The reform of Housing Revenue Account Subsidy

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Local authorities with housing stock are required to record all income and expenditure in relation to these dwellings in their Housing Revenue Account (HRA).

Until April 2004 local housing authorities whose income (e.g. tenants' rent payments) was projected to exceed their expenditure (e.g. on management and maintenance of the housing stock) on the Housing Element of their HRAs (i.e. their HRAs were projected to be in surplus) received reduced subsidy from the Government on the Rent Rebates (Housing Benefit) paid to their tenants. This system was criticised because it resulted in the rent payments of "better off" tenants not in receipt of Rent Rebates helping to meet the cost of financial help for poorer tenants via Housing Benefit: this process was labelled the "tenants' tax". More information on this system can be found in Library Research Papers 00/87, *Rent Rebates and Local Authority Housing Revenue Accounts,* and 02/71, *Local Government Bill: Housing Finance Clauses.*

In 1999 the then Government announced that it intended to introduce resource accounting into the HRA and that, as part of this process, Rent Rebates would be removed from the HRA. The *2003 Local Government Act* achieved this. It removed Rent Rebates from the HRA and provided for them to be met by Rent Rebate subsidy payable under the *Social Security Administration Act 1992.* However, the 2003 Act also made provision for housing authorities with an assumed surplus on their HRAs to pay these surpluses to central Government. These surpluses, together with a contribution from the Exchequer, are redistributed to those housing authorities whose assumed expenditure on their housing stock exceeds their assumed rental income. This system has proved highly controversial.

This note gives an overview of the HRA subsidy system and considers some of the ongoing issues associated with it. On 30 June 2009 the Labour Housing Minister, John Healey, announced that Government's intention to "dismantle" the current system; a consultation paper on the proposals was published on 21 July 2009 - the consultation period closed on 27 October. On 25 March 2010 the Minister published detailed proposals for reforming council housing finance. The views of councils on implementing this new system were sought up to 6 July 2010. On 8 June 2010 the new Housing Minister, Grant Shapps, confirmed that responses received would be analysed and announcement would be made on "whether the current proposal will be taken forward in part or in full, or whether an alternative model will be considered". On 5 October he announced that the existing system would be replaced; measures to achieve this have been included in the *Localism Bill,* which is currently before Parliament. Local authorities are now actively preparing for the end of the HRA subsidy regime.

Contents

A. Housing Revenue Account subsidy: an overview

Local authorities with housing stock are required to record all income and expenditure in relation to these dwellings in their Housing Revenue Account (HRA).[1] Councils that transfer their entire housing stock[2] are not required to maintain an HRA.

The Housing Revenue Account Subsidy system is governed by the *1989 Local Government and Housing Act* (as amended by the *2003 Local Government Act*). The HRA is often referred to as a 'landlord account'. The HRA is a "ring-fenced" account within the General Fund; this ensures that rent levels cannot be subsidised by increases in Council Tax and that rents cannot be increased in order to keep Council Tax levels down. The main items of HRA income and expenditure are:

Income

- Rents and service charges paid by council tenants;
- HRA subsidy – if eligible;
- The Major Repairs Allowance (MRA);
- Any special subsidies (such as the Arm's Length Management allowance in England);
- Other income such as rents from council-owned shops on estates; and
- Interest received on council mortgages.

Expenditure

- Loan service charges;
- Management costs;
- Spending on repairs and maintenance;
- Bought in services;
- Other outgoings, such as revenue contributions to capital outlay;
- Provision for bad debts;
- Any 'negative subsidy' payment to the Exchequer; and
- A contingency sum to cover any unforeseen expenses or shortfalls in income.

The HRA subsidy system is the system through which the Government determines the amounts local authorities need to spend on their council housing and whether subsidy is required to support this expenditure. HRA subsidy is the sum paid by Government to local housing authorities to make up any shortfall between income and expenditure on their HRAs. HRA subsidy may be a negative amount.

B. The notional HRA subsidy calculation

Assessments of authorities' deficits or surpluses are *notional* – this means that they are based upon <u>assumptions</u> made by the Government. In order to calculate how much subsidy an authority needs to run its housing stock, or how large a surplus it should transfer to the

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1 The requirement to keep a HRA dates back to the *1935 Housing Act*
2 Transfers usually take place to a housing association (also referred to as Registered Social Landlords)

Department of Communities and Local Government (CLG), the Government makes assumptions about authorities' costs and revenues. The reasoning behind this approach is:

> If subsidy were paid on the basis of the actual costs and revenues, authorities would have no incentive to control costs or set rents prudently as the extra costs or lost revenue would merely be met by increased Government subsidy.[3]

The subsidy calculation is based on the following assumptions:

- The rents charged.
- The proportion of vacant properties.
- Management and maintenance (M&M) costs.[4]
- The cost of servicing any housing-related debt.
- The cost of repairs needed to maintain the condition of the housing stock, i.e. the Major Repairs Allowance (MRA).

Where assumed costs exceed assumed income, the authority is deemed to be 'in deficit' and will receive a Housing Element subsidy equal to the assumed shortfall. Where assumed revenues exceed assumed costs the authority is deemed to be 'in surplus'. Housing Element surpluses are transferred to CLG where they are pooled and paid to deficit authorities:

> This keeps resources within the housing budget where previously they would have been lost to the individual authorities' general funds.[5]

The purpose of the pooling mechanism was also described in the Explanatory Notes to the *Local Government Bill 2002/03:*

> To ensure that authorities which are able to generate surplus rental income, even though incurring management and maintenance etc expenditure comparable with other authorities, make a contribution towards meeting the costs incurred by authorities which cannot generate sufficient rent income to meet such costs.[6]

A draft HRA determination prepared by the CLG announces the proposed national figures for guideline rents and the various allowances, together with the subsidy calculations for each authority, at the end of each calendar year. Authorities can submit comments to the CLG on the draft determination and this can result in changes to the final determination. The final 2011/12 HRA determination, together with commentary can be found online at:

http://www.communities.gov.uk/publications/housing/hrasubsidydeterminations1112

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3 Letter from Meg Munn, then Parliamentary Under Secretary of State at CLG to all Members of Parliament, March 2007, MGP 07/758

4 The Government takes a view on how much M&M costs should rise by, having regard to the scope for improved efficiency and what can be afforded. Having determined the size of the national pot, formulae share out the available resources in a way that takes account of relative need and regional cost variations. The formulae are reviewed periodically.

5 Letter from Meg Munn, then Parliamentary Under Secretary of State at DCLG to all Members of Parliament, March 2007, MGP 07/758

6 Bill 9-EN, paragraph 230

In *Financing Council Housing* (June 2005) the Audit Commission noted that 82% of housing authorities, managing 63% of council housing stock, were not in receipt of subsidy and had to make contributions to the national system out of their rental income. The Commission also pointed out that the asset base for these transfers was continuing to diminish through stock transfers and sales and that, ultimately, this contribution would need to be met through other means.

C. Ongoing issues

On 13 July 2009 the then Minister, John Healey, set out what he thought were the main disadvantages of the current subsidy system when giving evidence to the CLG select committee:

> John Healey: I think they are as follows. The operation of any national formula tends to take away a degree of proper local control. I think it takes away a strong degree of local accountability, and so I think that is its first weakness. Secondly, it is a national formula and a system that operates annually, so it undermines the proper ability of local authorities to plan for the long term, to manage for themselves over the long term the standard of the housing stock and improvements. Third, which is in the nature of national formulae as to the way they apply at local level, I think it lacks openness; it is difficult to understand; and I think it is a combination of those three factors which argues the case for me most strongly, that this is a system that we should now set out to dismantle, although there are clearly some strengths in the system that we need to make sure are there in the system we put in its place.[7]

1. Pooling surpluses

The pooling of HRA surpluses has proved to be highly controversial. The implications of pooling were raised by a number of witnesses who submitted evidence to the Transport, Local Government and the Regions Select Committee[8] during its scrutiny of the *draft Local Government Bill* in 2002. For example, Wolverhampton Council told the Committee that it paid around £10 million "surplus" on its HRA into its General Fund and was concerned that it would have to make similar payments to the Secretary of State under the new pooling provisions.

The Chartered Institute of Public Finance and Accountancy's (CIPFA) written evidence to the Committee noted:

> The proposal to redistribute excess rental income between local authorities raises questions of equity…Arguably, equity would dictate that rents should be reduced to match expenditure and that redistribution and equity should be achieved centrally through housing revenue account subsidy. The assumption behind these proposals seems to be that housing is a national service and that money from one area can be readily moved around the country.[9]

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7 Uncorrected transcript of oral evidence taken before the Communities and Local Government Select Committee, 13 July 2009, Q5

8 The Department of Transport, Local Government and the Regions was responsible for housing matters at the time.

9 HC 981-I of Session 2002-02, paragraph 46

The issue of equity was also highlighted up by the Audit Commission in *Financing Council Housing:*

> **Establish an equitable relationship in each locality between charges, service standards and investment in council housing and neighbourhoods.**
> Tenants are unlikely to see a clear relationship between the rents they are charged and the services they receive. For example, council tenants in the eastern region on average are currently paying £14 per week through their rents to support housing costs elsewhere, while those in London are receiving a £15 per week subsidy from tenants in other parts of the country.[10]

The Select Committee concluded that the Government should reconsider its proposals on the pooling of HRA surpluses. A common charge of "in surplus" authorities is that their tenants' rent payments are subsidising the management and maintenance of other authorities' stock. The then Government rejected this argument in its response to the Select Committee's recommendations:

> It is the case that under Clause 97,[11] councils that are able to generate a surplus on their HRA after meeting reasonable management and maintenance costs will be required to pay that surplus into the Exchequer. Those surpluses, together with additional funding from the Exchequer, will provide the resources necessary to make good the deficits faced by other authorities. However, these are just accounting devices to ensure that the available resources to manage and maintain council housing are shared out fairly between authorities, on the basis that the same rules should apply to all. It is incorrect to suggest that in any practical sense tenants in surplus authorities are subsidising those in deficit authorities. The practical reality is that the vast majority of council tenants, including those in surplus authorities, are being substantially subsidised – rents remain well below market rates. This is not evident in the HRA subsidy system, as the accounting system used does not require any return on the capital employed.[12]

The then Government's analysis of consultation responses to the *draft Local Government Bill* noted that not all authorities were opposed to the introduction of pooling:

> A total of 18 authorities commented on clause 97, pooling of HRA negative amounts of subsidy. There was some opposition with one or two references to the "Daylight Robbery Campaign"[13] and suggestions that negative amounts should be abated to zero. On the other hand the London borough of Tower Hamlets and Leeds City Council were in favour of pooling, and the London Government Information Unit welcomed the end of transfers of negative subsidy to the general fund.[14]

At that time calls to reform the HRA subsidy system to allow 'in surplus' authorities to keep more of their rental income were rejected:

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[10] June 2005, p3

[11] This is a reference to the clause in the *Local Government Bill 2002-03* which contained provisions to introduce the pooling mechanism.

[12] Cm 5638, November 2002, paragraph (ff)

[13] This campaign was launched by tenants in objection to the "tenants' tax", i.e. the use of HRA surpluses to pay for tenants' rent rebates as part of the pre-April 2004 system.

[14] Office of the Deputy Prime Minister (The ODPM took over responsibility for housing matters from the DTLR in 2002) *Draft Local Government Bill – Analysis of Consultation Responses,* November 2002

Mr. Drew: To ask the Secretary of State for Communities and Local Government what plans she has to reform housing revenue accounts to allow local authorities to keep more of their rental income.

Yvette Cooper: Housing Revenue Account (HRA) subsidy is based on a notional measure of authorities' income (which is mainly rents) and expenditure. If need to spend is assumed to be greater than assumed income, then the authority is assumed to have a deficit and HRA subsidy is paid to the authority to make up that shortfall. If the assumed income is greater than the assumed need to spend, this negative subsidy is captured, recycled within the HRA subsidy system and used to help pay for the subsidy entitlement of the deficit authorities. Even with this recycling, in the most recent year for which audited data are available (2005-06), the Exchequer still made an annual contribution of over £200 million.

Surpluses (and deficits) are not related to the efficiency of a council in operating its HRA. Surpluses rarely, if ever, occur where the need to spend is greatest; if those authorities that make surpluses retained them this would, within the total funding levels agreed, mean reduced subsidies and therefore higher rents, for all those authorities with a deficit. The alternative would be higher taxes or cuts in services. The surpluses that are being generated by some authorities also come from housing that has largely been funded by central Government.

My Department is currently working with a group of local authorities to investigate the potential benefits, in terms of asset management, efficiency and better outcomes, of allowing some councils to leave the subsidy system. Self financing would involve a one-off settlement to replace future subsidy or surplus payments. As such, it would not be a means for surplus authorities to have a larger share of overall housing resources.[15]

2. Rent increases and HRA subsidy

One way in which local authorities could make up a shortfall in subsidy would be to increase their rents; however, if an authority chooses to charge more than the 'limit rent'[16] it must justify this to tenants and must also meet the extra costs of Rent Rebates that will arise (i.e. the Government will not meet the additional cost of Housing Benefit arising an authority's decision to increase rents above the limit rent – this is known as the Rent Rebate Subsidy Limitation).[17]

Therefore, if an authority *does* increase rents above the limit rent it will not benefit from the full increase in rental income. Because authorities are restricted in the rents they can charge, a shortfall in HRA subsidy can mean that they are forced to reduce the services they provide to tenants. In 2005 the Audit Commission noted: "while housing rents are rising in real terms in all areas, in most areas this will not result in extra spending on services."[18]

15 HC Deb 26 March 2007 c1329W
16 The Government only reimburses local authorities for the cost of rent rebates (Housing Benefit) up to a limit rent which is set centrally.
17 Derogations from the impact of this limitation can be granted in certain circumstances.
18 *Financing Council Housing,* June 2005 p.4

3. Effective management of assets

As noted in section **B**, the current subsidy system treats the HRA as a national account – the system is criticised on the basis that it inhibits effective local management of assets:

> The system as it stands is ineffective and inefficient. It is complex with a series of grants for refurbishment and major maintenance work which councils have to apply for and administer. The resource allocation within the system can change at very short notice, making it difficult for councils to plan effectively and the system does not reward positive management practice or allow innovative approaches to stock investment. The allocation formula creates perverse incentives, for example, if a council pays off its housing debt, reduces the level of crime on its housing estates or reduces the vandalism of its stock, it is liable to lose subsidy.[19]

It is accepted that the system militates against local responsibility and accountability for services provided.

4. Heading for overall surplus

When the current subsidy system started, no local authority was "in surplus", i.e. obliged to pay money to the Exchequer. In 2004-05 182 councils paid a total of £615.3 million into the HRA subsidy system. This left 52 councils in receipt of subsidy payments of £694.2 million. Only five councils accounted for 40 per cent of the money taken out of the system; Southwark and Islington received around £130 million between them. The figures indicated that the subsidy regime was heading for surplus: in 2001-02 the Government contributed £351 million; this figure fell to £252 million in 2002-3 and £191 million in 2003-4. There was "mounting speculation" in the housing industry that in 2008-9 the system would finally "tip over into surplus", i.e. the Treasury would pay out less in HRA subsidy than it received from those authorities contributing to the pooling regime. Then Minister, Iain Wright, confirmed that the overall HRA did, in fact, move into surplus in 2008-09:

> In recent years the system of council housing subsidy has been in deficit throughout the country, with the Treasury making up the shortfall. It is only from 2008-09 that the position has reversed with the overall system moving into surplus. In this financial year the Treasury plans to allocate around £5.9 billion in total for housing expenditure, considerably more than the resources flowing back to Treasury.[20]

In 2007 John Perry, policy advisor at the Chartered Institute of Housing, reportedly said that the then impending surplus on the HRA "underlines the fact that the HRA system is no longer fit for purpose and should be abolished."[21]

Public Finance Magazine carried an article on 18 January 2008 in which it claimed that figures based on projections by six councils taking part in a Government pilot to assess the implications of leaving the HRA (see **D.1** below) indicated that in 2008-9 the national HRA "will be running at a surplus of £194 million." The article claimed that "within in ten years, the

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[19] Local Government Association (LGA), *Local Housing – Local Solutions – the case for self-determination,* June 2009

[20] HC Deb 15 January 2009 c940W

[21] "Tenants face new rents tax", *Inside Housing,* 16 November 2007

annual surplus is forecast to exceed £500m, with the trend set to continue well beyond 2020."[22]

The overall HRA continued to be in surplus in 2009-10. In the last financial year the Treasury paid out £113.2 million less in HRA subsidy than it received from those authorities contributing to the scheme. 142 councils paid a total of £687.3 million into the HRA subsidy system while 44 councils received subsidy payments of £574.1 million.[23]

D. Reforming the HRA – the Labour administration

1. Opting out of the HRA: the modelling exercise

As noted in section **C.1** of this note, CLG has been working with a group of local authorities to investigate the implications of allowing some councils to leave the HRA subsidy system.

In summer 2006 CLG approached Cambridge, Sheffield, Carrick, Warwick, Hounslow and Darlington councils (3 of which have set up Arm's Length Management Organisations[24] and 3 of which have retained their housing stock). They were invited to participate in a study to see if there would be any advantage to the operation of the housing service if they were to opt out of the current HRA subsidy system. All six agreed to participate and Housing Quality Network, a private consultancy, was appointed to undertake some business plan modelling on their behalf.

The six authorities produced model 30 year business plans based on a one-off settlement with central Government which would allow them to leave the national system. The premise was that, once out of the system, councils would keep all their rental income. Councils which were expected to make operating surpluses under the current system would not pay these into the national pot and councils which were expected to have a revenue shortfall would not receive any subsidies. The exercise examined whether the settlement price for leaving the system could meet two objectives: a) putting the councils in a position to finance their investment programme and service their debt over the 30 years of the business plan; and b) achieve this with resources set at a level which broadly matches the resources which would have been provided had the council remained within the HRA subsidy system. CLG published the outcomes of the modelling exercise in March 2008, *Self financing of council housing services: summary of findings of a modelling exercise.* The conclusions arising from the exercise are reproduced in full below:

> The modelling work has shown that self-financing could bring improvements in efficiency, long term planning and asset management. It could attract private investment and provide opportunities for local authorities to add new homes to the housing stock.
>
> The work has also demonstrated that, for one modelling authority in particular, and for a class of authorities in general, the level of starting debt would be too high under the base assumptions for the business plan to be viable. One reason for this is the way

22 "Treasury set to cream off surplus in housing revenue", 18 January 2008

23 Source: Deposited Paper 2010-2319

24 A number of councils have retained ownership of their housing stock but have set up Arm's Length Management Companies to manage the stock on their behalf.

that future supported capital expenditure is accounted for, and proposals for tackling this have been made. Another reason, also emerging from the modelling work and applying to authorities generally, is that the NPV [*net present value*] settlement is based on anticipated levels of future subsidy that are not sufficient to maintain a sustainable level of housing services within the HRA subsidy system.

So, at first sight, the modelling work appears to run into problems in that for many authorities the self-financing business plan would not be viable. However, the underlying cause relates to future funding problems that have their roots in the current levels of subsidy and the assumptions made about the system in the future. It is not a self-financing problem; rather it is a general problem which the self-financing exercise has highlighted.

The HRA subsidy system has, apart from internal redistribution, usually been a net consumer of Government funds. Calculations now suggest that it is reaching a turning point. Our forecasts show that if current assumptions about rents and allowances are maintained, the HRA will generate a surplus and that this will increase in size over the coming years.

In December the Housing Minister announced a wide ranging review of the HRA subsidy system, to be led jointly by officials in Communities and Local Government and HM Treasury. This will include various related issues, such as the future of rent policy, to which the outcomes of self-financing models are highly sensitive. The ministerial statement announcing this review in Parliament confirmed that it would build on the work of the self-financing project and would consider how self-financing might be implemented. The findings of the self-financing project will provide key evidence for the review.

The modelling work undertaken for this project has been designed to allow different factors and inputs to be substituted easily. The impact of changes or proposed changes to the housing finance system which emerge during the review can therefore be readily tested. The members of the self-financing project will welcome the opportunity to support the review and to use their work to help it set out a sustainable, long term system for financing council housing. The evidence from the current project is that self-financing could play a significant part in achieving this.[25]

The *2008 Housing and Regeneration Act* introduced measures to enable the pilot authorities to extend their HRA work. The Impact Assessment on the Bill stated that the Government's intention was: "to take powers to allow us to run live pilots with a number of councils before deciding whether to offer others this option."[26] Thus the Act enabled the Secretary of State in England and Welsh Ministers to enter into an agreement to dis-apply sections 79 to 80A of the 1989 Act. This has the effect that no HRA subsidy is payable in respect of properties covered by such an agreement.

The future of the HRA was raised several times by Members during the Second Reading debate on the Bill; for example, Mike Hancock spoke about the contribution to the national

[25] CLG, *Self financing of council housing services: summary of findings of a modelling exercise,* March 2008, p57

[26] CLG, *Housing and Regeneration Bill – Impact Assessment*, November 2007

"pot" made by Portsmouth City Council[27] while Paul Holmes, for the Liberal Democrats, cast doubt on the approach adopted in one of the pilot authorities:

> Reference has been made to the housing revenue pilots. Cambridge was one of the authorities that carried out a paper exercise and has done the number-crunching. As I have told the Minister in previous meetings, the current proposal is a complete non-starter. The money that authorities would have to borrow from the private market to pay off the Government – a debt the Government would write off if a housing association were taking over – would eat up all the money from the right to buy and rents that they were allowed to keep. They would not be a penny better off; they would be no more able to repair houses or build the new ones that local populations are desperately crying out for.[28]

2. Reviewing the HRA subsidy system

As noted in the conclusions of the self financing modelling exercise, on 12 December 2007 Yvette Cooper, then Minister for Housing, announced a full review of the HRA subsidy system to examine the case for a change to the current redistributive system:

> The purpose of the review is to ensure that we have a sustainable, long term system for financing council housing and that this system is consistent with wider housing policy, including the establishment of a regulator of social housing.
>
> This system should be fair to both tenants and taxpayers. It should be transparent, giving a clear and accurate picture of the balance of support from local and central government. It should enable delivery of agreed standards of service and accommodation. It should recognise that social rents should help tenants gain and retain work, whilst acknowledging the need for landlords to improve the quality and efficiency of services. And it should be affordable and not expose government to unacceptable fiscal risks.
>
> The review will build on the work of the pilots we have conducted with six local authorities which looked at the costs and benefits of councils operating outside the Housing Revenue Account subsidy system. It will consider evidence about the need to spend on management, maintenance and repairs. It will consider rent policy, including the relationship between council rents and rents set by other social housing providers. It will also consider how the self-financing model developed in the pilot exercise would fit with the aims of the review and, if it is consistent with these, how it could be implemented. And it will consider whether the rules which govern the operation of the HRA need to be changed in order to fit with a new system of financing.
>
> The review will make its final report in spring 2009, setting out a way forward for the subsidy system, rents policy across all social housing, and spending needs for council housing. It will be followed by a period of consultation. This will enable its findings to be considered in the next spending review. It will also be asked to provide earlier advice in 2008 to inform decisions about council rents and subsidy determinations in the remaining two years of the current spending period.

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[27] HC Deb 27 November 2007 c191
[28] HC Deb 27 November 2007 c172

> The report will also support our aim of a single regulator for social housing across all providers by developing a policy framework of rents and standards for the regulator of social housing. This output will also be delivered in 2008.
>
> The review team will establish its own detailed working methods. This will however include opportunities for practitioners and stakeholders to put forward their views.[29]

The review was jointly launched by the Treasury and CLG on 10 March 2008.[30]

At the Chartered Institute of Housing's 2008 Conference (Harrogate, June 2008) a seminar considered the review's progress. The following emerging themes were identified:

- The lack of transparency in relation to HRA subsidy has hindered debate.
- There is a tension between redistribution of funds versus localism. A new system will have to accommodate variable needs across all local authorities.
- It would be desirable for a new system to provide more scope for tenant involvement in levels of management and maintenance funding and service levels. Rent levels should be reconnected with service levels in order to offer tenants a real choice and the ability to hold their landlords to account.
- There is a general acceptance that management and maintenance allowances are under-funded. Although a substantial amount of investment in council housing has taken place through the decent homes programme there is a need to continue investment beyond 2010 to ensure that the benefits of this programme are not lost. 70% of the homes we will have in England by 2050 are already in existence – there is a need for sustainable spending levels to maintain them. This raises the issue of where the additional funds will come from; Government concerns over future funding form a key barrier to going forward.
- There is support for some sort of ring fence around HRA funds but there is no agreement over how tight this ring fence should be.
- The key to achieving self-financing will depend on getting the settlement for local authorities right and tackling the issue of under-funding.
- Some authorities are arguing for a complete overhaul of the council housing finance system to cover capital as well as revenue finance.
- There are a variety of possible options from tweaking the current system to a "big bang" approach – a transitional period may be inevitable.

On 24 June 2009 the then Government advised that a report of the review would not be published, instead "a public consultation" on the Government's proposals would be held later in the year.[31]

3. Consultation: "dismantling" the subsidy system

The then Housing Minister, John Healey, issued a Written Ministerial Statement on 30 June 2009 in which he announced an intention to publish a consultation document on the

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[29] HC Deb 12 December 2007 cc34-5WS

[30] CLG Press Release, *Yvette Cooper and Caroline Flint launch the review of Housing Revenue Account subsidy system*, 10 March 2008

[31] HC Deb 24 June 2009 c957W

reform of council housing finance before the summer recess. He said that there was an "intention to dismantle the HRA subsidy system and replace it with a devolved system of responsibility and funding." The statement set out the principles on which these changes would be based:

> Our consultation following this review will propose a devolved self-financing alternative to the current system. This would remove the need to redistribute revenue nationally, while continuing to ensure that all councils had sufficient resources. With these reforms, councils would finance their own businesses from their own rents, in exchange for a one-off redistribution of housing debt. By freeing councils from the annual funding decisions in the current system, this will enable councils to plan long-term and to improve the management of their homes, secure greater efficiencies and improve the quality of service to their tenants.
>
> This would provide councils with a financial framework in which they could plan and manage for the long-term in the same way we expect of other social housing providers. It would give councils a greater capacity and more freedom to respond to local needs and, in doing so, increase their responsibility and accountability to local tenants and residents.
>
> Change on this scale is complex and will require primary legislation. The consultation will set out how moving to a self-financing system will require an adjustment of debt levels for most authorities. At present around £17 billion of housing debt with annual servicing costs of around £l.1 billion is spread across the 202 councils in the system. The self-financing model would enable each council to manage directly and fund their own debt.
>
> In addition to revenue redistribution, councils are currently required to pay Government different proportions of the receipts from right to buy sales and sales of other HRA assets. There is a strong case for allowing councils to retain all of their capital receipts which could give councils the ability to develop a comprehensive strategy to maintain, improve and develop their housing. The consultation document will therefore set out proposals to end the pooling of all housing capital receipts.
>
> I want to see councils building and commissioning more of the new homes that people need in their area. We are therefore taking immediate steps to support this role for local authorities, based on the same principles I am setting out for our long-term reforms.
>
> For the first time, councils can now access the same capital subsidy through the social housing grant that is provided to housing associations for new affordable homes. Decisions on the first council schemes to be funded in this way will be confirmed in September.
>
> […]
>
> Tenants and council tax payers expect to see their services delivered with the very best value for money. I want to ensure that our reforms to the council housing finance system have strong incentives for improving efficiency, which will benefit councils and their tenants.
>
> We remain committed to completing our comprehensive decent homes programme and to maintaining this standard. The reforms I propose will safeguard this commitment. Capital funding will be provided to support this. We also intend to

complete improvements required to common areas of estates and will ensure that there is sufficient funding in the system to maintain them in the future.

Our aim in setting up the self-financing system is to ensure that it delivers the investment needed to sustain and maintain the existing stock of council homes.

In the future within this self-financing system, local authorities may also wish to borrow to fund investment. Government are currently considering whether and how any local flexibilities for new investment could be reconciled with the need to ensure that the overall fiscal position for Government is not undermined.

The benefits delivered by arm's length management organisations that manage council housing services should not be affected by a change in the system for financing council housing. We see a strong future role for ALMOs which are valued by their tenants. We would expect ALMOs to continue to develop their housing management capacity and to look for opportunities to extend the range of services they offer, including to other landlords, where this would improve efficiency and effectiveness.

Transferring to a housing association should also remain an option that council tenants can choose. There are potential benefits from bringing in a not-for-profit body with access to private finance to own and manage the homes. However, there should be equity in the terms of public funding whether they are transferred or retained in the future under self-financing. The value placed on the stock in a self-financing agreement and a transfer deal will be based on delivering the same standards of service at a comparable cost.

We will continue to work with councils whose tenants have voted for transfer and councils who are currently developing transfer proposals to bring these to completion. Future transfer proposals will not gain any financial support beyond what would be provided under self-financing.

A number of councils have been developing proposals to establish Local Housing Companies (LHCs) that combine public land and private finance to deliver new mixed tenure housing. Current market conditions create difficulties in taking the next steps, and the consultation document will confirm how we will assist the establishment of viable LHCs as quickly as possible. In future, self-financing will provide another option for councils who want to put their land and income into schemes to deliver new housing.

Responses to the review showed strong support for a more devolved approach to financing council housing.

A fully self-financing locally devolved system cannot be implemented in a single step but I want to move as rapidly as possible to put these reforms in place and the consultation document will set out my proposed timetable.

However, there are steps we can take without delay. So I am announcing that from today we will exclude all new build council housing from the HRA subsidy system which means that councils will retain in full the rent and capital receipts from these homes.

> I will work with all those with an interest in improving the system to make sure that these plans for reform are robust and deliverable.[32]

The consultation paper, *Reform of council housing finance,* was published on 21 July 2009; consultation closed on 27 October 2009.

a. Key proposals

The paper set out an option for a devolved self-financing system under which there would be no redistribution of revenues in return for a one-off allocation of debt to local authorities. This allocation would be based on each authority's ability to service the debt and maintain their housing stock. In turn, this would be calculated using the projected rental stream from the stock and an assessment of the costs of management and maintenance and major repairs. The ring-fencing of the HRA would remain. The benefits of the self-financing model are seen as:

- councils will have enough money from the rental income from their stock to be able to service debt over time and to pay for ongoing maintenance at the Decent Homes Standard as well as works needed to maintain lifts and common parts
- because of this certainty of funding councils will be able to plan ahead for works and procure them efficiently; and
- councils will be better able to plan longer term for the management of their assets and manage them on a portfolio basis because they will be able to keep more of the capital receipts from Right to Buy sales and to reinvest this in replacement stock. There should be tangible improvements in service delivery and tenant engagement.[33]

Under this model it was envisaged that councils would be able to retain 100% of their capital receipts from the sale of council houses with the requirement that the 75%, which is currently subject to similar pooling arrangements as those applied to HRA surpluses, would be reinvested in housing.

There was recognition that funding for management and maintenance of council housing stock needed to rise by at least 5% over its current level. The Building Research Establishment had carried out research indicating that Major Repairs Allowances needed to rise significantly to tackle newly arising need.[34] The report concluded that the ongoing post-decent homes backlog of works was £6 billion and the non-decency backlog was between £1.4 billion and £2.9 billion.

b. Reactions and issues

The Chartered Institute of Housing, which has campaigned for changes to the HRA since 2005, welcomed John Healey's announcement as "a major victory". Sarah Webb, the Institute's Chief Executive said:

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32 HC Deb 30 June 2009 7-10 WS

33 CLG, *Reform of council housing finance,* July 2009

34 *ibid*

> A new system that lets local authorities in England keep council house rents and proceeds from all sales could lead to councils building thousands of new homes rather than the 520 that were built last year. When councils become self-financing rather than relying on an opaque system of subsidies they will be able to make better and more locally-based decisions about the upkeep of existing homes and the building of new homes in their area.
>
> However, if councils are to manage their own housing stock to the best advantage of local people, they will need new skills in long-term business planning. We know that councils are ready to take on this challenge and as the professional body for people involved in housing and communities, we will do all we can to support them.[35]

Steve Hilditch, an independent consultant who chaired the HRA review sessions, is reported to have said: "For the first time in 30 years council housing has got a sustainable future, and what's needed is for people to grab that opportunity."[36] However, he warned that the plan would need bipartisan support to succeed and expressed concern that a General Election might get in the way of reform.[37]

The proposal to redistribute debt was not popular amongst certain debt free authorities - these authorities preferred debt cancellation. The then Minister acknowledged this in oral evidence to the CLG Select Committee:

> **Q11 Mr Turner:** One of the biggest difficulties you will have is in persuading those councils that are debt free to take on somebody else's debt, as they all see it. How do you propose to persuade them that it is a good deal for them?
>
> John Healey: As I said to Sir Paul, in practice those councils, for whatever reason they may be debt-free now, are essentially carrying part of the burden of servicing the notional debt that is in the system. If we were at one and the same time to write off or somehow the Treasury take - the central taxpayer were to pick up the cost of all the debt that is in the system, and then simply said to councils "there will be no balancing as we set you free", then you would have a situation where, whatever the historical circumstances and in some cases the historical accident that may be responsible for the current debt situation, you would have what I regard as an unfair situation where that council and their cost then of maintaining their stock without any borrowing or debt to service would be incomparably cheaper than in some other authorities that may have some debt to carry down. My concern is not so much for the councils and their financial situations; but my concern is for the tenants because, clearly, in the former case they would be able to get a standard of housing service and standard of home that was much better for much less than any comparable tenant in a council that carried that debt and had to service it entirely.[38]

It was also tackled in the consultation paper:

> It has been suggested that Government should pay off all the housing debt held by local authorities (currently in excess of some £18bn), leaving rents to support only the

[35] CIH, *Scrapping of council house finance system, welcome,* 1 July 2009
[36] *Inside Housing*, "Reviled council cash system bites the dust", 3 July 2009
[37] *ibid*
[38] Uncorrected transcript of oral evidence taken before the Communities and Local Government Select Committee, 13 July 2009, Q5

> day to day running costs of the stock. This debt was incurred in building and maintaining council housing. It is therefore right that it should continue to be serviced from council rents. It would be unaffordable and unfair to ask the general taxpayer to support this debt in future.[39]

Grant Shapps, then Shadow Housing Minister for the Conservatives, is reported to have said:

> [*he had*] grave concerns over the suggestion that responsible councils should be punished for being prudent, and will be burdened with other people's debt. He added: 'I fear that this is an excuse for partisan Labour ministers to transfer funds from efficient Conservative councils to badly run Labour councils.'[40]

John Perry, policy advisor to the CIH, set out the various options and issues facing the Government in an article for Public Finance Magazine on 16 July 2009:

> All those who fed in to the review were aware that the outcome must address the issue of council housing's £17bn historic debt, but there have been different views on how to do it. Both the Local Government Association and the lobby group Defend Council Housing argued that debt should be 'cancelled' – which would effectively mean the Treasury paying for it. This solution might have been workable if the Treasury could retain the income needed to pay for the debt.
>
> Yet these and the other major contributors to the review also argued that councils should keep all their rent income locally. This would create a double bind for the Treasury – it would have to service the debt from general taxation, while councils would simultaneously be free to finance more prudential borrowing, adding to total public sector debt. The prize, according to some of the councils that would benefit, is that as many as 139,000 extra homes could be built in a decade.
>
> The government correctly realised that councils having command over the income they get from rents was the more important of the competing demands. Nothing annoys councillors or tenants more than paying perhaps a third of this income to Whitehall in negative subsidy, which many councils do. To achieve this and still pay for the debt, the only solution is to redistribute the debt so that councils who get more income also take on a share of the £17bn.
>
> In one of the last submissions to the review, five housing advisers – including myself – gave a highly controversial verdict. We argued that debt redistribution is perfectly feasible and is a price worth paying for an end to the complex national system. We also called for a national debt 'settlement' based on a limited round of negotiations with councils. This would be similar to the way that regulators in other sectors hold periodic negotiations over costs and charges, but then make a final determination that is binding on all parties. The process would decide local shares of housing debt and prevent a few authorities from holding up a national settlement.
>
> This approach could pave the way for councils to become 'self-financing' and for the national subsidy system to be wound up. There was near unanimity among the lobbying organisations that self-financing is the desired outcome. Only the DCH

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[39] CLG, *Reform of council housing finance,* July 2009
[40] *Inside Housing*, "Reviled council cash system bites the dust", 3 July 2009

dissented, fearing the risks that 'opting out' might pose for tenants and the danger of further 'privatisation'.

As an apparent indication of the seriousness of Healey's intention to 'dismantle' the system, the minister has also said he wants to allow councils to keep all their capital receipts from right to buy sales. While the details of how this will work also await the consultation paper, he announced immediate changes for newly built council houses. From now on, councils will be able to depend on getting all the receipts should new houses have to be sold. They will also keep all the rental income from any new homes.

Of course, there are many difficult issues still to be resolved. For example, a policy is needed that keeps rents in both parts of the sector at affordable levels, but with a margin to raise extra finance to invest in the stock. Councils will be looking to ensure that the levels of finance being assumed in the new system, allowing for future rent increases, will be sufficient both to maintain the stock at the decent homes standard and to provide for much needed work to improve estates.

Finally, the government should recognise that having local control of income and expenditure is only part of a desirable solution. Unless councils can undertake reasonable levels of prudential borrowing, the government's ambition that they start building significant numbers of new homes will remain a pipe dream. As a minimum, they should be able to develop business plans based on using at least part of their surpluses for new building.

Ideally, council housing would be regarded as a trading activity outside the main measure of public sector debt, bringing councils in line with housing associations. This could finally end a false and totally unproductive distinction between the two main players in the social housing sector.[41]

c. Index to the review

In addition to the consultation document, CLG published a series of associated papers on HRA subsidy on 21 July 2009. These are all accessible on the CLG website:

Review of council housing finance: Summary of commissioned research

Review of council housing finance: Impact assessment

Review of the major repairs allowance

Tenants' attitudes towards council housing finance and rents policy: to inform the review of council housing finance

Review of council housing finance: Analysis of rents

Evaluation of management and maintenance costs in local authority housing: Report of findings

[41] "Bringing it home", 16 July 2009

Evaluation of management and maintenance costs in local authority housing: Summary report

Options for dealing with housing loan debt in the local authority sector

4. Labour Government announcement March 2010

On 25 March 2010 John Healey issued a statement on the future of council housing finance:

> The consultation on our broad proposals ended on 27 October 2009. We received 223 responses showing strong support for our proposed system of self-financing, which many in local government have been calling for over many years. Since then we have worked closely with local authorities, experts and representative bodies in a Government-led project group to develop soundly based and detailed proposals. I am grateful to all those who have contributed to this work.
>
> The detailed plans I am publishing today for local self-financing and management mean 4.2 million people living in council homes will have landlords with more money to maintain their homes and neighbourhoods. This reform will guarantee tenants whose homes have been upgraded through the Government's Decent Homes programme that their homes will be maintained at least to this standard for the future. I can confirm the detailed principles and terms on which our plan for this self-financing settlement is based. These include:
>
> All councils will have at least 10 per cent. more each year to spend on managing, maintaining and repairing their homes-the equivalent of over £500 million more per year nationally. This deals with the underfunding for maintenance which was identified in the review of Council Housing Finance last year.
>
> There will be a one-off distribution and allocation of debt between local authorities in order to put all councils in an equal position to support their stock from their future income without the need for annual subsidy. The total debt that is supported in the current system will be around £21.48 billion by April 2011. The value of the stock under self-financing using our lead option of a 7 per cent. discount rate is £25.13 billion. This means there will be a net receipt for Government of around £3.65 billion at the point of the self-financing settlement, making this settlement neutral between central and local government.
>
> All rents and receipts from sales of houses and land within the HRA will be retained in full by the local authority. By ending the national pooling of all capital receipts, we will support local authorities in creating full asset management strategies covering both capital and revenue. No local authority will have a proposed allocation of housing debt which is not sustainable for the long-term.
>
> Rental income assumed in the calculation of debt is based on current rental policy which is designed to keep rents affordable and limit annual increases to tenants.
>
> Funding capacity created for a new generation of council house building.
>
> Since the late 1980s, councils have effectively been unable to build new council houses for their communities. I have now made social housing grant available to local authorities and released funding for two rounds of local authority new build schemes. As a result, we have underway this year, with the first round funding, schemes to

build over 2,000 new council houses, the largest council house building programme for nearly two decades. In total over 87 councils, led by all political parties, will start more than 4,000 homes over this year and next.

Today's announcement and the self-financing reform means we can go much further. My plans set the self-financing settlement with a 7 per cent. discount rate at a level which will give councils, after they have met the spending needs to manage and maintain their existing homes, the capacity to fund 10,000 new council homes each year from 2014-15-a five-fold increase in the council house building programme in the current year; this would generate over 20,000 jobs and over 1,000 apprenticeships. Councils will be able to build new homes without increasing local authority borrowing once the self-financing settlement is in place.

I am looking to establish as part of this consultation whether local authorities have the will to use this funding capacity to build new homes to help meet local housing needs. The response of local government to this challenge in the consultation will help us determine whether our lead option of a 7 per cent. discount rate is appropriate for the final terms of the self-financing settlement.

The Government are totally committed to completing the Decent Homes programme and recognise that £3.2 billion of works are still needed to meet their Decent Homes commitment. Meeting this investment need will therefore be a central element of their decisions on investment priorities at the next spending review.

Self-financing will fundamentally change the relationship between central Government and local authority landlords. It both strengthens local accountability and creates a more strategic relationship between local authorities and central Government. Today's consultation makes proposals for improving the accounting and financial framework within which self-financing will operate. This will provide assurances that, there will be sufficient safeguards for tenants and local and national taxpayers, under a devolved financing system.

The settlement will provide councils with the resources they need for effective management of their housing without recourse to further borrowing. Because of this, we will set a cap on the borrowing each local authority can service from the HRA, based on the opening debt. The prospectus sets out details for the calculation of this cap. It is a fiscally prudent deal which protects the interests of tenants and taxpayers.
This is a once and for all settlement. Any major future policy changes would need also to take into account the financial consequences as an additional consideration and funding transaction. If this plan and the terms set out in the prospectus are broadly accepted by local authorities, this devolved system of financing and accountability could be in place by 2011-12 through a voluntary agreement between Government and councils. If not, legislation will be required, delaying implementation by at least a year.

I hope local authorities will seize this opportunity for radical reform of the HRA subsidy system which they have long criticized, and this opportunity to build new council homes for their local communities.

In order to assist councils in examining the potential of this self-financing deal for their housing services and tenants, CLG officials will be available to meet and explain the proposals during the consultation period.

> I urge all local authorities to examine carefully the plans I am publishing today, and to respond fully to our consultation. The consultation will run until 6 July.[42]

Full details of the proposals are contained in the CLG prospectus, *Council housing: a real future.*

The summary of consultation responses to the July 2009 review was also published on 25 March 2010 along with other information for local authorities on modelling business plans and an impact assessment on the proposals – these are all accessible online:

Reform of council housing finance: consultation - A summary of the housing sector response

Modelling business plans for council landlords: local authority financial model user guide

Modelling business plans for council landlords: Report on model inputs assumptions and outputs - final report

Council housing: A real future (Impact Assessment)

5. Early reactions

The summary of the housing sector response to the July 2009 review provided an overview of reactions to the self-financing proposals:

> 3.5 Although 64% agree with the proposals, only 10% of respondents do so without expressing significant reservations or caveats. Some 49% offer support for the proposals and accept the redistribution of debt on condition that the amount of debt to be allocated at the local level is acceptable.
>
> 3.6 About 5% expressed particularly strong disagreement with the redistribution of debt but accept that it may be unavoidable and, on balance, support the proposals, again subject to the level of debt.
>
> 3.7 Of the 15% who disagree with the proposals, some two thirds, about 9% of respondents, feel that their disagreement with the redistribution of debt prevents them from offering their support. The other third, about 6% of respondents, do not support the proposals for other reasons. This 6% has expressed disagreement with the principles of self-financing.
>
> 3.8 The reasons for indecision given by those in the 'too early' group tend to be based on the mechanics of the proposal that have yet to be determined, rather than on matters of fundamental principle.[43]

The Chartered Institute of Housing quickly issued a press notice expressing its support for the proposals; however, some notes of caution were sounded:

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[42] HC Deb 25 March 2010 c49-50WS

[43] CLG, *Reform of council housing finance: consultation - A summary of the housing sector response,* 2010

While CIH welcomes the long overdue commitment to new council house building, CIH cautions that if grant is not available to support the work, investment in new build will be limited significantly in the early years, given the restrictions on borrowing for local authorities that are still in place.

CIH also warns that the focus on new build must not be at the expense of investment in existing housing stock, completing the overdue Decent Homes programme and improving environmental efficiency.

Sarah Webb, CIH Chief Executive, said: "We are delighted at the Government's clear commitment to new council house building and are also very pleased that our work to help shape a new self-financing future for councils has been taken on board. We are calling on the Government to honour its commitments to existing tenants and communities and also ensure that sufficient capital finance is available to get the existing council housing stock and estates up to a standard where they are all attractive places to live. Key elements of today's announcements are subject to confirmation in the next Comprehensive Spending Review in the autumn."

CIH has also called for a review of borrowing for public housing as this could lead to more fundamental changes in enabling the full use of existing housing assets.

Steve Partridge, Director of Financial Policy at CIH concluded: "While we recognise that the Treasury wishes to control the level of councils' borrowing, especially given the current spending pressures, we continue to call for future investment in council housing to be treated differently from other Government borrowing, in line with European rules. This would give councils the same freedom as housing associations to borrow to invest in what is one of the country's greatest assets and an important legacy to the nation."[44]

Trowers and Hamlins carried out an initial analysis on the impact of the changes on local authorities. This analysis assumed councils' existing housing debt was £21.5 billion - the sum that would be used in subsidy calculations for April 2011. It added on £3.6 billion of central government debt which will transfer to local authorities to make the deal fiscally neutral for the Treasury.[45] Authorities that would take on additional debt included Barking and Dagenham, Birmingham, South Cambridgeshire and Waverley. There was certainly concern amongst some authorities over the level of debt that they may have to take on – *Inside Housing* reported:

The Local Government Association said its initial response to the complex proposals was that it is pleased the government has produced plans for reform, but careful analysis of the detail is required.

However some individual local authorities were less positive. The largest, Birmingham, said it was concerned by the proposals on debt.

John Lines, cabinet member for housing, said: 'Sadly, I'm not convinced by Mr Healey's deal because we will still be saddled with extra debt which is £3.65 billion nationally.

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44 http://www.cih.org/news/view.php?id=1199
45 analysis from Trowers & Hamlins

> 'This equates to £2,000 per property nationally if it was shared equally and frankly this just isn't good enough.
>
> 'I'm disappointed that the new proposed settlement involves a sharing of extra debt, which is something Birmingham could certainly do without in the recession.'
>
> Other bodies gave a mixed response.
>
> Gareth Swarbrick, chief executive of arm's-length management association Rochdale Boroughwide Housing, said: 'For us, the critical issue will not just be the amount of debt we will take on - but whether or not we will have the scope to borrow the amount we need for the critical investment our neighbourhoods require using the headroom in our business plan we will create from delivering efficiencies.'
>
> The Local Government information Unit welcomed the news, but was also concerned by the plans on debt.
>
> Chief executive Andy Sawford said: 'Reform of the subsidy system is a major step in the right direction, now the government should allow councils to take payment holidays from these massive loans which would enable them to pay off debt in 25 years.'[46]

The Chartered Institute published a briefing for authorities in December 2009 which was intended to assist them in developing the main criteria upon which they might base a decision to implement the new system, *Next steps in HRA reform: preparing for an offer*.

E. The Coalition's approach

1. Announcement 13 December 2010

Shortly after taking office the new Housing Minister, Grant Shapps, confirmed that the Coalition Government would continue with the consultation exercise started by the previous administration and, in October 2010, he confirmed that the current system would be scrapped and replaced.[47] On 13 December 2010 he set out, in a written statement, further details of the basis on which Government intends to implement reforms to council housing finance – this statement is reproduced in full below:

> We are satisfied that self financing is the right approach and represents a good deal for all authorities over the longer term. However, the success of self-financing depends on a fair valuation of their housing business that guarantees all councils receive a sustainable level of debt that they can afford. As such we will continue to finalise the precise details of the settlement over the next year to ensure they take account of any relevant changes in economic circumstances. The Government will then confirm that the settlement is fair and sustainable and should be implemented next year.
>
> We propose to adopt the basic method for calculating the debt reallocation consulted upon in March, based on a 30 year notional business plan of income and expenditure

[46] *Inside Housing,* "Councils voice fears over HRA debt plans", 26 March 2010
[47] CLG Press Release, 5 October 2010

for each landlord. A payment to or from each council will then be made to reflect the difference between the value of the business and the housing debt currently supported under the HRA. The income assumptions built into the valuation will be based on the existing social rent policy for councils that their rents should “converge” with standard housing association rents in 2015/16.

We will publish a policy document in the new year setting out how these proposed reforms are envisaged to work in practice, together with the underpinning model which will include updated indicative numbers per council. This much more detailed information will provide Parliament and local authorities with the opportunity to assess these proposals and their likely impact at the same time as they scrutinise the powers proposed to support them during passage of the Bill.

This policy document will set out the updated methodology in more detail and will incorporate the following parameters:

- a discount rate of 6.5 per cent for calculating the net present value of each council’s housing business;
- providing for realistic expenditure for management, maintenance and major repairs as identified in independent research published last year, increasing the costs used in the valuation by an average of 11.7%;
- £116 million of extra funding each year for councils to pay for disabled adaptations to their stock;
- funding for Treasury Management costs and to reflect planned demolitions;
- Government continuing to pay subsidy to local authorities for the PFI schemes currently funded through the HRA;
- 75% of net receipts from any Right-to-Buy sales continuing to be returned to the Exchequer. Estimates of the loss of income from RTB sales will be built into the valuation of each council’s housing business. Receipts from other disposals will continue to be held locally to spend on affordable housing or regeneration; and
- Council landlords being subject to a cap on overall housing borrowing for each local authority. This cap will be linked to the opening debt level under self-financing.

Using today’s figures, economic assumptions and these parameters, the net receipt to the Exchequer from these transactions is projected at approximately £6.5 billion. These will be updated in the model issued alongside the policy document and before the implementation of self-financing using the latest data and economic assumptions.

This projected receipt includes £1.2 billion attributable to the decision to continue funding PFI[48] separately. Local authorities with PFI schemes will share this extra amount but will continue to receive subsidy. This was the option preferred by all local authorities with PFI schemes.

This is a reform intended to endure for the long term. In order to ensure it continues to be viable the Government is committed to assessing over the long term the impact of policy changes that may affect landlord income and the case to make good any losses or address any gains. The Localism Bill contains a power for the Secretary of State to make a further adjustment to the debt allocated to local authorities if a future

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48 Private Finance Initiative schemes

policy change has a significant material effect on their costs or income. This is designed to protect both councils and the Exchequer.

Some councils may be considering taking forward housing transfer proposals with their tenants in advance of or post self financing. In order to agree a transfer in future, the financial terms of any proposals will need to be clearly comparable with what self-financing would provide. The Government will consider transfer proposals against the costs under self financing. This will include dealing with backlogs, the costs of future management, maintenance and major repairs and the costs of essential regeneration works due to be undertaken through the proposed transfer. There will be an expectation that councils must provide significant financial support for the transfer, and no assumptions of financial benefit should be made where some measure of Government support may be required. Proposals will be subject to a rigorous value for money assessment.[49]

2. The *Localism Bill* and responses to the December 2010 announcement

Part 6 of the *Localism Bill*, which is currently before Parliament, contains provisions to repeal the existing subsidy system and replace it with powers for the Secretary of State to introduce self-financing from April 2012.[50] Until the new system is implemented the existing HRA subsidy system will remain in place.

The summary of responses to the prospectus published by the Labour administration in March 2010, *Council housing: a real future*, was published in November 2010. There are some key differences in the parameters for reaching a settlement proposed by the previous Government and those announced by Grant Shapps on 13 December 2010; however, many of the responses to the prospectus are still relevant.

The principle of moving to a self-financing regime has overwhelming support from local authorities. 87% of local authorities that responded to the prospectus were in agreement with its proposals with varying degrees of conditionality around confirmation of the final figures and resolution of some local and technical issues. Of the 41 non-local authority responses submitted, 85% expressed "support in principle", while four were opposed and two did not give a clear indication of their views.

While the level of debt to be taken on by local authorities remains a key issue, the responses submitted on the prospectus indicate "a broader acceptance that a level of housing debt redistribution was an acceptable or necessary price to pay for the freedoms and benefits the reforms would bring." The summary of responses notes that "this view was shared by many of the respondents who faced the prospect of new or increased debt."[51]

Some of the key priorities for authorities include:

- getting the settlement calculations right - the level of debt allocated must be affordable;
- ensuring that the levels of finance assumed in the new system are sufficient to both maintain the stock at the decent homes standard and to fund work to improve estates,

[49] HC Deb 13 December 2010 WS
[50] See Library Research Paper 11/03
[51] CLG, summary of responses to the prospectus, *Council housing: a real future,* November 2010, p6

i.e. tackling the acknowledged under-funding of management and maintenance allowances and the Major Repairs Allowance;

- ensuring that rent levels remain affordable while giving authorities flexibility to raise extra finance to respond to future challenges;
- allowing all surplus revenue to be retained locally to develop services in response to local requirements;
- allowing authorities to undertake reasonable levels of prudential borrowing;
- the retention of capital receipts raised by authorities to be applied locally; and
- a transparent and simple system that allows tenants to see the connection between rent and service charge levels and the services provided.

Respondents to earlier consultation exercises on HRA reform made the point that, given the scale of the reform and its implications, the starting point should be a clear vision of where social housing should be in 10 years' time and the role of self-financing in achieving that vision. There is a view that there has been a disproportionate focus on the technicalities of self-financing.

The Minister's announcement on 13 December 2010 made it clear that the basic method for calculating debt reallocation would be as set out in the March 2010 prospectus. With that in mind, the sections below consider some of the more detailed responses to the main proposals in the prospectus (based on the published summary of responses) and highlight early reactions where the statement of 13 December indicates a departure from the contents of the prospectus.

a. Allocated and ongoing debt

The general acceptance of a move to self-financing requiring the reallocation of debt has been referred to above. However, "widespread concern" is reported over the proposal to cap debt at the opening level:

> It was commonly felt that this would reduce and in some cases remove the headroom needed within business plans to manage risks and would undermine the flexibility and opportunity that was seen as a major attraction to self financing.[52]

Respondents made the point that the Prudential Code and the track record of responsible borrowing by local authorities should be viewed as a sufficient safeguard against imprudent borrowing.[53] The CIH and others argued that capping debt at opening levels will artificially restrict "spend to save" type investment which has the capacity to provide better value for money in the longer term.

Responding to concerns around this issue at CIPFA's November 2010 Housing Finance Conference, the head of local authority housing finance at CLG, Peter Ruback, acknowledged that the cap was not a popular aspect of the settlement but said it "reflects the fairly tight fiscal position and the way housing borrowing is accounted for in the national

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52 *Ibid* p7
53 *ibid*

accounts."[54] Housing bodies have long made the case for a reclassification of borrowing to invest in council housing by local authorities:

> We also believe that implementation of the reforms as planned would represent the government missing another opportunity to review the rules for council housing borrowing, reclassifying it as outside of general government expenditure and recognising that such borrowing represents an investment which is repaid with future income generated by housing assets.[55]

Clause 158[56] of the *Localism Bill* gives the Secretary of State the power to issue determinations "from time to time" to set a maximum amount of housing debt that can be held by each local housing authority. There is significant concern around whether, or in what circumstances, the cap on borrowing might be adjusted, lifted or otherwise refined.

The announcement in the October 2010 Spending Review that Public Works Loan Board (PWLB) rates were to increase by 1% with immediate effect attracted comment from housing bodies concerned about the impact this might have on the self-financing proposals:

> The increase in PWLB rates will inevitably present plans with significant extra costs in the long term, especially with large amounts of debt being taken on by many local authorities, and limit the benefits that the move to a local system could otherwise bring.[57]

b. Financial regulatory and accounting framework

The prospectus included, amongst other things, a proposal that council landlords should maintain a council housing balance sheet setting out the assets and liabilities that support the HRA. Most respondents supported the regulatory and accounting framework set out in the prospectus but concerns were raised around the additional cost of maintaining a separate housing balance sheet, the effect on risk management, and the need for new treasury management functions. The Minister's 13 December statement included a commitment for the settlement to take account of funding for treasury management costs.

c. Rents

The prospectus proposed that under self-financing local authority landlords would still be required to follow national social rent policy.[58] This was also confirmed in the Minister's 13 December statement where he set out a target convergence date for housing association and council rents of 2015/16.

Respondents to the prospectus raised issues around the balance between central and local control and uncertainly around future rent policy. There were calls for long-term assurances about rent policy, which many view as central to the success or otherwise of the reforms, and concerns around the impact of any changes to Housing Benefit on rental income. There is certainly a tension between the Government's desire for the continuance of a national social rent policy and authorities' desire for more local control, possibly involving tenants in decision making over rent levels.

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[54] Reported in *Social Housing*, "Sales concern over HRA reform, November 2010

[55] CIH Response to the prospectus, *Council housing: a real future,* July 2010

[56] Note that clause numbers are likely to change as the Bill progresses through Parliament.

[57] *ibid*

[58] For additional information see Library Note SN/SP/1090

Subsequent to the publication of the prospectus the Coalition Government *has* announced significant reforms to Housing Benefit.[59] From 2013, household benefit payments will be capped on the basis of median earnings after tax for working households, which is estimated to be around £500 per week (£350 for a single person household). Where total benefits exceed this level Housing Benefit entitlement will be reduced. Other Housing Benefit measures that will affect council tenants include the uprating of non-dependent deductions from April 2011 and, from April 2013 Housing Benefit for working-age social tenants who occupy a larger property than their family size warrants will have their Housing Benefit entitlement limited to a standard regional rate for a property of the appropriate size. Social landlords are concerned about the potential impact that these measures will have on their rental streams.

d. Assumptions on costs in the valuation

The prospectus set out an intention to uplift allowances in the valuation. The combined increase to management and maintenance and Major Repairs Allowances would represent an average uplift to local authorities of 11%. The Minister confirmed the intention to "provide for realistic expenditure for management, maintenance and major repairs" with an average increase of 11.7% in his statement on 13 December. Respondents have noted that this falls short of the need for additional funding identified in published research or local surveys:

> Some respondents questioned the methodology for translating the national figures into local adjustments, arguing that this required stock condition surveys or, at a minimum, the application of local knowledge about specific local circumstances.[60]

e. New Build

The prospectus set out an intention to include in the self-financing settlement some "headroom" to enable councils, after meeting the spending needs associated with their existing stock, to deliver "a substantial new build programme." This headroom was to be achieved by the use of a 7% discount rate[61] to value council businesses:

> Government would use a 7% discount rate in valuing the business, rather than the 6.5% discount rate typically used in housing transfer. This would reduce the receipt for Government from self-financing by around £1.2 billion. This should enable councils to deliver 10,000 new homes each year from the end of the next Parliament. [62]

The possibility of creating financial "headroom" to enable authorities to build new council housing had been seen as one of the key attractions of the self-financing model. Ambitions in this area were modified somewhat by respondents' uncertainty around the cap on borrowing and the availability of social housing grant.

Following the October 2010 Spending Review it became clear that there would be very limited grant funding for new social housing development up to 2015 and the focus for raising additional finance for new build has moved towards the development of the Affordable Rent model. It seems likely that any additional expenditure released through self-financing will be focused on maintaining and improving the existing stock.

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59 For additional information on these Housing Benefit measures see Library Note SN/SP/5638
60 CLG, summary of responses to the prospectus, *Council housing: a real future,* November 2010, p10
61 The discount rate is the percentage rate required to calculate the present value of a future cash flow.
62 CLG, *Council housing: a real future*, March 2010

Furthermore, in his 13 December statement the Minister said that the Coalition would use a discount rate of 6.5% to calculate the net present value of each council's housing business. This will increase the net receipt payable to the Exchequer by an estimated £1.2bn but this sum will be used to continue separate funding for housing Private Finance Initiative (PFI) schemes. The Minister said that "Local authorities with PFI schemes will share this extra amount but will continue to receive subsidy. This was the option preferred by all local authorities with PFI schemes."[63] Respondents to the prospectus had urged the then Government not to change the discount factor proposed when making the final debt allocations.

f. Capital receipts

The prospectus proposed that local authorities would retain all capital receipts locally – this was "widely welcomed" by respondents. This is an area where the Coalition has announced a different approach. On 13 December Grant Shapps advised that 75% of net receipts from any Right-to-Buy (RTB) sales would continue to be returned to the Exchequer. He went on to explain that estimates of the loss of income from these sales would be built into the valuation of each council's housing business, while receipts from other disposals would continue to be held locally to spend on affordable housing or regeneration.

The proposal to suspend the Labour administration's policy for 100% of RTB receipts to be retained locally was trailed in the October 2010 Spending Review. The Chartered Institute of Housing issued the following response:

> The proposal to retain Right to Buy receipts could cause genuine pressures for authorities which will have debt in the new system but where government will still retain 75% of the receipts if properties are sold. The retention of any amount of RTB receipts by government is unsustainable to self-financing plans and could cause unforeseen additional pressures on wider council capital programmes.[64]

Steve Partridge, director of ConsultCIH (a company owned by the CIH), has likened the proposal to "having a mortgage but not being allowed to sell the house" [...] "you cannot have the responsibility for debt and not have the ability to recoup money through receipts."[65] Peter Ruback of CLG told delegates at the November 2010 CIPFA Housing Finance Conference that given the low scale of RTB receipts, the proposal "should not have a considerable effect on local authorities in the short-term."[66] It is unclear at this point whether authorities will be required to repay 75% of receipts from RTB sales to the Exchequer beyond 2015.

g. Reopening the settlement

Many respondents to the prospectus were opposed to the inclusion of any provisions to allow the Government to revisit the settlement at a future date. It was felt that this could undermine the principles of self-financing and the ability to plan long-term. The alternative view is that a limited re-opening provision could act as a useful safety measure which could benefit councils seeking compensation for any additional costs arising from future changes in Government policy, e.g. changes in rent policy.

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63 HC Deb 13 December 2010 WS
64 CIH, Comprehensive Spending Review Briefing, 21 October 2010
65 CLG, summary of responses to the prospectus, *Council housing: a real future,* November 2010, p11
66 Reported in *Social Housing*, "Sales concern over HRA reform, November 2010

Clause 156[67] of the *Localism Bill* gives the Secretary of State power to make a further payment to a local authority or require a payment from a local authority where a settlement payment, as defined in **Clause 155**, has been made previously. It will be possible to revisit the settlement payment where there has been a change in any matter that was taken into account in making:

a. the determination relating to the settlement payment or a calculation under that determination; or

b. a previous determination made under **Clause 156** relating to the local housing authority or a calculation under that determination.

Those who supported the inclusion of a re-opening provision specified that it should be very carefully defined "leaving no doubt about the circumstances under which it could be used."[68] The Government has said that the provision will allow "a further adjustment to the debt allocated to local authorities if a future policy change has a significant material effect on their costs or income" and that the measure "is designed to protect both councils and the Exchequer."[69]

The Local Government Association's "on the day briefing" on the *Localism Bill* said it was "vital" for Government powers to re-open the buy-out figure and limit the amount of borrowing by local authorities to be dropped:

> Only by embracing genuine devolution will the Government enable this important reform to unlock efficient management of housing operations and assets locally.[70]

h. Decent homes, the backlog and other grant funded needs

Respondents expressed "widespread concern" that outstanding decent homes work would not be funded from within the settlement. There was also a call to fund disability adaptations through the self-financing settlement rather than through grant funding. In the Minister's statement on 13 December he announced that the settlement would include £116 million of extra funding each year for councils to pay for disabled adaptations to their stock.

Capital funding to deal with the decent homes backlog will be allocated by the Homes and Communities Agency (HCA). £1.6 million will be available over the period of the Spending Review for councils with a decent homes backlog of at least 10% of their stock (around 48 authorities are in this position[71]). Authorities with a backlog of less than 10% will be expected to use the freedoms and additional resources offered by HRA reform to achieve the necessary improvements to their stock. In exceptional circumstances these landlords may make a case for additional funding.[72]

The funding for disabled adaptations has been welcomed but respondents to the prospectus identified a need for substantial additional funding to cover backlogs in investment in the environment, in communal areas and for tackling conditions in non-traditional dwellings (estimated at £6bn), and to address health and safety issues (estimated at £5bn), such as

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67 Note that clause numbers are likely to change as the Bill progresses through Parliament.

68 CLG, summary of responses to the prospectus, *Council housing: a real future,* November 2010, p11

69 HC Deb 13 December 2010 WS

70 LGA, *Localism Bill – LG Group on the day briefing*, 13 December 2010

71 CLG, 2010 Business Plan Statistical Appendix

72 For information on the future of decent homes funding see: *Decent homes backlog funding for council landlords 2011-15,* HCA

fire safety.[73] Although debt reallocation will allow authorities to build up resources to meet these needs over time, respondents made the point that many of the investment needs are real in the short-term.

3. HRA settlement details

On 1 February 2011 the Government published details of the new financial deal for council housing. These details include "a detailed description of how each council's opening financial position will be determined and the process for implementing these reforms in April 2012."[74]

The changes will involve the movement of £19bn between authorities and the government to reflect the redistribution of debt. The proposals confirm that an overall borrowing limit will apply to the sector in addition to caps on the borrowing of individual authorities. The settlement includes assumptions about future right to buy sales as councils will continue to have to repay 75% of these receipts to the Government after the reforms have been implemented.

Alongside the policy document on the future financial arrangements for councils entitled *Implementing self-financing for council housing*, CLG published the following three documents:

1. a model which applies the settlement methodology to local authority data to provide indicative figures per council, *Modelling business plans for council landlords: Local authority financial model user guide;*
2. a user guide to accompany this model, *Local Authority Financial Model*; and
3. a report on the model inputs, assumptions and outputs, *Modelling business plans for council landlords: Report on model inputs assumptions and outputs.*

On 28 July 2011 the Government published *DCLG: Self-financing - Planning the transition.* This document updates the policy and implementation arrangements set out in *Implementing Self-financing for Council Housing*. It aims to provide local authorities with detailed information to prepare for and achieve a successful transition to self-financing

Local authorities are now assessing the impact of the changes on their financial positions.

[73] CIH Response to the prospectus, *Council housing: a real future,* July 2010
[74] CLG Press Release, 1 February 2011