APPENDIX 2

ASSOCIATION OF RETAINED COUNCIL HOUSING

To secure a fair deal for our residents

ARCH Member Briefing: July 2009

Reform of council housing finance: consultation

Key issues

Current HRA subsidy system to be dismantled
Greater financing flexibility and responsibility for local authorities
Impacts on risk management, borrowing, capital receipts and management options
Request for comments from ARCH members to the consultation paper

1. Introduction

The review of council housing finance was announced in December 2007 and launched by ministers in March 2008. ARCH has been involved in the review process already by supplying papers on elements of the review and through ARCH representatives on the 4 work streams.

Recent announcements have been made by the Prime Minister Gordon Brown and Housing Minister John Healey outlining changes to housing policy in response to continued lobbying around the problems with the supply of social housing and concerns about the redistributive Housing Revenue Account system. Since coming to the post of Housing Minister, John Healey has made significant progress both in terms of specific initiatives and the review. This consultation document is the latest step in the review process.

It follows on from a number of initiatives providing resources for new build schemes and changes to HRA arrangements for new build, purchased and refurbished homes.

2. The consultation document

The consultation document refers to England and is available at http://www.communities.gov.uk/documents/housing/pdf/1290620.pdf

The foreword to the document by John Healey re-iterates the scale of the investment made in the council and housing association stock since 1997 and government's commitment to the Decent Homes programme. It states that reform of the system that finances council housing is imperative if improvements made to date are to be maintained.

The Minister states that his 'intention is to dismantle the Housing Revenue Account subsidy system and replace it with a devolved system of responsibility and funding' and is very clear about his objectives around providing more flexibility in finances and more transparency in the operation of the system, devolving control from central to local government and, in return, increasing local responsibility and accountability for long term planning, asset management and for meeting the housing needs of local people.

The Minister goes on to summarise his proposals which are a devolved self-financing alternative to the current system which will remove the need to redistribute revenue nationally while continuing to ensure that all councils have sufficient resources. Councils will finance their own businesses from their own rents and revenues, in exchange for a one-off allocation of housing debt. It will be a once-and-for-all settlement to create a new baseline for all local authorities currently in the HRA subsidy system, from which each will be able to sustain and maintain their homes on an equitable basis.

3. Background to the review

Section 1 notes the background to the review, how the Homes and Communities Agency and Tenant Services Agency have been created and the expected future role of local authorities but that the financing arrangements for local authority housing have remained substantially unchanged for over 20 years.

It notes some of the steps taken so far in the review and the four work streams:

- costs and standards for social housing:
- rents and service charges:
- rules governing a local authority's Housing Revenue Account and capital:
- mechanisms for delivering funding:

4. The current housing finance system

Section 2 identifies some elements and problems associated with the current system explaining the background to the HRA and the subsidy system. It states that 'There is a clear rationale for redistribution of income between landlords' and states the reasons for this including differing spending needs and capacity to raise income.

It goes on to discuss issues around notionality, debt, capital expenditure and receipts, borrowing, standards and rents. It notes some of the problems which have been identified as the system has evolved over time and these are the main arguments which have been made against the system by local authorities.

5. Costs and standards of council housing in future

Section 3 attempts to look at a range of costs and how they will impact on the financing of the service in future. It notes that the Government has concluded that provision nationally for management and maintenance needs to increase by 5% above current levels. It also states that BRE concluded that the MRA tackling newly arising need should be uplifted by an average of 24 per cent

The issue of core and non-core activities is addressed with the document noting that research undertaken for the review showed that at least 40 per cent of general management costs are additional to core management costs. It notes that defining a list of non-core activities is difficult and not something the Government intends to do but it does wish to establish a series of principles to enable local authorities to decide whether the service should be paid for through the HRA or the general fund.

There is a section which considers standards and it is noted that future funding will be provided to at least continue to deliver the Decent Homes standard for all social stock. Furthermore funding for items that were missing from the original standard such as lifts and common areas will be provided. The impact of climate change is also noted and improving energy performance in the sector is discussed.

There is a section about service charges and the use of sinking funds.

6. Options for fundamental reform of the system

<u>Improvements to the current system</u>

The paper looks first at improving the current arrangements. One of the options noted would be to move to longer determination periods, of between three to five years, during which time assumptions made about costs and income would not change. Some triggers could be built into the determination so that if a variable, for example inflation, moved outside a range, it would trigger a revised determination. This could be combined with measures to address debt in order to reduce the need for redistribution over a longer period. Housing debt could be allocated between local authorities to leave them with debt in proportion to the value of their stock.

As a result these councils would instead have debt that they could manage themselves rather than indefinitely paying the interest on debt held elsewhere under the current system. An alternative to reallocating debt between councils would be to take debt into central Government and instead to charge each council for the cost of servicing an amount equal to the sum they would have been allocated.

A self-financing option

The second option looked at is self financing under which each local authority would keep the money raised locally from rents and use it to run their stock.

The paper notes that self-financing would require a one-off reallocation of housing debt in order to put all councils in a position where they could support their stock from their rental income in future. Without this reallocation of debt, the paper claims, some councils would either have to cut services or increase rents. But with this settlement on debt, the review found that rents set in line with current social rent policy would generate sufficient income to sustain the stock in all local authorities at the higher funding levels identified as necessary.

Housing debt would be allocated to councils on the basis of each council's ability to service it, using the same updated figures for costs of management, maintenance, major repairs and income that would be used to calculate subsidy if the current arrangements were to remain. Under this option:

- each council would produce a 30 year business plan.
- the value of the stock would be calculated from the present value of the cash flows in the business plan
- each council's housing debt would be adjusted to reflect the value of its stock, entailing either a capital payment to or from Government

The paper states that the principle of debt allocation is that it should achieve neutrality with the subsidy position, to the extent that this can be achieved in commuting an income stream into a capital sum.

It envisages that the debt settlement would take the following form:

- the value of the landlord business would be based on the present value of the cash flows in the business – excluding any existing housing debt
- if this value was lower than the current notional debt supported by subsidy (the subsidy capital financing requirement), a payment would be made by Government to the council sufficient to reduce the notional debt to the level of the valuation.
- if the value of the stock was higher than the current notional debt level, new debt would be imposed on the council to bring it up to the level of the valuation.

A number of associated costs are identified and the paper notes that it is the Government's intention to identify any additional costs which would fall on either the HRA or the general fund as a result of the debt reallocation and to provide a settlement that funds these. The paper states that there are detailed accounting and treasury management issues to be worked through if we implement self-financing.

Borrowing under self-financing

The paper notes additional borrowing under the current system could only be achieved by sustained improvements in operating surplus over the assumed surplus in the HRA. Ending the current subsidy system and moving to a self-financing model without constraints could therefore enable a significant increase in prudential borrowing. It goes on to say that if this borrowing were not controlled, it would be of serious concern to Government, so, in moving to a self-financing model for council housing, it will be necessary to retain some controls. The principle underpinning any controls is that surpluses generated under self financing would be retained locally to spend on local housing services. The issue is around how these surpluses might be used, and in particular whether there would need to be restrictions on any new borrowing financed from these surpluses.

The Government sees a system continuing in which a strict ring fence around the HRA would provide a framework that enabled control over the scale of borrowing. The department would therefore need to ration or limit in some way any additional borrowing over what was implied by the notional initial business plan and would have to adjust its expenditure on other housing programmes to accommodate this. The Government is considering how to ensure that the overall fiscal position for itself is not undermined under self financing.

Managing risk under self financing

The paper notes how self-financing would give councils the ability to manage their business better and how this would be accompanied by extra risk. It notes how central Government would have an ongoing interest in ensuring that it was managed well and that tenants' interests were protected and highlights that any local failure could have a cost nationally, as it would be difficult to leave tenants exposed to the consequences of a major problem arising within a council landlord. It identifies The Tenant Services Authority, working in support of the local government performance framework, as the organisation providing the framework for managing these risks.

The need to build capacity in some councils to take on the responsibility and accountability of self-financing is also mentioned

Capital receipts

The paper states that the Government think there are strong arguments for allowing councils to retain all of their capital receipts and so end the current arrangements for pooling housing receipts, on the basis that it is sensible that councils should keep the capital receipts arising on disposal of those operating assets that they would now support the debt on.

The Government's preference under self financing is to allow local authorities to keep 100 percent of their Right to Buy receipts, keeping the local discretion over how the 25 per cent currently retained is split between the general fund and the HRA assets, but requiring the additional 75 per cent to be reinvested in housing.

It is noted that this would have the overall impact of reducing the resources available for centrally funded housing programmes.

Implications of self-financing for transfer and ALMO policy

The paper notes that self-financing would create a level playing field between transfer and retention in terms of public funding support. The valuation of a transfer proposal should follow the same principles that apply in valuing the stock and setting standards in a self-financing settlement.

The HCA will continue to consider existing transfer proposals to ensure that they are good value for Government and the local authority, and have the support of tenants. We would expect all transfer proposals to proceed to completion where tenants have already voted in favour of a change in landlord. For further cases, we will only fund transfers at standards materially the same as those proposed for self-financing.

Implications for ALMOs and LHCs

The paper notes that it sees a strong future for ALMOs and that self-financing would provide for financial flexibility and the resources to plan ahead and prosper. It also states that self-financing will provide another option for councils who want to put their land and income into schemes to deliver new housing.

7. Timetable for change

Depending on the outcome of this consultation, the Government would wish to move swiftly to have a self financing option up and running and some changes have already been made to the revenue and capital rules for new build using powers in the Housing and Regeneration Act 2008 and through secondary legislation. The powers in the 2008 Act allow for individually negotiated agreements between local authorities and central Government to exclude specified stock from the HRA subsidy system. This could, in principle, be used to bring about voluntary self financing. To achieve this would need:

- an agreement about the costs of running the stock at the local level
- an understanding about the operational practicalities of the HRA ring fence in the context of self-financing; and
- any significant transaction costs from taking on or writing off debt to be reflected in the proposed debt settlement

Government feels it would be possible to set out the terms of such an offer by spring 2010, subject to satisfactory working with local authorities. They do not however think it would be practical to conduct negotiations with over 200 local authorities and the claim that this could only work if all stock owning authorities accepted the terms. If this could not be brought about, then primary legislation would need to be secured to achieve a national settlement and they feel that subject to Parliamentary time, a self financing system could be legislated for and be in operation from 2012-13.

The ability to deliver early departures using current powers would depend on the willingness of councils to accept some clear principles up front and to work positively with Government towards an agreement based on these principles. Whatever deal was agreed in voluntary agreements would have to be sustainable for all

8. Consultation questions

<u>Core and non-core services</u>

1. We propose that the HRA ring fence should continue and, if anything, be strengthened. Do you agree with the principles for the operation of the ring fence set out in paragraph 3.28?
2. Are there any particular ambiguities or detailed concerns about the consequences?

<u>Standards and funding</u>

3. We propose funding the ongoing maintenance of lifts and common parts in addition to the Decent Homes Standard. Are there any particular issues about committing this additional funding for lifts and common parts, in particular around funding any backlog through capital grant and the ongoing maintenance through the HRA system (as reformed)?
4. Is this the right direction of travel on standards and do you think the funding mechanisms will work or can you recommend other mechanisms that would be neutral to Government expenditure?

<u>Leaseholders</u>

5. We propose allowing local authorities to set up sinking funds for works to leaseholders'stock and amending HRA rules to permit this. Will there be any barriers to local authorities taking this up voluntarily, or would we need to place an obligation on local authority landlords?

<u>Debt</u>

6. We propose calculating opening debt in accordance with the principles set out in paragraphs 4.22- 4.25. What circumstances could lead to this level of debt not being supportable from the landlord business at the national level?
7. Are there particular circumstances that could affect this conclusion about the broad level of debt at the district level?
8. We identified premia for repayment and market debt as issues that would need to be potentially adjusted for in opening debt. How would these technical issues need to be reflected in the opening debt? Are there any others? Are there other ways that these issues could be addressed?
9. We propose that a mechanism similar to the Item 8 determination that allows interest for service borrowing to be paid from the HRA to the general fund should continue to be the mechanism for supporting interest payments. Are there any technical issues with this?

10. Do you agree the principles over debt levels associated with implementing the original business plan and their link to borrowing?
11. In addition to the spending associated with the original business plan, what uncommitted income might be generated and how might councils want to use this?
Capital receipts
12. We have set out our general approach to capital receipts. The intention is to enable asset management and replacement of stock lost through Right to Buy. Are there any risks in leaving this resource with landlords (rather than pooling some of it as at present)?
13. Should there be any particular policy about the balance of investment brought about by capital receipts between new supply and existing stock?
14. Are there concerns about central Government giving up receipts which it currently pools to allow their allocation to the areas of greatest need?
Equality impact assessment
15. Would any of our proposed changes have a disproportionate effect on particular groups of people in terms of their gender or gender identity, race, disability, age, sexual orientation, religion or (non-political) belief and human rights?
16. What would be the direction (positive or negative) and scale of these effects and what evidence is there to support this assessment?
17. What would be necessary to assemble the evidence required?

9. ARCH Comment

ARCH has consistently argued for a level playing field for stock retaining councils and the move to self-financing arrangements is cautiously welcomed.

Overall ARCH sees the proposals as a positive step in the development of a transparent and local-based finance system for housing management where the responsibility for management is retained by the local council who are best able to deliver a service for local people taking into account local circumstances. A radical attempt to address the failings of the system (some of which are highlighted in this paper) has been a long time coming and ARCH is happy to work alongside the department to see effective change.

ARCH looks forward to the change in approach from the Government which these proposals appear to signal whereby councils are left to manage their housing assets and income in as they see fit with appropriate involvement from the TSA and other regulatory bodies. ARCH sees this as potentially a real step forward both for housing services and for the 'place-shaping' role of councils of which housing makes up such a significant element.

Clearly the detail of the formula which will allocate debt amongst councils must be appropriate and individual allocations are likely to be a disruptive factor for specific councils. An ideal solution for councils would have been the write–off of the debt but ARCH realises this is unlikely to take place under any administration.

Whilst welcoming the spirit of the consultation paper, ARCH does however wish to introduce an element of caution. Self-financing/self-determination indeed sounds a suitable way forward but the funding noted in the paper, such as £12.3bn of spending uplift, would have to survive the next Comprehensive Spending Review and the next Government's economic hardship.

There are issues around the self-financing arrangements that are not entirely straightforward and differ in important respects from what was anticipated. ARCH is concerned that what is proposed is not a redistribution of existing debt but rather the calculation of buy-out debt based on the commuted value of future cash flows. This could have a further impact at individual authority level where spend above subsidy allowances financed locally risks being excluded from settlement business plans and commuted into new debt.

Under the proposals, only spend that is allowed into settlement business plans will be available to resource future HRA spend. All income, including locally retained rents will be commuted into the debt allocated, so never really add to resources (as it would if only existing debt had been redistributed). There are clear signals about moving 'non-core' service costs out of the HRA in the paper. Depending on the approach taken to settlement business plans this might not extend for all categories of spend to allowing meeting the cost from existing miscellaneous income sources such as non-dwelling rents, tenant service charges, and existing reserves. ARCH also feels that the TMV actuals approach is inappropriate and a calculation based on uplifted notional subsidy allowances and guideline rents would be a better method to use. Under the TMV approach existing use of freedoms and flexibilities discretion may be swept away in a new rebasing of the system based solely on standard costs.

ARCH is further concerned that interest rate risk on the £18bn debt will pass to councils. AS such they need access to fixed rate long term loans made available from the Public Works Loans Board in order to neutralise this very material risk.

Finally, in welcoming the independence of self-financing, ARCH notes the statement that says "there would also need to be a mechanism to re-open the debt settlement, following consultation, in the event of major changes on either long terms rent policy or the standards that applied to social housing". The review of housing finance should be considered by all as a one-off exercise. Providing Government with an opportunity to intervene under certain criteria runs against the grain of the paper. There are arrangements in place for the TSA and others to play an overseers role and Government should not be looking to build in methods of intervention.

ARCH appreciates the need to increase the overall level of housing supply and specifically the number of council housing units. The Association also supports the changes as long as they are able to allow for greater borrowing freedom for new build by local councils.

ARCH would encourage all members to provide their thoughts on the consultation paper so that the Association can provide a comprehensive response on behalf of all members. Ideally this would be in the form of a comment on each of the questions with additional text as appropriate.

10. Consultation Response

ARCH will be sending a joint response to this consultation document on behalf of its members and all comments should be sent by 1 October 2009 by e-mail to pbrennan@apse.org.uk

The consultation period will run from 21 July to 27 October, 2009.

Further questions can be directed to

councilhousingfinance@communities.gsi.gov.uk or 0207 944 3425

If individual councils wish to respond to the consultation document they can be submitted to

Review of Council Housing Finance
Communities and Local Government
Zone 1/J9
Eland House
Bressenden Place
London
SW1E 5DU

Or emailed to councilhousingfinance@communities.gsi.gov.uk

John Bibby (ARCH)
Phil Brennan (APSE)