and have enough funding available to finance the inspections expected to be 'carried forward' at the end of the scheme.

## Measuring positive impact

As noted above, the national review of Selective Licensing schemes identified that authorities were struggling to measure the impact of their schemes, and Nottingham is no different in that regard. Selective licensing schemes aim to tackle a range of complex problems which are affected by a range of factors, in the context of the operation of a market with only limited previous regulation.

Internal Audit's review in 2018/19 rightly identified that no measurable targets had been set for the impact of the scheme. While the scheme documentation specified inputs such as numbers of staff, and outputs such as numbers of licences granted and numbers of inspections carried out, there was no attempt to quantify the outcomes of the scheme, as linked to the criteria on which the scheme was justified. Officers responded to Internal Audit, agreeing to take this matter forward. However, more recent reporting on the progress of the scheme still focuses on the quantification of outputs and not of outcomes. Without measurable outcomes, it is much harder for the Council to demonstrate to critics of the scheme that it is worthwhile and provides value for money. The interim review of the scheme identified many positive outcomes in terms of improvements secured, and while the number of such improvements was measured, it is difficult to judge whether or not this represents real success without any target having been set for such improvements.

That said, we recognise that such measures of outcomes are difficult to specify and monitor, and that the whole legislative approach appears to rely on an assumption that putting a licensing scheme in place will have a positive outcome. At the same time, however, the scheme is a major undertaking which can involve considerable expense for landlords if they have not been meeting the required minimum legal standards prior to being licensed. There is a commitment of time from landlords in making applications, and it is therefore important that positive impacts can be demonstrated to the fullest possible extent.

## Possible negative impacts

The scheme's critics suggest that:

- the licence fees were largely passed on to tenants in the form of higher rent levels, rather than being borne by landlords
- the cost and administrative burden has led to some landlords ceasing operations in the City, reducing the supply of accommodation and further impacting on rent levels
- the scheme has led to increased incidence of homelessness

As with measuring positive impact, assessing such negative possible impacts is made more difficult by the overall complexity of the situation and the number of different factors coming into play and it would be a disproportionately time-consuming exercise for us as auditors to reach definitive conclusions on these possible impacts. However, we do believe that the Council needs to be sufficiently confident that either these impacts are not being felt, or that they are a price worth paying for the wider benefits of the scheme, before giving the new scheme final approval.

From our limited discussions with and document review, it is clear, and unsurprising, that many landlords did pass the licence fees on to tenants, as there was a rise in average rent levels in the City following implementation of the scheme. However, there have been, and continue to be, many other factors which are impacting on the buoyant private rented sector in the City which have arguably had more significant consequences. Whilst Selective Licensing contributed to rising rent levels, it is far from being the only factor in operation in what is essentially a supply-demand relationship. Average rent increases in the City recently have been reported as 7.6%, which is far in excess of the impact of selective licensing.

Again, in relation to landlords ceasing operations in the City, we are aware that some landlords have indeed ceased operating for reasons connected with Selective Licensing, but this is against the background of a much bigger reported trend of the replacement of many traditional landlords with a smaller number of larger-scale corporate operators, and in the context of a sector where supply is growing (alongside growing demand and increasing rent levels).- there is clear evidence that the private rented sector in the city has grown during the lifetime of the scheme, and projections suggest this growth will continue.

Any impact of Selective Licensing on homelessness would require landlords to be terminating tenancies as a result of the cost or administrative burden of the scheme. Officers are confident that there has been no significant impact on homelessness, based on the reasons being given by those presenting as homeless, which are many and varied, with no clear trend relating to Selective Licensing, although their conclusion is not fully supported because the data is arguably not specific enough about the reasons for homelessness. Again, though, there are in any case multiple factors at play such as the wider rent increases mentioned above. Given the importance which the Council attached to reducing incidence of homelessness, however, it is vital that it continues efforts to confirm conclusively that selective licensing is not having a significant impact.

### **Towards a new scheme**

As noted above, the Council is currently in the consultation phase for a replacement scheme to run for five years from August 2023. The current proposals are for a slightly reduced geographical and sector footprint, covering approximately 40% of the City's geography and 80% of the private rented sector. The proposed licence fees for individual properties are reduced to £820 for non-accredited landlords and £630 for accredited, with the overall costs and numbers of staff in the scheme remaining broadly in line. The new scheme anticipates over 28,000 properties being licensed, reflecting experience from the first scheme and the continuing growth of the sector in the City.

The details of the proposed new scheme were considered by Executive Board on 24 May 2022, with the proposals again clearly backed by a high level of analysis and research. The report included extensive consideration of the various other actions being taken by the Council and other agencies to address the various issues in the sector, in accordance with the guidance.

We note, however, that while the documentation clearly sets out how it will achieve its outcomes, it does not set out measurable targets for those outcomes, with those measurable targets which are included focused on areas of process such as the speed of processing applications. Officers are now, however, developing clearer measures and we have seen the measures currently proposed.

The proposed scheme is now the subject of consultation, with an application to DLUHC for approval expected to be made later in 2022 and, subject to this and final member approval, a go-live date of 1 August 2023.

### **Challenges for a new scheme**

The Council has clearly learned lessons during the implementation of the original scheme, and the Covid-19 pandemic and changes to the economy and housing markets generally have greatly impacted on the scheme. What matters now is that the lessons and changing circumstances are reflected in the design of any new scheme.

Based on our views on the first scheme as set out above, our view is that the Council needs to challenge itself on the following aspects of the scheme:

- *The application process* – given that the application process itself is one of the key points at which landlords 'interact' with the scheme, are officers confident that they have minimized the range of information due to be required with applications in the second scheme, have fully explored the possibilities for information to be rolled forward from previous applications and, where applicable, for multiple applications for a single landlord, and are they confident that the on-line process is properly tested and runs effectively? Given the issues which arose from the August commencement of the first scheme, has the Council taken this into account in setting out expected timescales for applications under the second scheme?
- *Footprint of the scheme* – while we recognize that the geographical and sector footprint of the scheme is likely to be a key focus for DLUC in giving approval to any scheme, and the extent of the analysis which officers have already undertaken to support the preferred footprint, it is vital that the Council continues to challenge itself on whether the scheme could be more selective in its coverage, with the consequent increased focus enabling more improvements to be secured in the areas that need it most.
- *Setting outcome measures* – while we recognize that setting measurable targets for the desired outcomes of the scheme is inherently difficult, is the Council satisfied that it has done all it can to specify such targets?

- *Achievability of inspection targets* – given recent recruitment difficulties, the specialised nature of the inspection role and the importance of inspections to achieving the outcomes of the scheme, is the Council confident that it can deliver the planned number of internal inspections for a second scheme while also clearing the backlog of inspections from the first scheme?

We therefore recommend that officers and Members consider the above issues in an open and challenging manner before giving final approval to a new scheme.