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CABINET - 7 OCTOBER 2009 **PORTFOLIO: HOUSING**

REFORM OF COUNCIL HOUSE FINANCE

1. INTRODUCTION

1.1 The Government in July 2009 issued the long awaited consultation paper on the reform of the council housing finance. This paper sets out New Forest District Council's suggested response to the questions posed by the Government within this paper. Consultation responses are required by 27 October 2009.

1.2 A copy of the full consultation paper is attached at Appendix 1 for Cabinet members only (the document is 60 pages long and is available on the Council's website at newforest.gov.uk/committeedocs/cab/CDR05311.pdf

2. BACKGROUND

2.1 The current housing finance system stems from a requirement of the 1935 Housing Act which requires local authorities to keep a separate housing revenue account (HRA). The HRA is a separate record of revenue expenditure and income relating to an authority's own housing stock.

2.2 The HRA is a ring fenced account within the general fund and is operated within government guidance and professional accountancy protocols. One purpose of introducing the HRA ring fence policy in 1989 was to create a more coherent "landlord account". It ensures that rent levels cannot be subsidised by increases in council tax and that rents cannot be increased to keep council tax levels down.

3. THE HRA SUBSIDY SYSTEM

3.1 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. Of the 205 local authorities in the HRA subsidy system in 2008/2009, 153 were in surplus and therefore making a contribution into the system (negative subsidy) and 52 in deficit and receiving subsidy from the system (positive subsidy). New Forest District Council is in negative subsidy and makes a contribution of £8m per annum to the government. This effectively means that nearly 40% of the rent that any tenant pays goes to government and brings no benefit to the District.

3.2 The Government consider that there is a clear rationale for the distribution of income between landlords. They argue that Councils have different spending needs and different capacities to raise income. Without redistribution, some Councils would have to charge higher rents or deliver lower quality services.

3.3 The factors that determine whether a council is in a deficit or surplus under the current subsidy system are complex. The three main factors are:-

- Assumptions made about the need to spend on management, maintenance and major repairs.

- Assumptions made about rental income

- The amount of housing debt a council is assumed to hold.

3.4 An important driver of subsidy redistribution is the cost of servicing housing debt. The subsidy system supports an amount of **notional** debt in each council, based on **assumptions** about what councils should have borrowed and repaid over time. The average debt is equivalent to around £7,000 per property but about a quarter of authorities are debt free and others have debt of up to £30,000 per property. New Forest District Council is debt free.

3.5 Any Capital expenditure which an authority wishes to spend on housing is outside the constraints of the HRA. The exception is the major repairs allowance (MRA) which is held in a separate reserve account and can only be used for capital expenditure on the housing stock.

3.6 Government policy is that all social landlords (local authorities and housing associations) should offer similar rents for similar properties, whilst maintaining substantial discounts to market rents. The HRA subsidy system requires government to make assumptions about the rental income of every council landlord. This has led to extremely complex calculations within the subsidy system relating to an individual councils progress with the rent restructuring process (the aim being to equalise council and housing association rents).

4. PROBLEMS WITH THE CURRENT SYSTEM

4.1 The review of the HRA carried out by the government has identified a number of problems in operating a national system for redistributing rental income between landlords. These are:-

- The fairness of the system depends on the accuracy of the assumptions it makes about spending needs in over 200 councils. It is difficult to manage this information nationally.

- Over time, the balance of deficit and surplus authorities has changed. The system is now roughly in balance nationally, but 75% of councils pay notional surpluses into the system, with only 25% receiving subsidy.

- The requirement for many authorities to contribute to a central pot from their tenants' rental income is deeply unpopular with tenants.

- The annual nature of the process mitigates against longer term planning by councils

- The government's pursuit of fairness within the system has led to increasingly complex calculations and less transparency.

- Local accountability and responsibility is weak.

5. THE CONSULTATION

5.1 New Forest District Council have been campaigning with other local authorities for some time for a review of the HRA financing system and in broad terms welcome the government's aim of reviewing the HRA to ensure greater fairness for all particularly our tenants.

5.2 The consultation paper asks a series of questions and these are repeated below with a suggested response for Cabinet to consider.

Costs and Standards of council housing in the future

Q1 We propose that the HRA ring fence should continue and, if anything, be strengthened. Do you agree with the principles for the operation of the ring fence set out in paragraph 3.28?

We agree that the ring fencing should continue and support strengthening where necessary. However, we are aware of the debate between core landlord services and other services and the possible impact that this could have upon the Council's general fund costs.

Q2 Are there any particular ambiguities or detailed concerns about the consequences?

Linking to question 1, that the HRA should be required to fund the fundamental services whether required now or as determined by future legislation but funding must be provided by Central Government (whether through Tenant Services Authority or direct) where there are cross-domain (between the HRA and general fund) or new initiatives.

Tenants should not, as a group, be expected to wholly fund a new initiative to tackle, say, anti-social behaviour on estates where there is a larger benefit to be gained across the authority. The HRA is not a tool to mitigate expenditure for the tax payer.

Where some services are now to be considered General Fund expenditure, allowance must be made within the Revenue Support Grant to support the absorption of these costs and not apply an unacceptable additional burden on the Council Tax payer.

Q3. We propose funding the ongoing maintenance of lifts and common parts in addition to the Decent Homes Standard. Are there any particular issues about committing this additional funding for lifts and common parts, in particular around funding any backlog through capital grant and the ongoing maintenance through the HRA system (as reformed)?

NFDC has few properties that would benefit from such capital funding but nonetheless the principle is worthy of support.

If any backlog is funded by capital grant, it should not be done at the detriment to the HRA or to the other areas related to the housing finance. For example, HCA funding should not be cut forcing the burden of responsibility onto authorities.

There must be some fairness included so that authorities benefitting from this additional funding have a reduced or deferred MRA uplift when compared to those authorities that managed to achieve DHS from within their existing resources.

Should those authorities benefit again at the expense of the majority of authorities within the HRA (that is to say, the c. 50 in receipt of subsidy compared to the c. 150 paying subsidy), this would not be supported as it is subsidy by another name. As clearly stated in 2.29, this procedure is highly unpopular.

Any capital grant awarded must be specifically earmarked for purpose and audited correctly. Grant should be separately identified from any other receipts.

Q4. Is this the right direction of travel on standards and do you think the funding mechanisms will work or can you recommend other mechanisms that would be neutral to Government expenditure?

There must be some allowance provided to direct funding towards locally identified areas of need. It is a lofty goal to have a common minimum standard, which should be supported, but environmental enhancements would differ and therefore cannot be prescribed centrally. At which stage is control actually handed over? Much of the proposal appears to be that authorities are being led along a path of accepting financial responsibility without Government relinquishing control of the system?

To allow some mechanisms to be neutral to Government expenditure, target/limit rents could be left unaltered for say one year, but an inflationary uplift applied so that a local contribution per tenant can be made to local priorities.

By adopting this approach, each authority could use a percentage of their rents (after voids) to fund specific local environment policies without support or interference from Government. Although it could easily include a caveat that these enhancements meet minimum criteria (e.g. safe, well maintained play areas).

Local authority leaseholders

Q5. We propose allowing local authorities to set up sinking funds for works to leaseholders' stock and amending HRA rules to permit this. Will there be any barriers to local authorities taking this up voluntarily, or would we need to place an obligation on local authority landlords?

We consider that they are very difficult to manage and those that do have them (mainly private landlords) advise avoiding them if you can. Our buildings have been historically well managed and it is unlikely that leaseholders would be faced with an invoice that could not be paid by some means or another. Furthermore, we do offer the possibility of paying over a number of years, interest free.

Debt

Q6. We propose calculating opening debt in accordance with the principles set out in paragraphs 4.22- 4.25. What circumstances could lead to this level of debt not being supportable from the landlord business at the national level?

Q7. Are there particular circumstances that could affect this conclusion about the broad level of debt at the district level?

Q8. We identified premia for repayment and market debt as issues that would need to be potentially adjusted for in opening debt. How would these technical issues need to be reflected in the opening debt? Are there any others? Are there other ways that these issues could be addressed?

Q9. We propose that a mechanism similar to the Item 8 determination that allows interest for service borrowing to be paid from the HRA to the general fund should continue to be the mechanism for supporting interest payments. Are there any technical issues with this?

We consider that there is currently insufficient data available to properly formulate a response to these questions. (Without knowing the proposed level of debt, the type of debt and whether it is real or notional.)

We do, however, believe that debt write off should not be ruled out. If the government intend to be serious about freeing Councils from the burden of the negative subsidies that many currently face then the proposal to re-allocate a proportion of the notional historic housing debt to those Councils will stagnate any hope that those authorities might have in raising investment for new social housing in those areas. The reallocation of debt would mean that New Forest District Council would effectively be saddled with a one off lump sum debt and this would be difficult to justify to our tenants.

Borrowing

Q10. Do you agree the principles over debt levels associated with implementing the original business plan and their link to borrowing?

Q11. In addition to the spending associated with the original business plan, what uncommitted income might be generated and how might councils want to use this?

Subject to the comments made in relation to questions 6 -9 we believe that a buoyant HRA would enable business decisions to be taken using rental income to support appropriate levels of borrowing. Such borrowing could be used for a range of options from paying for much need environmental improvements to providing substantial investment for much need social housing in the District. Surely it would be far more equitable for tenants to see any rental income go towards meeting local priorities rather than to service a notional debt imposed by central government.

Capital receipts

Q12. We have set out our general approach to capital receipts. The intention is to enable asset management and replacement of stock lost through Right to Buy. Are there any risks in leaving this resource with landlords (rather than pooling some of it as at present)?

Q13. Should there be any particular policy about the balance of investment brought about by capital receipts between new supply and existing stock?

Q14. Are there concerns about central Government giving up receipts which it currently pools to allow their allocation to the areas of greatest need?

We support the retention of capital receipts generated by sales of land or property within the District. Decisions on the use of these receipts should rightfully be made by the residents of the District.

Equality impact assessment

Q15. Would any of our proposed changes have a disproportionate effect on particular groups of people in terms of their gender or gender identity, race, disability, age, sexual orientation, religion or (non-political) belief and human rights?

The proposed changes should have equal impact on existing and potential tenants and are unlikely to have a disproportionate effect.

Q16. What would be the direction (positive or negative) and scale of these effects and what evidence is there to support this assessment?

Subject to our specific comments we believe there could be a positive long-term effect on housing services and meeting the future needs of housing within our District. We could maintain and enhance the condition of our stock. Evidence on the Decent Homes Standard, our long term ten-year improvement plan and (proposed) 30-year business plan will evidence this.

Q17. What would be necessary to assemble the evidence required?

Collation of existing reports. Creation of 30-year business plan. Sample surveys via tenant groups and residents.

6. FINANCIAL IMPLICATIONS

6.1 There is no doubt that the review of Housing finance will have significant implications. However, with the lack of detail in the consultation paper it is impossible at this stage to identify what the implications might be for New Forest District Council. Further reports will be prepared once any detail is made known.

6.2 Without sufficient detail, we cannot predict with any accuracy the likely debt level that will be assigned to NFDC or which repayment method would best suit us to fund that debt.

6.3 The reform of housing finance consultation document does specifically state that under a self financing model “Councils will have enough money from the rental income from their stock to be able to service debt over time”.

6.4 Therefore as NFDC pays over £8m per annum in Subsidy whilst still achieving the Decent Home Standard and maintaining our stock, it is reasonable to assume this figure as the basis for any provisional calculations for affordably servicing a debt levied by Government as part of self financing.

6.5 To give some indication of affordable levels of debt, calculations have been completed using the following assumptions:

- The loan is repayable over a 25-year period, therefore within the life of the 30-year business plan;
- Annual interest rate is based on current long-term rate of 4.09%;
- "Serviceable cash" to fund any loan is based on £8m, growing annually by 1%, equating to £10.2m at the end of the 25-year term.

SCENARIO ONE
The serviceable cash will fund an original loan of £84m.

This debt level would result in a cash surplus of approximately £90m during the life of the debt. Ignoring the possibility of an early repayment of debt, it is highly unlikely that Government would allow any Council's HRA to develop such reserves without retaining some control over how that surplus is to be spent or increasing the original loan to mitigate the surplus.

SCENARIO TWO
If we took an approach similar to a repayment mortgage and allowed for an increase in repayment level equal to the serviceable cash available each year, a debt of £137m could be funded.

This debt level would result in no cash surplus over the period.

SCENARIO THREE
Akin to an interest-only mortgage, repaying that interest only and retaining the cash surplus to pay the loan at the end of the 25-year term would provide for a debt of £113m.

This is a cash-only basis assuming the money was put under the mattress and forgotten about. There would obviously be investment opportunities, which even at a modest 2% interest rate of return would enable us to service debt of £126m.

6.6 In each scenario, after the 25-year term when we assume the debt will be fully repaid and without further debt burden to the HRA, the £8m would have grown to an annual amount of approximately £10.2m which could be invested to enhance or add to our HRA stock levels. As with Scenario one, it is difficult to envisage the Government allowing any Council to have free use of such funds without retaining some form of control.

6.7 These three scenarios, ranging from a debt of £84m to a debt of £137m and repayable over very different methods begin to illustrate the wide variation of options and debt-levels that could be imposed on the HRA.

Therefore until the Government are willing and able to provide substantial and objective guidance regarding the debt levels and associated controls, and this Council has been able to fully assess the implications of such debt or how it could be financed, no financial implications can be identified.

7. ENVIRONMENTAL, CRIME AND DISORDER AND EQUALITY AND DIVERSITY IMPLICATIONS

7.1 There are none arising directly from this report.

8. TENANTS COMMENTS

8.1 This report was discussed at the Policy and Report Focus Group on 15 September 2009. Tenants expressed their concerns that over £8m of their rents was paid to government as subsidy and had been hopeful that the consultation paper would clearly explain proposals for this unjust practice to cease.

8.2 Nevertheless the tenants expressed support for the Council's responses to the consultation paper and hoped that a satisfactory resolution would be found to reform council house finance as soon as possible.

9. HOUSING PORTFOLIO HOLDERS COMMENTS

9.1 Whilst I welcome the government's intention to reform council housing finance I am disappointed that the consultation paper does not make it clear what the impact might be on New Forest District Council and in particular the current situation where our tenants pay over £8m of their rents to government. There is an opportunity here for the government to make a significant difference to the future of housing finance without burdening local authorities with significant debt as a price for improvements in the way that our local housing service is provided in the future.

10. CONCLUSION

10.1 The reform of council house finance is recognised as long overdue. The government has produced a consultation paper which in some ways does identify many changes for the better. However, until the situation with the notional national housing debt is resolved it is difficult to clearly ascertain what the impact might be on New Forest District Council.

10.2 With a favourable conclusion of the debt issue there could be an opportunity for the Council to have significant more income available than currently that could be invested in new council owned homes and improved services for our tenants.

10.3 We will continue to lobby with our partner Councils for an improved outcome for New Forest District Council and for all our tenants. A meeting is due to be held during September with Waverley District Council and other south east stock owning authorities and if possible a verbal update will be given to the meeting on the outcome of this meeting.

11. HOUSING REVIEW PANEL COMMENTS

11.1 The Review Panel agreed the draft response to the Consultation as set out in Appendix 1 to them and to the Cabinet. However, they expressed their disappointment at the lack of detail and information from the Government.

12. RECOMMENDATION

12.1 The Cabinet is asked to agree the proposed response to the consultation paper on the reform of council housing finance as set out in this report.

For Further Information Please Contact:

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Head of Housing
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E-mail: dave.brown at NFDC

Background Papers:

Consultation Paper: Reform of Council Housing Finance - July 2009

APPENDIX 1

Communities
and Local Government

Reform of council housing finance

Consultation

communities.gov.uk
community, opportunity, prosperity

Reform of council housing finance

Consultation

July 2009
Department for Communities and Local Government

Department for Communities and Local Government
Eland House
Bressenden Place
London
SW1E 5DU
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Contents

Foreword

Local authorities provide around two million rented homes and, together with housing associations, they provide decent, secure and affordable accommodation for over eight million people.

Housing suffered a long period of severe neglect. In 1997 there was a £19bn backlog of repairs to four million council and housing association homes and more than two million homes were below basic decency standards. Over £33bn has been invested in improving those homes and by the end of 2010 we expect around 95 per cent of council and housing association homes to be warm and weather-proof.

As a Government we remain fully committed to completing our comprehensive Decent Homes programme and to seeing this standard maintained. The reforms proposed in this consultation will safeguard this commitment. We will also improve the common areas of estates and will ensure that there is sufficient funding in the system to do so.

If we are to maintain these improvements for the long term then it is imperative to reform the system that finances council housing.

My intention is to dismantle the Housing Revenue Account subsidy system and replace it with a devolved system of responsibility and funding. This consultation sets out the steps required to do so, together with the timescales on which changes can be made. I want to provide more flexibility in finances and more transparency in the operation of the system. I want to devolve control from central to local government. And, in return, I want to increase local responsibility and accountability for long term planning, asset management and for meeting the housing needs of local people.

The current national system for financing council housing makes this difficult to achieve. It reflects significant shortcomings in the relationship between central and local government despite greater funding, flexibilities and freedom for local authorities in recent years. That is why, alongside this consultation on radical reforms to the system of financing council housing, we are launching a separate consultation on local democratic renewal. This consultation aims to strengthen the involvement of citizens in their communities and reinforce the role of local authorities to help residents hold local services to account.

I am therefore proposing a devolved self-financing alternative to the current system which will remove the need to redistribute revenue nationally while continuing to ensure that all councils have sufficient resources. With these radical reforms, councils will finance their own businesses from their own rents and revenues, in exchange for a one-off allocation of housing debt.

I aim to make this a once-and-for-all settlement to create a new baseline for all local authorities currently in the HRA subsidy system, from which each will be able to sustain and maintain their homes on an equitable basis. By freeing councils from the annual funding decisions in the current system, councils will be able to plan long term and improve the management of their homes, secure greater efficiencies and improve the quality of service to their tenants. This will be a financial framework in which councils can plan and manage for the long term, in the same way that we expect of other affordable housing providers, like housing associations. It will give councils greater capacity and more freedom to respond to local needs and, in doing so, increase their responsibility and accountability to local tenants and residents.

I am grateful for the high level of interest and the high quality of contributions to our review of council housing finance to date. There is wide and strong support for a local self-financing system, particularly in local government. The challenge now is whether local government is ready to work with me and ministerial colleagues to make these radical reforms through detailed work together, or whether it will be necessary to use primary legislation to implement these changes.

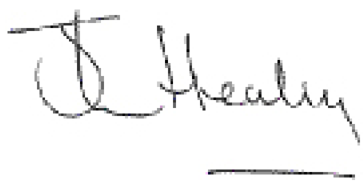
My proposals offer a fair deal for all councils. They will provide a way for those councils currently paying high levels of surplus into the system to stop doing so, in exchange for some additional debt. They also offer a sustainable future for those now relying on high levels of subsidy to support historic debt and expensive-to-maintain properties. All councils will be able to plan and fund the work they do on their stock, and to implement long term development and improvement strategies. The standards and costs of council housing will also now be on a common basis with the standards and costs that we will accept in a transfer of stock to a housing association.

With greater freedom comes greater responsibility and accountability. The Tenant Services Authority will in future play a major role in ensuring that local authorities are seeking efficiency and value for money in their service delivery, providing greater openness on costs and making sure that every penny of tenants' and taxpayers' money is spent well.

I also want local authorities to play a bigger part in building and commissioning new affordable homes that people in their area need. I am using powers in the Housing and Regeneration Act 2008 to exclude newly-built or newly acquired dwellings from the HRA subsidy system, with immediate effect, and I am also making changes to allow councils to keep the full capital receipts from any subsequent sale of a new home.

In addition, we are giving councils access to capital grant to build. At the Budget, we announced £100m to fund some 900 new council homes. In his Housing Pledge, as part of *Building Britain's Future*, the Prime Minister announced a further £1.5bn to build an extra 20,000 affordable and energy efficient homes, increasing the scale of the programme for the next two years to a £2.1bn investment for 110,000 new homes that people can afford to rent or buy. This includes a fourfold increase in our plans for new council homes. Together, these changes will enable councils to become, once again, significant providers of new housing, with further flexibility to do more where councils can act rapidly and offer good value for money.

Any changes must balance the interests of tenants with the interests of wider taxpayers. The plans I set out in this consultation do so in a way that means we can make the radical reforms to council housing finance that are needed now.



The Rt. Hon. John Healey MP, Minister for Housing and Planning, attending Cabinet

Scope of the consultation

Topic of this consultation

The review of council housing finance aimed to find a long term, sustainable solution to improve or replace the current Housing Revenue Account subsidy system that would be fair to both tenant and taxpayer and fit with wider housing policy.

Scope of this consultation

We have signalled our intention to dismantle the current Housing Revenue Account subsidy system and replace it with a devolved system of self-financing for all local authorities. This will depend on a one-off allocation of housing debt, after which councils will be able to keep all their rental income. An alternative option would be to retain but improve the current system.

Our externally commissioned research reports are published alongside this document.

You are asked for views on the preferred option of self-financing and the practicalities of implementing self-financing.

Geographical scope

This consultation applies to England.

Impact assessment

Impact assessments are needed where proposals impact upon business or the third sector, or have significant costs (above £5m p.a.) for the public sector. An impact assessment accompanies this consultation.

Basic information

Target audience

This consultation is aimed at social housing stakeholders, including:

- local authorities
- relevant non-departmental public bodies (Tenant Services Authority, Homes and Communities Agency, Audit Commission)
- bodies representing the interests of tenants of social housing
- bodies representing the interests of housing associations or other private providers of social housing
- bodies representing the interests of local housing authorities
- tenants

Responsibility for the consultation

The Local Authority Housing Finance Division in the Department for Communities and Local Government is responsible for this consultation.

Duration

The consultation starts on 21 July 2009 and finishes on **27 October 2009**.

Enquiries

For further information on this consultation document please email:

councilhousingfinance@communities.gsi.gov.uk

or telephone 020 7944 3425

How to respond

Consultation responses should be submitted by email to:

councilhousingfinance@communities.gsi.gov.uk

Or by post to:

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

Additional ways to become involved

You can request a hard copy of this consultation by writing to the address above.

After the consultation

The Government will publish a summary of responses to the consultation and its own response in early 2010.

Compliance with the code of practice on consultation

This consultation document and the consultation process have been planned to adhere to the Government code of practice on consultation issued by the Department for Business, Innovation and Skills and is in line with the seven consultation criteria. The period of consultation will be 14 weeks.

Background

Getting to this stage

The review of council housing finance was announced in December 2007 and launched by ministers in March 2008.

Previous engagement

From March 2008 to January 2009 the review held 19 stakeholder sessions with a wide range of representatives from local authorities, tenant groups, housing organisations and housing academics. It also consulted directly with tenants through focus groups and a tenant questionnaire.

The consultation criteria

This consultation document and consultation process have been planned to adhere to the Code of Practice on Consultation issued by the Department for Business, Innovation and Skills and is in line with the seven consultation criteria, which are:

1. formal consultation should take place at a stage when there is scope to influence the policy outcome.

2. consultations should normally last for at least 12 weeks with consideration given to longer timescales where feasible and sensible.

3. consultation documents should be clear about the consultation process, what is being proposed, the scope to influence and the expected costs and benefits of the proposals

4. consultation exercises should be designed to be accessible to, and clearly targeted at, those people the exercise is intended to reach.

5. keeping the burden of consultation to a minimum is essential if consultations are to be effective and if consultees' buy-in to the process is to be obtained.

6. consultation responses should be analysed carefully and clear feedback should be provided to participants following the consultation.

7. officials running consultations should seek guidance in how to run an effective consultation exercise and share what they have learned from the experience.

Representative groups are asked to give a summary of the people and organisations they represent and, where relevant, who else they have consulted in reaching their conclusions when they respond.

Information provided in response to this consultation, including personal information, may be published or disclosed in accordance with the access to information regimes (these are primarily the Freedom of Information Act 2000 (FOIA), the Data Protection Act 1998 (DPA) and the Environmental Information Regulations 2004).

If you want the information that you provide to be treated as confidential, please be aware that, under the FOIA, there is a statutory code of practice with which public authorities must comply and which deals, among other things, with obligations of confidence. In view of this it would be helpful if you could explain to us why you regard the information you have provided as confidential. If we receive a request for disclosure of the information we will take full account of your explanation, but we cannot give an assurance that confidentiality can be maintained in all circumstances. An automatic confidentiality disclaimer generated by your IT system will not, of itself, be regarded as binding on the department.

Communities and Local Government will process your personal data in accordance with DPA and in the majority of circumstances this will mean that your personal data will not be disclosed to third parties.

Individual responses will not be acknowledged unless specifically requested.

Your opinions are valuable to us. Thank you for taking the time to read this document and respond.

Are you satisfied that this consultation has followed these criteria? If not or you have any other observations about how we can improve the process please contact:

Kavian Thompson
CLG Consultation Coordinator
Zone 6/J10
Eland House
London SW1E 5 DU

or email: consultationcoordinator@communities.gsi.gov.uk

Executive summary

This consultation is the result of a detailed investigation into the operation of the council housing finance system. It has drawn extensively on the input from a variety of organisations and individuals and has been underpinned by a strong evidence base. The review team is grateful for the many contributions that it has received and the support of stakeholders during the evidence gathering process.

This document is divided into five sections:

Section 1 describes the background to the review, its terms of reference, working methods and the ways we have engaged with stakeholders.

Section 2 provides an overview of the current system for financing council housing, covering the ring-fenced landlord account (the Housing Revenue Account) and the system for redistributing income between councils (the Housing Revenue Account subsidy system). It describes the current distribution of housing debt within the system and the rules that apply to capital receipts and borrowing. It also provides an overview of the Decent Homes Standard and social rent policy.

Section 3 covers the future costs and standards of council housing. It describes the allowances within the current system and the evidence gathered during the review about the need to spend in future. It proposes changes to the framework for allocating costs between the Housing Revenue Account and a local authority's general fund. It sets out a proposal for continuing the Decent Homes Standard in future and how we might address energy efficiency. It also proposes changes to the Housing Revenue Account which would allow sinking funds to be set up for works to leaseholders' homes.

Section 4 describes the options for fundamental reform of the council housing finance system. It covers improvements to the current system which would reduce volatility and improve long term planning – in particular through multi-year subsidy determinations and/or debt allocation. It also sets out an option for a devolved system – self-financing – which would remove the need for redistribution of revenues in return for a one-off allocation of debt. It describes methods for assessing the level of debt each council would be required to support under self-financing and how this debt would be allocated. It also identifies some potential costs to the general fund from debt allocation and how these could be mitigated or funded.

In addition, Section 4 sets out proposals for managing the amount of new borrowing councils might undertake under self-financing, so that this is consistent with overall public borrowing and spending policies. It considers risks arising from self-financing and how these could be managed. It also includes a proposal to end the pooling of capital receipts, subject to a condition that the currently pooled amounts are reinvested locally in housing. Finally it describes the implications of our proposed changes on disabled adaptations, on transfer and arms-length management organisation (ALMO) policy and programmes and on local housing companies. It also invites views about any impact on equalities.

Section 5 covers implementation of reforms. It describes the measures being taken immediately on new council homes in order to remove disincentives to council house building, the powers which would be required to implement self-financing across all councils and stock, and an indicative timetable for implementing the revenue and capital reforms.

Section 1

The review

Why was the review set up?

1.1 We are at the start of a new era in the provision of social housing. The Housing and Regeneration Act 2008 has led to the creation of two major new agencies to invest in housing and to regulate to protect the interests of tenants. And we are increasingly looking to local authorities to play a bigger role in the housing arena, both at a strategic level and as a direct provider of housing services and new social housing. But against that changing environment, the financing arrangements for local authority housing have remained substantially unchanged for over 20 years.

1.2 The review was proposed in the housing green paper in July 2007 and was announced in a written statement to the House of Commons on 12 December 2007. The joint CLG and HM Treasury review was launched at a stakeholder event in the House of Commons on 10 March 2008. The aim of the review is ***"…to develop a sustainable, long term system for financing council housing that is consistent with wider housing policy and fair to both tenant and taxpayer."*** The terms of reference are set out at Annex B.

Scope and working methods of the review

1.3 The review was arranged into four workstreams, with extensive stakeholder input through workshops and seminars:

- **costs and standards for social housing:** the standards and services that all tenants should expect, the future of the Decent Homes Standard and any future standards (including any further work to reduce energy costs for tenants and reduce emissions), and the costs of delivering these standards and services
- **rents and service charges:** current social rent policy, progress towards rent restructuring and convergence of social rents, the impacts of this on rent levels and affordability and on other objectives set for social rents
- **rules governing a local authority's Housing Revenue Account and capital:** the rules and regulations covering the landlord account and the rules relating to capital receipts, and whether changes to the rules would improve accountability and performance
- **mechanisms for delivering funding:** the current national HRA subsidy system and the potential to improve it, and whether a devolved system of financing council housing could provide a better framework for delivering housing services.

1.4 The review focuses on council housing finance, but its considerations are relevant to all social landlords, particularly in relation to the standards of service and accommodation that social landlords provide. The review therefore involved housing associations and representative bodies including the National Housing Federation.

Methodology and evidence gathering

1.5 The review engaged stakeholders and experts throughout the process:

- The Chartered Institute of Housing (CIH) facilitated 15 workshops across the country involving a range of experts and practitioners. It also set up a web-based discussion forum to encourage dialogue between practitioners and to enable a wider audience to participate in the debate
- CLG invited written contributions to the review, receiving 40 submissions from a wide range of organisations, and placed key documents on its website
- CLG and HM Treasury held a series of bilateral meetings with key stakeholders including landlord and tenant organisations.

1.6 In addition to the workshops, a tenant questionnaire was developed with national tenant organisations and a number of local authorities. This was used to seek the views of tenants. Results were collated from the Housing Corporation panel survey of about 1,000 council and 1,000 registered social landlord (RSL) tenants[1]. Online responses via the CLG website and via a facilitator pack sent to every stock-owning local authority which resulted in 1,700 responses from tenants. A series of independent focus groups was also commissioned, covering both council and RSL tenants[2]. Results quoted in the research report are for council tenants unless stated.

[1] Results from the Housing Corporation survey were weighted to give a representative sample, taking into account the age, region, employment status, etc of the respondent. Information on relevant questions was collected from RSL tenants but figures quoted in the report are for council tenants unless otherwise stated. On questions affecting tenants of both local authorities and RSLs, there was little difference in their responses. Results from the other survey methods may not be fully representative of a cross-section of tenants since it is a voluntary response; this has been taken into account in the analysis of the results.

[2] Seven focus groups were held covering a range of demographics and regions. Each group comprised 6-8 participants. The groups are not fully representative and results are only indicative. Few differences were noted between council and RSL tenants although RSL tenants were more able to distinguish between landlord services and general council services.

Section 2

The current housing finance system

The Housing Revenue Account

2.1 The requirement for local authorities to keep a housing revenue account (HRA) dates back to the 1935 Housing Act. The HRA is a record of revenue expenditure and income relating to an authority's own housing stock. Local authority income and expenditure on other housing services (e.g. support for RSLs or private sector schemes) are not charged to the HRA but to the general fund. The Government has published guidance about the powers and duties underpinning the strategic housing role[3].

2.2 The HRA is a ring-fenced account within the general fund; credits and debits are governed by statute and the ring-fence is operated within Government guidance and professional accountancy protocols. One purpose of introducing the HRA ring fence policy in 1989 was to create a more coherent 'landlord account'. It ensures that rent levels cannot be subsidised by increases in the council tax and that rents cannot be increased in order to keep council tax levels down.

2.3 Although it is a ring-fenced account within the general fund, there are certain prescribed circumstances when transfers into and out of the HRA are permitted. DoE Circular 8/95[4] provides guidance on the operation of the ring fence but it is not intended to be an exhaustive list of every item or new initiative. It enables local authorities to exercise their own judgement on what is reasonable and justifiable to charge to the HRA.

2.4 However, the circular reflects the provision of housing and housing services 15-20 years ago. Many services and facilities on estates which were originally provided specifically for council tenants are now available to the mixed tenure households living on the estates.

The Housing Revenue Account subsidy system

2.5 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

[3] *The Strategic Role of Local Authorities: Powers and Duties*, September 2008, CLG

[4] Circular 8/95, Department of the Environment (DoE) published 1 May 1995

2.6 required to support this. The Government makes notional calculations of how much income and expenditure each authority should have. If assumed spending is greater than assumed income, Government pays HRA subsidy to make up the deficit; where it is less, the local authority pays the surplus to Government. While the calculations are notional, they are based on actual data such as stock numbers, interest rates and deprivation indices, all of which are adjusted annually.

2.7 Of the 205 local authorities in the HRA subsidy system in 2008-09, 153 were in surplus and therefore making a contribution into the system (negative subsidy) and 52 in deficit and receiving subsidy from the system (positive subsidy).

2.8 There is a clear rationale for redistribution of income between landlords. Councils have different spending needs and different capacities to raise income. Without redistribution, some councils would have to charge higher rents or deliver lower quality services. By redistributing resources, all councils should be able to deliver a similar level of service while charging a similar level of rent.

2.9 However, the factors that determine whether a council is in deficit or surplus under the current subsidy system are complex, reflecting a number of different elements which impact on income and spending needs. The three main factors that drive subsidies are:

- assumptions made about the need to spend on management, maintenance and major repairs
- assumptions made about rental income
- the amount of housing debt a council is assumed to hold

2.10 The notionality in the current system means that the subsidy position is not influenced by the relative efficiency of different landlords. The subsidy system makes assumptions about spending needs based on standard costs for delivering services; a council may spend more or less than this amount on delivering a service, but this will not change the amount of subsidy which it is eligible to receive.

The notionality in the system also ensures that local choices about rents do not influence the amount of subsidy a council is eligible to receive. It is assumed that all councils will set rents in line with national policy. As with costs, a decision by a council to set rents above or below this amount will not increase or reduce its entitlement to subsidy.

Debt

2.11 An important driver of subsidy redistribution is the cost of servicing housing debt. The subsidy system supports an amount of notional debt in each council, based on assumptions about what councils should have borrowed and repaid over time. The average debt is equivalent to around £7,000 per property, but about a quarter of authorities are debt free and others have debt of up to £30,000 per property.

2.12 Around £1.1bn of the £6bn of income raised annually in the HRA subsidy system is used to service around £18bn of notional housing debt held by councils. This debt is very unevenly distributed between councils, being much higher in London, the North West and in Metropolitan councils. This debt is fully supported by the subsidy system, wherever it sits. For this reason, the resources that a council has to spend on housing services are largely unrelated to the debt that they hold.

2.13 The reasons for the current distribution of housing debt are complex and often historical, depending largely on which authority was building at what time under which financial regime and – when they had a choice – what they did with receipts. Around two thirds of this debt is estimated to date back before 2001. The review commissioned research on debt to examine the implication of the options for dealing with debt in local authority housing.[5]

Capital expenditure and receipts

2.14 The HRA controls revenue expenditure, but local authorities are also responsible for significant capital investment programmes, often funded directly or indirectly by central Government. Unlike revenue transactions, capital transactions are not subject to the same separation of housing and non-housing expenditure. Apart from rules which allow local authorities to retain a greater share of receipts if they spend them on affordable housing, authorities are free to spend their usable receipts on whatever capital purpose they wish.

2.15 The one element of capital directly related to the HRA is the major repairs allowance (MRA) which is held in a separate reserve account and can only be used for capital expenditure. All other housing capital expenditure and capital receipts are accounted for outside the HRA.

[5] *Options for dealing with housing loan debt in the local authority sector,* Tribal Consulting (2009)

Rules on borrowing

2.16 Since 1 April 2004, local authorities have been free to borrow for capital purposes subject to that borrowing being assessed as affordable against the terms of the Prudential Code established by the Chartered Institute for Public Finance Accountancy (CIPFA). Borrowing is governed by self-regulation under the code which includes a number of affordability indicators. The legislative framework places a number of legal responsibilities on finance officers to ensure the code is adhered to.

2.17 The Housing Revenue Account indicates how much of an authority's outstanding borrowing is attributable to its housing assets and therefore how much of an authority's debt servicing charges should be charged to the HRA.

Quality of accommodation: the Decent Homes Standard

2.18 By 1997 there was a backlog of disrepair estimated at £19bn. The Decent Homes Standard was introduced to set a minimum standard for all social housing, covering the basic components of a home that make it warm, wind and weather-tight. The Government made a commitment to bring all social housing up to the Decent Homes Standard.

2.19 The Government set out four routes to achieving Decent Homes for council housing: using their own existing resources, establishing an ALMO, transferring their stock to a housing association, or by entering into a Private Finance Initiative (PFI) contract.

2.20 Over £33bn, including £21bn of extra support from central Government, has been invested in the Decent Homes programme and, as a result, the number of non-decent social homes has been reduced by more than one million. Many local authorities have gone beyond the Decent Homes Standard and have also incorporated strategies and policies in relation to fuel poverty, energy efficiency, and regeneration.

2.21 There has been marked improvement in energy efficiency of social sector homes. The average Standard Assessment Procedure (SAP) rating[6] for the social sector has increased from 47 in 1997 to 57 in 2006 – a higher rating and faster increase than the private sector. Beyond this, Government is considering whether to develop a sustainability standard and a range of funding mechanisms.

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[6] Standard Asssessment Procedure (SAP) for Energy Rating of Dwellings. bre.co.uk/sap2005

Rents

2.22 Government policy is that all social landlords (local authorities and housing associations) should offer similar rents for similar properties, whilst maintaining substantial discounts to market rents.

2.23 The rent formula was established by Government[7] to gradually bring about this policy, with actual rents moving towards a national formula rent that took account of values of properties and local earnings relative to national earnings. A ‘bedroom weighting’ factor was also applied to try and ensure the resulting rents better reflected the perceived value of the properties being occupied. These formula rents have been increased each year since 2002 at RPI +0.5%.

2.24 The original objective was that actual rents would converge to within 5 per cent of formula rents by 2012, by applying annual increases above or below the increase in formula rents, but subject to a maximum annual increase in actual rent of RPI+0.5%+£2 per week. (The £2 is therefore the maximum annual ‘catch-up’ for rents which are below formula.)

2.25 The HRA subsidy system requires Government to make assumptions each year about the rental income of every council landlord and to take a view about progress towards restructuring for each council. This has led to complex calculations within the subsidy system, using trajectories for each council based on their actual rents at the start of the restructuring process.

2.26 In addition, mechanisms have been introduced to compensate landlords for charging rents below the guideline rent, if moving to the guideline rent would breach aspects of the overarching rent policy. These have included a cap on actual rent rises of RPI+1/2%+£2, and a ceiling on individual rent rises which have, from time to time, been included in the annual subsidy determination itself.

2.27 The review commissioned research to examine the impact of rent restructuring policy on social rent levels.[8] This compared the rents for social homes with the rents that the same properties might secure in the market. This found that in 2007-08, council rents were on average 63 per cent of equivalent market levels while housing association general needs housing stock were on average 66 per cent of equivalent market rents.

[7] *The Guide to Social Rent Reforms in the Local Authority Sector*, ODPM (2003)

[8] *An Analysis of Rents*, S.P. Wilcox, (2009)

2.28 The evidence on rents is being published as part of the review. This consultation document is not however proposing any changes to rent policy. It will be necessary to establish long term rent policy in advance of implementing any changes to the system for financing council housing. But we expect to deal with future council rent policy separately, in the context of the HRA subsidy determination for 2010-11 and a future direction by the Secretary of State to the Tenant Services Authority on council rents.

Problems with the current system

2.29 The Review has identified a number of problems in operating a national system for redistributing rental income between landlords:

- the fairness of the system depends on the accuracy of the assumptions it makes about spending needs in over 200 councils. It is difficult to manage this information nationally
- over time, the balance of deficit and surplus authorities has changed. The system is now roughly in balance nationally, but three-quarters of councils pay notional surpluses into the system, with only a quarter receiving subsidy
- the requirement for many authorities to contribute from their rent income back to central Government for redistribution to other areas is particularly unpopular – especially now it is projected that the national system as a whole will begin to move back into surplus
- the annual nature of the process, and the volatility this brings, militates against longer term planning by councils. Currently there are annual changes in allowances, rents and borrowing allocations at short notice
- pursuit of fairness within the system has led to increasing complexity and less transparency, with lots of subtle adjustments to reflect local circumstances. This has made the system hard to understand and its outcomes sometimes unpredictable. The assumptions it makes about rent levels are also highly complex
- local responsibility and accountability is weak and the system adds a great deal of operational detail into what should be a strategic relationship between council landlords and central Government.

Section 3

Costs and standards of council housing in future

This section sets out the evidence about the need to spend on council housing in future. The research report published alongside this consultation document provides the detailed analysis which underpins our proposals.

Management and maintenance

3.1 The national pot for spending on management and maintenance of council housing is calculated each year on the basis of the GDP deflator. The level of assumed costs for each authority reflects four key factors: stock numbers, stock type, relets and voids, and compensating indicators used to reflect the fact that some localities have higher costs than others.

3.2 The management allowance is calculated as a base of £357,000 plus £233 for every dwelling over 1400[9]. Adjustments are then made to take account of: properties with common facilities; medium and high rise flats; the level of violent crime; the level of relets and terminations; ranking against measures of deprivation; the area cost adjustment (ACA) for personal social services for older people; any transitional protection.

3.3 The maintenance allowance reflects four separate items:

- response repairs – a set amount for each dwelling in a particular archetype, a crime factor and an adjustment for the proportion of medium and high rise flats
- planned works – a fixed sum for each dwelling in each archetype
- relets and terminations – a fixed sum for each dwelling in each archetype
- crime work related to voids – a certain amount of work is assumed to occur due to crime affecting void properties.

3.4 The maintenance allowance is then adjusted by a measure of building costs by county. As with the management allowance, transitional protection is applied to prevent local authorities facing disruption due to previous changes in the formula.

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9 *Consultation on Revised Formulae for the Allocation of Management and Maintenance Allowances within HRA Subsidy*, ODPM (2003). communities.gov.uk/archived/publications/housing/allocation

3.5 We commissioned research on the level of allowances and actual spending in authorities.[10] This also drew on data on spending on comparable activities in the housing association sector.

3.6 The research drew the following conclusions:

- the need to spend on management and maintenance at a national level is about 5 per cent higher than current allowances. However, further work is needed to understand how this is distributed at a local authority level
- around 40 per cent of management costs are spent on what were traditionally 'non-core' services e.g. initiatives to tackle anti-social behaviour or services to help tenants into work
- there is a lack of transparency in the treatment of the administration of the maintenance function within the allowance methodology. Even allowing for differential treatment between authorities it is estimated that expenditure on management exceeds allowances by about 8 per cent and on maintenance by about 3 per cent

3.7 The Government has concluded that provision nationally for management and maintenance needs to increase by 5 per cent above current levels and that this level of need should be assumed in the financial provision for whichever model is taken forward. However, further work is needed to understand how this is distributed at the local level.

Major repairs

3.8 The allowance for major repairs was introduced in 2001-02 as a new allowance, paid through HRA subsidy, to help authorities maintain the value of their housing assets. It is based on the average cost over a 30 year period of replacing individual building components (walls, roofs, windows, central heating etc) as they reach the end of their useful lives.

3.9 The MRA is accounted for in a major repairs reserve (MRR). This means MRA funds are effectively ring-fenced for HRA capital expenditure. Beyond that, there are no restrictions on what types of work MRA funds can be used for. Councils are also able to carry over unspent balances in the MRR from one year to another and their HRA benefits from the potential for short-term investment of these balances.

3.10 The MRA reflects the cost of maintaining the stock in its current condition i.e. the expenditure required to fund 'newly arising needs'. The MRA is calculated by estimating the annual cost of replacing individual building elements as they reach the end of their useful life.

[10] An evaluation of Management and Maintenance costs in Local Authority Housing. Housing Quality Network (2009)

3.11 The point was frequently made during the review that the MRA did not accurately reflect the need to spend, because:

- it does not include external components that need replacement, for example, lifts, environmental facilities and CCTV equipment
- the formula is based on 12 year old data and homes now generally, following Decent Homes, contain more features which require replacement and servicing (for example smoke alarms and boilers)
- the assumed lifetimes of some components are not the same between the MRA and Decent Homes and/or may not be realistic (it is currently assumed that kitchens and bathrooms will last longer than is likely in practice)
- there have been variations in prices for some elements which need to be updated

3.12 The review commissioned Building Research Establishment (BRE)[11] to update the estimates of the resources required to maintain the stock in a decent condition beyond 2010, looking forward on a 30 year planning basis to 2040, by revising the existing MRA model to bring it into line with Decent Homes. As a result:

- prices used in the model have been revised, with some significantly higher and some significantly lower
- a number of previously excluded elements (notably lifts, garages, CCTV, TV reception, alarms, play areas, external lighting, walls and fences, and grass and planted areas) have been included
- the assumed lifetime for some elements, including kitchens, bathrooms and roof coverings, were changed

3.13 Regional factors still need to be addressed, and the initial results reported here are subject to caveats and revisions.

3.14 BRE concluded that the MRA tackling newly arising need should be uplifted by an average of 24 per cent to £825 per unit per year over 30 years, made up of £734 for the main home elements and £91 for lifts and common parts. The asset lifetimes used in this scenario were the most consistent with Decent Homes. (This may change after the new BRE work on energy *'Energy performance in the social rental sector'* has been completed).

3.15 This long term estimate was then broken down into work needed to 2010-11 and five year bands thereafter. The conclusions were that, because of the currently high level of major repairs activity funded through the Decent Homes programme, work should be weighted towards the last 10 years i.e. 2030 – 2040. We are currently assessing the future energy performance of the programme of work implied by the above activity.

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[11] *Review of the Major Repairs Allowance*, Building Research Establishment (2009)

3.16 The proposed funding would allow for ongoing maintenance and replacement of all elements that comprise the Decent Homes Standard and for lifts and common parts.

3.17 After 2010 there will, in addition, be a backlog that requires ongoing capital grant separate from the MRA. The backlog assessed in this report is the backlog of time- expired elements already in place and is estimated to be approximately £6bn. This is higher than the backlog of non-decent homes, because it includes work to elements that are time expired, but still in good order, and therefore meet the Decent Home Standard.

3.18 Separate analysis has estimated that the costs needed to deal with the non-decent backlog in 2010 will be between £1,400m to £2,900m based upon modelling from local authority predictions, English House Condition Survey (2006) data and Business Plan Statistical Appendix (2006) data. Costs to make stock decent are not simply a sub-set of the backlog of time expired elements because work to make stock decent may involve other types of work e.g. improving heating and insulation. It is likely that around 25-30 per cent of the costs to make stock decent consist of these types of additional improvements.

3.19 The review considered whether the new MRA could be 'built up from the bottom', taking account of detailed local plans and asset management strategies, but concluded that this would be more complex. Our approach therefore will be based on combining a national formula (which may be revised) with some scope for local adjustments.

Core and non-core services

3.20 Research conducted for the review showed that at least 40 per cent of general management costs are additional to core management costs (as defined by HouseMark[12]). Under this definition, core management costs are traditional landlord services, including rent collection, repairs and lettings management. Non-core services include tackling antisocial behaviour, debt and employment advice. Only a proportion of the non-core costs are paid from income streams such as service charges or the general fund, so a significant part is being met by rents.

3.21 To improve the transparency of the system, the review sought to identify and define core and non-core services, using a variety of sources including a sample of landlords and the tenant surveys. It was however difficult to gain a consensus around a strict definition of core and non-core.

[12] HouseMark is a membership-based organisation for the social housing sector jointly owned by the Chartered Institute of Housing (CIH) and the National Housing Federation (NHF)

3.22 A third category, core-plus, was therefore created to cover a range of services where there is now a general expectation that landlords will provide a service, for example on anti-social behaviour and tenancy sustainment.

3.23 Several reasons were put forward to explain the growth of spending on core-plus and non-core services. These include: rising expectations from tenants and politicians; the apportionment of a proportion of the costs of new local authority services to the HRA to reflect work on estates; and the comprehensive nature of the Audit Commission's KLOEs (key lines of enquiry)[13] used to determine star ratings during inspections.

3.24 Landlords have been able to diversify their services because there have been substantial and sustained efficiency improvements in the delivery of core services, brought about by the introduction of more specialised teams. Examples include improved rent collection, better procurement especially of maintenance services, better scrutiny and inspection of services, and a strong switch in provision from local offices to call centres and corporate 'one stop shops'.

3.25 Both core-plus and non-core activities can attract funding from a variety of external sources to supplement the funding from the HRA, including non-rent charges, other funding streams and grants, and the general fund. As a general approach, the net cost of core-plus services to the HRA could be taken into account through allowances. Over time, non-core services should be regarded as services provided by the landlord but funded from sources other than rent.

3.26 It is not the Government's intention to provide prescriptive lists of services that should be categorised along the core/non-core divisions described above. Nor do we wish to reduce the flexibility local authorities should have in order to respond to local demands. But this needs to be balanced against the pressures that are being placed on the HRA to provide an increasing range of services, often to a higher standard, from a limited resource.

3.27 For this reason we would prefer to establish a series of principles to enable local authorities to decide whether the service should be paid for through the HRA or the general fund. These decisions should reflect changes to Circular 8/95 and the new role of the Tenant Services Authority.

3.28 The principles we propose are that:

- there should be a separate local authority landlord account that records all landlord income and expenditure (both capital and revenue) and the transfer of resources between the HRA and the general fund
- housing services that a landlord is required to provide should be paid through the HRA

[13] audit-commission.gov.uk/housing/inspection/keylinesofenquiry/pages/default.aspx

- some defined services should be paid for from the general fund e.g. housing advisory services, administration of a common housing register and other strategic housing functions
- any requirements placed on landlords should either arise as statutory obligations or through standards set by the TSA as cross-domain regulator of social housing or be directly funded. When TSA sets standards (whether or not it is the subject of a direction by the Secretary of State) it will need to take into account the consequences for tenants, for new supply and for public expenditure
- standards should build in tenant choice and influence
- the costs of meeting TSA standards should fall on the HRA

3.29 Beyond these standards, if there is ambiguity as to whether a particular cost should fall on the HRA, the test should be 'who benefits?' If services are provided for everyone or as part of a general obligation, the costs should fall to the general fund. If the cost of a service can be seen to be of wider benefit than solely to tenants or leaseholders of properties within the HRA, that cost should be divided between the HRA and the general fund according to a local agreement.

Question 1:
We propose that the HRA ring fence should continue and, if anything, be strengthened. Do you agree with the principles for the operation of the ring fence set out in paragraph 3.28?

Question 2:
Are there any particular ambiguities or detailed concerns about the consequences?

Standards

3.30 The current national minimum standard for quality of council accommodation is the Decent Homes Standard. The Standard incorporates flexibility for landlords to determine, in consultation with their tenants, what works would be completed, and in what order, to meet the Standard.

3.31 Tenants have supported the idea of a national minimum standard, with a target date. There has, however, been some criticism of the focus the standard has placed on features within the home, potentially at the expense of other things outside the home such as lifts and common parts and energy performance, that are important to tenants. Tenants also want improvements to the environment and the look and feel of their estates and other works to deliver higher environmental standards.

3.32 The Government remains committed to delivering and maintaining the Decent Homes Standard. The review has concluded that future funding will be provided to at least continue to deliver this minimum threshold for all social stock. In addition, we will provide funding for items that were missing from the original standard such as lifts and common areas. Backlogs will be dealt with by capital grant programmes, and a continuing need for capital grant is acknowledged to do this.

3.33 The Government committed in the Heat and Energy Saving Strategy[14] to show leadership by ensuring that social housing meets, and where possible, exceeds, the aims it is setting for all housing on energy efficiency and heat and electricity supply. We are working on ways in which this can be funded. In the Energy and Climate Change white paper published on 15 July 2009[15], the Government is considering, with the Tenant Services Authority, the need to identify aspirational standards and benchmarks for energy savings and emissions reductions in refurbishment, for different property types.

3.34 Government recognises that improving energy performance in the social sector may require funding from external sources, and new financing mechanisms may need to be developed:

- private capital grant could be provided to landlords for the works (through energy suppliers or investors), with all tenants who benefit from the lower energy bills contributing through a 'pay as you save' mechanism
- under a self-financing model where local authority housing moves outside of the HRA subsidy system, local authorities would potentially be able to benefit from any real efficiency improvements they can deliver, which could then be applied to improving their stock
- additional energy savings measures might also be financed by recovering from tenants directly some of the savings they get in the form of lower energy bills as a result of those extra works.

Question 3:
We propose funding the ongoing maintenance of lifts and common parts in addition to the Decent Homes Standard. Are there any particular issues about committing this additional funding for lifts and common parts, in particular around funding any backlog through capital grant and the ongoing maintenance through the HRA system (as reformed)?

[14] hes.decc.gov.uk [15] decc.gov.uk

Question 4:
Is this the right direction of travel on standards and do you think the funding mechanisms will work or can you recommend other mechanisms that would be neutral to Government expenditure?

Local authority leaseholders – service charges and sinking funds

3.35 The review looked at the issue of leaseholders and the substantial costs that some have incurred from improvements to meet the Decent Homes Standard.

3.36 A sinking fund is a reserve of funds that can be built up from contributions from leaseholders (service charges) and used for a number of purposes. Whilst often used to cover expenditure which may be incurred fairly infrequently, such as large scale works, it can also be used to meet other costs that are incurred more frequently, such as redecoration of the common parts. The use of sinking funds allow contributions from leaseholders towards the cost of such works to be spread more evenly over a longer period rather than the full amount being demanded all in one go.

3.37 The legislation does not expressly prevent the operation of sinking funds but we are not aware of any local authorities that operate them. There are a number of reasons for this:

- technical issues related to the HRA rules
- early local authority leases do not provide for the operation of sinking funds
- it is difficult to set contributions at a level that is both affordable and realistic in terms of meeting the costs of works
- there is no guarantee of work being carried out as scheduled (some earlier sinking funds lapsed because leaseholders were reluctant to make further contributions after work was not carried out on schedule).

3.38 We propose that HRA rules should be amended so that they expressly allow sinking funds.

3.39 On *future* sales, we will undertake further work to investigate whether:

- the sale price can be adjusted to include a lump sum that covers costs of outstanding work on the property, allowing the local authority to place this element of the sale price in a sinking fund for the property

- provisions allowing for the collection of sinking fund contributions can be introduced into the standard leasehold contract
- more information can be provided for leaseholders on their responsibilities for contributing towards costs of repair and maintenance of the building containing their property and any other estate or communal costs.

3.40 We will encourage local authorities to establish sinking funds where they are supported by leaseholders and will provide more information to encourage leaseholders to make use of sinking funds.

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

Section 4

Options for fundamental reform of the system

4.1 The review has examined a range of options for reform within two broad models for financing council housing in future:

- **improvements to a national system for funding council housing** in which revenues continue to flow between local and central Government as a result of ongoing assumptions made by Government about landlord costs and income
- **a devolved system (self-financing)** in which rents are retained by councils to spend on their own services, in exchange for a one-off reallocation of debt

4.2 All the options would share a number of characteristics:

- costs, standards and rents would be based on the same principles
- local authorities would be required to draw up 30 year business plans based on updated stock condition surveys following the completion of their Decent Homes programme
- all housing capital receipts would be retained locally and would be accounted for alongside housing revenues
- any option which is taken forward following the consultation process will be fully compliant with the Government's new burdens procedures.

Improvements to the current system

4.3 A key criticism of the current system is the unpredictability and volatility inherent in an annual subsidy determination process. This, it is argued, makes it hard to plan long term.

4.4 One option for addressing this issue would be to move to longer determination periods, of between three to five years, during which time assumptions made about costs and income would not change. It would facilitate better management and enable plans for maintenance and repairs to be drawn up and adhered to with greater certainty than currently applies. It should also assist procurement, and in practice would improve the incentives for local authorities in running the stock.

4.5 The determination could be expressed in cash terms or could include some variables, (for example being expressed as increasing at RPI for some elements of the determination) so that annual subsidy levels took account of, for example, changes in cost inflation (this has some similarities with utility pricing regulation).

4.6 Alternatively, it would be possible to include some triggers in the determination so that if a variable, for example inflation, moved outside a range, it would trigger a revised determination. However the inclusion of such mechanisms would tend to undermine the original purpose of a multi-year determination.

4.7 There is a risk that a three to five year subsidy determination could result in greater volatility at the end of each determination period, but this might be mitigated by an increased use of rolling averages for indicators.

4.8 A three to five year determination (with an implied subsidy redistribution between authorities) could also be combined with measures to address debt in order to reduce the need for redistribution.

4.9 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 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.

4.10 We could allocate housing debt between local authorities to leave them with debt in proportion to the value of their stock. Besides removing a main driver for revenue redistribution, it would also allow the subsidy position of each council to more closely reflect the relationship between its rental income and the running costs of its stock, providing greater transparency.

4.11 While reallocation of debt is likely to be contentious with debt-free and low debt authorities, those councils will already be supporting debt in other councils through the subsidy system and should be no worse off over time. Rather than indefinitely paying the interest on debt held elsewhere under the current system, these councils would instead have debt that they could manage themselves.

4.12 An alternative to reallocating debt between councils would be to take debt into central Government and instead to charge each council for the cost of servicing an amount equal to the sum they would have been allocated. This would address concerns by councils about taking on debt. It would however require an ongoing relationship between local authorities and central Government in making annual payments. One attraction of this approach might be that these payments could be adjusted to reflect changes in interest rates or other factors which related to the ability of councils to pay. The risk is that this would evolve over time into another mechanism for adjusting incomes – not dissimilar to the current subsidy system.

4.13 Finally, a national ring-fence could ensure that all the money paid into the system would either be redistributed to authorities with deficits or, if there was a national surplus, reinvested in housing. This could provide further transparency about how tenants' rents are used.

Self-financing options

4.14 Under self-financing, each local authority would keep the money raised locally from rents and use it to run their stock.

4.15 Self-financing would require a one-off reallocation of housing debt in order to put all councils in a position where they could support their stock from their rental income in future. Without this reallocation of debt, some councils would either have to cut services or increase rents. But with this settlement on debt, the review found that rents set in line with current social rent policy would generate sufficient income to sustain the stock in all local authorities at the higher funding levels identified as necessary in Section 3.

4.16 Under self-financing we will move to a sustainable funding model for council housing:

- 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

4.17 Housing debt would be allocated to councils on the basis of each council's ability to service it, using the same updated figures for costs of management, maintenance, major repairs and income that would be used to calculate subsidy if we were to continue with a subsidy system.

4.18 In principle, the total debt allocated to councils under self-financing could be higher or lower than the current level of debt in the system. This would depend on the value to the landlord of the stock, which in turn is determined by the assumptions made about future costs and rental income.

4.19 The opening debt level would be one based on the tenanted market value of the stock. Under this option:

- each council would produce a 30 year business plan. The investment needs in the plan would be based on common service standards and evidence from the review about the costs of delivering those standards. Assumptions about income in the plan would be based on rent levels set in line with Government social rent policy
- the value of the stock would be calculated from the present value of the cash flows in the business plan
- each council's housing debt would be adjusted to reflect the value of its stock, entailing either a capital payment to or from Government

Mechanism for debt allocation and potential costs

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

4.21 However there are a number of issues related to the nature of this debt and the relationship between the HRA and the general fund which might give rise to costs and benefits which fall on different parts of the council. Our aim is to identify these and to ensure that they are fully funded within the self-financing settlement. These costs should be relatively small, arising from transactional issues related to the reallocation of debt and not from any changes to the principles about how costs of services or overheads are allocated between the general fund and the HRA.

4.22 We envisage that the debt settlement would take the following form:

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

4.23 The review has identified some potential administrative and transactional costs from this activity:

- the debt attributable to housing is part of a council's overall debt portfolio. The council's general fund charges interest to the HRA at the consolidated rate of interest (CRI) on the amount of debt attributable to housing. New borrowing attributable to either the HRA or the general fund will therefore have an impact on the CRI and on charges to both the HRA and the general fund. A significant increase in debt attributable to the HRA as a result of reallocation of debt could have a positive or negative impact for the general fund, depending on whether the new borrowing is above or below the CRI
- there might be premia payable for early repayment of loans
- there could be extra debt management expenses incurred in borrowing and managing additional amounts of debt, particularly in councils which are currently debt free

4.24 Our intention would be to identify any additional costs which would fall on either the HRA or the general fund as a result of the debt reallocation and to provide a settlement that funds these.

4.25 It has been suggested that the valuation of the stock could include current housing debt, rather than excluding it. Rather than producing a value to which current debt is adjusted, this would then be a sum which is added to, or, in a negative valuation, subtracted from, the current debt. It is suggested that this could better capture the higher cost of redeeming debt at higher interest rates.

4.26 Another option would be to use existing powers or take new powers to hold housing debt separately from other council debt. This would remove the impact of the 'averaging' effect, where incremental debt taken on at a higher or lower interest rate affects the rate of interest paid across the council. This might however not be efficient in terms of treasury management.

4.27 A final option would be to calculate the value of the stock in the way first proposed (i.e. excluding any existing housing debt) but then to assess any additional costs attributable to paying off or taking on new debt – falling either on the HRA or the general fund – and to add this amount to the opening debt settlement.

4.28 We recognise that there are detailed accounting and treasury management issues to be worked through if we implement self-financing. There would also need to be a mechanism to re-open the debt settlement, following consultation, in the event of major policy changes on either long term rent policy or the standards that applied to social housing.

Question 6:
We propose calculating opening debt in accordance with the principles set out in paragraphs 4.22- 4.25. What circumstances could lead to this level of debt not being supportable from the landlord business at the national level?

Question 7:
Are there particular circumstances that could affect this conclusion about the broad level of debt at the district level?

Question 8:
We identified premia for repayment and market debt as issues that would need to be potentially adjusted for in opening debt. How would these technical issues need to be reflected in the opening debt? Are there any others? Are there other ways that these issues could be addressed?

Question 9:
We propose that a mechanism similar to the Item 8 determination that allows interest for service borrowing to be paid from the HRA to the general fund should continue to be the mechanism for supporting interest payments. Are there any technical issues with this?

Borrowing under self-financing

4.29 Since 1 April 2004, local authorities have been free to borrow for capital purposes subject to that borrowing being assessed as affordable against the terms of a prudential code established by the accounting profession. However, various aspects of the HRA and the subsidy system have effectively constrained authorities' ability to use housing revenues to finance additional borrowing:

- the ring fence separating the HRA and the general fund has put the flow of resource that could service additional debt under administrative control
- while the system has allowed prudential borrowing where that can be serviced from the income in the HRA, the subsidy system and associated rules have limited the scale of additional borrowing that can be serviced
- the HRA framework has required authorities to use certain revenues for capital purposes through the major repairs reserve, and the subsidy system has removed and redistributed resources that otherwise might have supported prudential borrowing.

4.30 Effectively, additional borrowing under the current system could only be achieved by sustained improvements in operating surplus over the assumed surplus in the HRA. Ending the current subsidy system and moving to a self-financing model without constraints could therefore enable a significant increase in prudential borrowing.

4.31 If this were not controlled, it would be of serious concern to Government, as it is required to keep the overall level of public spending at a prudent level. The Government is also committed to reducing the level of public borrowing once the economy emerges from the current economic downturn. Local authorities are part of the public sector and thus their borrowing and spending has a direct impact on the overall fiscal position. So, in moving to a self-financing model for council housing, it will be necessary to retain some controls.

4.32 The principle underpinning any controls is that surpluses generated under self-financing would be retained locally to spend on local housing services. The issue is around how these surpluses might be used, and in particular whether there would need to be restrictions on any new borrowing financed from these surpluses.

4.33 We see a system continuing in which a strict ring fence around the HRA would provide a framework that enabled control over the scale of borrowing. This would first allow the level of debt associated with the move to self financing to be serviced – it would be likely to rise and fall – in line with the original business plan. This borrowing would be outside the prudential framework, in that it was borrowing necessary to deal with the debt taken on with self financing, consistent with the original business plan.

4.34 Over time landlords might generate uncommitted revenue streams from efficiencies above the original assumptions when self-financing was set up. New revenue streams might also arise from differences between the original business plan and actual costs and income. These revenues could potentially be used for a range of purposes, including spending in-year on services, paying off debt, building up reserves or, in principle, supporting additional prudential borrowing.

4.35 Allowing unlimited prudential borrowing would be inconsistent with the Government's overall fiscal and macroeconomic policy. The department would therefore need to ration or limit in some way any additional borrowing over what was implied by the notional initial business plan and would have to adjust its expenditure on other housing programmes to accommodate this.

4.36 The Government is considering how to ensure that the overall fiscal position for itself is not undermined under self financing and the consequences for controls on additional borrowing over the debt profile associated with the original business plan.

Question 10:
Do you agree the principles over debt levels associated with implementing the original business plan and their link to borrowing?

Question 11:
In addition to the spending associated with the original business plan, what uncommitted income might be generated and how might councils want to use this?

Managing risk under self-financing

4.37 Self-financing would devolve significant responsibility and accountability to local authorities. Local authorities would be responsible for their own long term planning and asset management. This should give councils the ability to manage their business better; but with responsibility comes risk.

4.38 Council housing would remain a major national public service and central Government would have an ongoing interest in ensuring that it was managed well and that tenants' interests were protected. Any local failure could have a cost nationally, as it would be difficult to leave tenants exposed to the consequences of a major problem arising within a council landlord.

4.39 The Tenant Services Authority, working in support of the local government performance framework, would provide the framework for managing these risks. We would expect the TSA to work closely with self-financing councils to ensure they develop strong business plans in consultation with tenants, and that they deliver these efficiently and effectively. We will shortly be bringing forward for consultation regulations which would provide the TSA with strong regulatory powers applying to local authority landlords. Under a common approach to regulation, the TSA would be able to set standards applying to local authorities, subject to strategic direction by central Government.

4.40 We expect there will be a need to build capacity in some councils to take on the responsibility and accountability of self-financing. We will look first to the sector itself to help build this capacity, using the framework that now exists to support improvement.

4.41 Government and the TSA would need to have in place robust systems for monitoring performance and for identifying, at an early stage, any problems. The TSA would have, under a common approach to regulation across all providers of social housing, sufficient powers to take effective action to deal with problems if they were not being managed well locally. The TSA has a range of powers which it would use in a proportionate manner. An alternative, in case of a very serious problem, would be a return to a direct annual funding relationship with Government.

4.42 National Tenant Voice, a new body we are establishing to give tenants both a voice and expertise at national level, will also have an important role to play in making sure that the views of tenants are reflected in the decisions made by landlords and in the national framework set by Government and the regulator.

Capital receipts

4.43 Redistribution is also currently applied to capital receipts through the 'pooling' rules. Under pooling, councils are required to pay Government different proportions of the receipts from Right to Buy sales, Social Homebuy sales and sales of other HRA assets. Pooled receipts are used centrally to support other housing and capital programmes. Councils are allowed to keep more of the receipts from some disposals if they are reinvested for specified purposes related to affordable housing and regeneration. In addition, we recently announced changes to the treatment of capital receipts arising from the sales of new council housing. This now allows councils to keep the full receipt from those sales provided that they are used for affordable housing and regeneration.

4.44 We think there are strong arguments for allowing councils to retain all of their capital receipts i.e. to end pooling of housing receipts. Alongside changes to the revenue rules this would give councils the ability to develop a comprehensive asset management strategy. It would also allow councils to account for revenue and capital in the same place, as part of a single business plan and set of accounts.

4.45 The main justification for pooling has been that receipts do not arise in the areas that need new capital investment most. It has also been argued that, as central Government provided a large part of the investment to acquire many of these assets, it is right that Government should benefit from a share of the receipt.

4.46 However, if councils take on direct responsibility for supporting the debt on their operating assets, it is sensible that councils should also keep the capital receipts arising on disposal of those operating assets.

4.47 In 2008-09, approximately £160m of capital receipts was pooled and paid to Government. When implemented, this proposed change will require CLG to make offsetting changes to its capital programmes. Councils could be required to reinvest some or all of these receipts in new supply or regeneration (particularly where the receipts arose from a sale of a social home). This would help ensure that the receipts continued to be reinvested in housing programmes, and in particular new supply. The impact of the change would be to devolve the investment decision, not to reduce the amount of investment.

4.48 Our preference under self financing is to allow local authorities to keep 100 per cent of their Right to Buy receipts, keeping the local discretion over how the 25 per cent currently retained is split between the general fund and the HRA assets, but requiring the additional 75 per cent to be reinvested in housing. This change would bring the policy on Right to Buy receipts closer into line with other housing receipts.

4.49 If we made these changes, we would also look again at the definitions of affordable housing and regeneration applying to such investment that already exist in legislation, to ensure that they are clear and not susceptible to misinterpretation.

4.50 This change represents a transfer of funds from central to local government and so would reduce the resources available for centrally funded housing programmes.

Question 12:
We have set out our general approach to capital receipts. The intention is to enable asset management and replacement of stock lost through Right to Buy. Are there any risks in leaving this resource with landlords (rather than pooling some of it as at present)?

Question 13:
Should there be any particular policy about the balance of investment brought about by capital receipts between new supply and existing stock?

Question 14:
Are there concerns about central Government giving up receipts which it currently pools to allow their allocation to the areas of greatest need?

Disabled facilities in local authority housing

4.51 An outstanding issue which we agreed to address in the review is the unmet demand for disabled adaptations in local authority housing stock. Local authorities provide adaptations through their HRA allowances. This is not explicitly included as an item in the formula. It is not proposed to change this arrangement.

4.52 In addition specific disabled facilities provision (through disabled facilities grant – DFG) is paid to local authorities for provision in the private sector (including RSLs).

4.53 Local authorities are expected to contribute to this grant in terms of delivering services on the ground. In doing so, local authorities use capital receipt income.

4.54 We suggest above a policy on local authority retention of capital receipts. This would be split 25 per cent and 75 per cent between receipts that could go to the general fund (the status quo) and those ring fenced for the HRA. Such an arrangement would not disturb the income currently used as a source of funds for disabled adaptations in the private sector (including RSLs) and would give additional scope to local authorities to use some of their Right to Buy receipts in the HRA to meet rising demand for disabled adaptations in the LA sector.

Implications of self-financing for transfer and ALMO policy

4.55 Since 2001, the Decent Homes programme has been the main driver for changes to the ownership and management of council housing. All stock-owning local authorities were required to conduct an options appraisal as part of their plan to deliver Decent Homes. This appraisal compared the different models available for delivering their housing services, leading to a local decision about which was most appropriate. Councils who wished to implement a model which involved a change from direct ownership and management were then required to seek the agreement of tenants.

4.56 At present, councils can choose between three main options for delivering their housing services:

- retain ownership and management of the stock
- retain ownership and establish an arms-length management organisation (ALMO) to manage the stock
- large scale voluntary transfer (LSVT) to a registered social landlord (RSL).

4.57 The 2007 housing green paper set out some further options for joint ventures which might combine private finance with an ongoing public sector stake, in particular local housing companies (LHCs). These could be combined with other options and are generally intended to cover only part of the stock. Private finance initiative (PFI) funding is also available for estate-based schemes.

4.58 Government has provided financial incentives for the ALMO and LSVT routes:

- two star ALMOs get extra revenue funding through the Housing Revenue Account subsidy system (HRAS) to finance the borrowing for the capital works needed to bring the stock up to the Decent Homes Standard

- transfers have been supported through payment of ‘overhanging debt’ where the receipt from the RSL taking the housing has been insufficient to pay off the HRA debt, and also ‘gap funding’ grant arrangements for housing stock which has a negative value on sale

4.59 The extra Government funding for ALMOs and LSVT has reflected a view about the benefits of separating the LA strategic role from delivery. Funding for LSVT also prices in a transfer of risk to the private sector and a value placed on ‘off public balance sheet finance’.

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

4.61 The HCA will continue to consider existing transfer proposals to ensure that they are good value for Government and the local authority, and have the support of tenants. We would expect all transfer proposals to proceed to completion where tenants have already voted in favour of a change in landlord. For further cases, we will only fund transfers at standards materially the same as those proposed for self-financing. Where proposals incorporate redevelopment and estate remodelling, the Government will consider such proposed transfers on the same basis as it funds new supply of affordable housing.

Implications for ALMOs

4.62 The Government sees a strong future for ALMOs. Under self-financing they and their local authorities should have the financial flexibility and resources to plan ahead and prosper, and should utilise their experience and local knowledge to broaden and enhance their role.

4.63 A number of ALMOs/LAs have already completed their Decent Home investment programmes and now wish to do more for their tenants, such as engage in a wider range of activities and secure funding from external sources to increase investment levels.

4.64 The Government has already provided very substantial funding to ALMOs for Decent Homes investment programmes. It is expected that the investment carried out would be reflected in any valuation of the housing stock and thereafter any transfer price. The Homes and Communities Agency is currently considering a small number of ALMO/local authority transfer proposals. Going forward, these proposals will need to be demonstrably a good deal in terms of any financial support required from Government. For the future we are proposing that the financial support available for a transfer would be no different from that on offer for self-financing.

4.65 Under domain regulation, we see ALMOs as being able to take on management of stock of other social landlords, where this makes sense. Domain regulation under the TSA is intended to lead to a more vibrant market in management and offer new opportunities for providers.

Local housing companies

4.66 The 2007 Housing green paper introduced local housing companies as a new and innovative approach to public–private joint ventures which provided local authorities with an opportunity to directly influence the place shaping agenda and the provision of affordable homes within their area.

4.67 Fourteen local authorities were identified as part of a pilot programme. These local authorities have been developing proposals to establish local housing companies that combine public land and private finance to deliver new mixed-tenure housing. Current market conditions have impacted upon land values and the availability of both development and mortgage finance, which have, in turn, directly impacted the pace of delivery of local housing companies across the pilot programme. Notwithstanding this, the ability of local authorities to share the development risks as well as the rewards with the private sector through an LHC ensures the continued relevance of the LHC approach to housing delivery in the current climate.

4.68 Working with the Homes and Communities Agency, we will continue to explore opportunities to make progress across the pilot programme 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.

Equality impact assessment

4.69 The Government aims to address any disadvantages that individuals experience because of their gender or gender identity, race, disability, age, sexual orientation, religion or belief, and take into consideration human rights. In making any changes we will have to assess whether they would have any disproportionate impact on particular groups of people and take account of this when implementing changes – detailing potential negative impacts, opportunities to positively advance the equality agenda, or importantly, gaps in our knowledge about likely impacts.

Question 15:
Would any of our proposed changes have a disproportionate effect on particular groups of people in terms of their gender or gender identity, race, disability, age, sexual orientation, religion or (non-political) belief and human rights?

Question 16:
What would be the direction (positive or negative) and scale of these effects and what evidence is there to support this assessment?

Question 17:
What would be necessary to assemble the evidence required?

Section 5

Implementing reform

Timetable for change

5.1 Depending on the outcome of this consultation, the Government would wish to move swiftly to have a self financing option up and running. We have already moved to create a self financing mechanism for local authority new build properties:

- from now on councils will be able to keep the operating profits from newly built stock (instead of losing them through the subsidy system)
- they will also be able to keep all capital receipts from new build units sold
- we have opened up grant from the Homes and Communities Agency to build new homes so that local authorities can now bid

5.2 We are making these changes to the revenue and capital rules for new build using powers in the Housing and Regeneration Act 2008 and through secondary legislation.

5.3 The powers in the 2008 Act allow for individually negotiated agreements between local authorities and central Government to exclude specified stock from the HRA subsidy system. This could, in principle, be used to bring about voluntary self financing. To achieve this would need:

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

5.4 We think it would be possible to set out the terms of such an offer by spring 2010, subject to satisfactory working with local authorities. We do not however think it would be practical to conduct negotiations with over 200 local authorities. So this could only work if all stock owning authorities accepted the terms.

5.5 If this could not be brought about, then we would need to secure primary legislation to achieve a national settlement. The work set out above would be necessary to inform the legislation anyway. We would aim to complete as much of the information and practicalities to get a fair debt settlement while legislation was being prepared. Subject to parliamentary time, a self financing system could be legislated for and be in operation from 2012-13.

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

Annex A:

List of consultation questions

Core and non-core services

1. We propose that the HRA ring fence should continue and, if anything, be strengthened. Do you agree with the principles for the operation of the ring fence set out in paragraph 3.28?

2. Are there any particular ambiguities or detailed concerns about the consequences?

Standards and funding

3. We propose funding the ongoing maintenance of lifts and common parts in addition to the Decent Homes Standard. Are there any particular issues about committing this additional funding for lifts and common parts, in particular around funding any backlog through capital grant and the ongoing maintenance through the HRA system (as reformed)?

4. Is this the right direction of travel on standards and do you think the funding mechanisms will work or can you recommend other mechanisms that would be neutral to Government expenditure?

Leaseholders

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

Debt

6. We propose calculating opening debt in accordance with the principles set out in paragraphs 4.22- 4.25. What circumstances could lead to this level of debt not being supportable from the landlord business at the national level?

7. Are there particular circumstances that could affect this conclusion about the broad level of debt at the district level?

8. We identified premia for repayment and market debt as issues that would need to be potentially adjusted for in opening debt. How would these technical issues need to be reflected in the opening debt? Are there any others? Are there other ways that these issues could be addressed?

9. We propose that a mechanism similar to the Item 8 determination that allows interest for service borrowing to be paid from the HRA to the general fund should continue to be the mechanism for supporting interest payments. Are there any technical issues with this?

10. Do you agree the principles over debt levels associated with implementing the original business plan and their link to borrowing?

11. In addition to the spending associated with the original business plan, what uncommitted income might be generated and how might councils want to use this?

Capital receipts

12. We have set out our general approach to capital receipts. The intention is to enable asset management and replacement of stock lost through Right to Buy. Are there any risks in leaving this resource with landlords (rather than pooling some of it as at present)?

13. Should there be any particular policy about the balance of investment brought about by capital receipts between new supply and existing stock?

14. Are there concerns about central Government giving up receipts which it currently pools to allow their allocation to the areas of greatest need?

Equality impact assessment

15. Would any of our proposed changes have a disproportionate effect on particular groups of people in terms of their gender or gender identity, race, disability, age, sexual orientation, religion or (non-political) belief and human rights?

16. What would be the direction (positive or negative) and scale of these effects and what evidence is there to support this assessment?

17. What would be necessary to assemble the evidence required?

Annex B:

Terms of reference for the review of council housing finance

1. The review of the Housing Revenue Account subsidy system was announced in a written statement to the House of Commons on 12 December 2007. It will be a joint review between CLG and HM Treasury.

2. The review will have regard to wider Government policy that is material to the outcomes of the review: tenant aspirations and empowerment; the role of OFTenant; incentives to work; housing benefit policy; and fiscal policy. It will have regard to the impact that social housing has on other policy areas such as a contribution to the reduction in child poverty, regeneration and health of citizens.

3. The aim of the review is to work towards a solution that allows a long term sustainable system for financing council housing to be put in place.

Purpose of the review

4. To develop a sustainable, long term system for financing council housing, one that is consistent with wider housing policy, including the establishment of a regulator of social housing.

5. Any new proposals must conform to the following conditions:

   - fairness and affordability for both tenants and taxpayers
   - transparency, giving a clear and accurate picture of the balance of support from local and central government
   - agreed minimum standards of service and accommodation
   - social rents can provide a platform for social and economic mobility to tenants
   - landlords will continue to improve the quality and efficiency of services
   - government is not exposed to unacceptable fiscal risks
   - there will be more certainty and less volatility in the funding of council housing.

Guiding principles

6. The review will be underpinned by a set of principles consistent with wider Government policy on Central Government's engagement with local authorities and the commitment to improving the quality of life in local communities and better public services through the new local performance framework. We will need to take full account of the renewed emphasis on empowering citizens (including social tenants) through their meaningful engagement in the design and delivery of services, as

people want a clear voice in how services are provided: they want to live in strong and resilient communities and they want their public spaces and buildings to express their pride in those communities.

7. We will also be mindful of our responses to the Cave Review and Hills Report and the current policy on the delivery of Decent Homes.

8. The principles are:

- tenant involvement in local decision-making about the homes in which they live should be strengthened, with greater choice and mobility introduced into the system
- standards and services at similar costs should be provided to all tenants regardless of which landlord (local authority or housing association) owns the property
- similar properties should have similar rents regardless of landlord and that we should work towards achieving this in a timescale which maintains affordability for tenants
- where appropriate, the system should allow more flexibility and greater devolution to the local level, supported by some degree of control and appropriate safeguards
- the system of funding council houses should not work against the broader policy of helping more tenants into work
- local authorities will continue to be landlords
- there will be a single cross-domain regulator
- the system should enable landlords to deliver improved efficiency and cost effectiveness in services
- to introduce greater transparency into the system and reduce administrative burden where possible.

Remit

9. To inform the annual HRA subsidy determinations in the remaining two years of the current spending period.

10. To inform a policy framework for rents and standards for the regulator of social housing.

11. To consider options for the future of the subsidy system including rents policy and to inform the next spending review.

12. To commission research to support the review.

Broad scope

13. There will be five workstreams in the review: four will cover the detail of issues in each area, as exemplified below, and an overarching workstream will ensure integrity across the piece and that the review takes full account of other interdependent policies.

a) Costs and standards for social housing could take into account:

- minimum standards and services that tenants should expect
- potential to link service delivery and what tenants pay
- maintaining decent homes and any future physical and/or other standards
- costs of delivering standards and services
- can formulae ever deliver the right amount of money to the right places
- the role of the regulator in standard setting

b) Within the principle that similar rents will be charged for similar properties the work on rents could take into account:

- tenant influence over rent levels in relation to costs/standards of service delivered
- separation of rents and service charges
- effectiveness of the current rent formulae
- the process of rent restructuring and the timescale for convergence; convergence and achieving common rents across RSLs and LAs
- rent levels and utilisation of surplus rental income

c) Mechanisms for delivering funding could take into account:
- devolution to LAs and possible contractual relationship with LAs
- how to exercise influence over devolved system
- utilisation of any surpluses generated from rental income
- handling of historic debt
- for a national system –improved formulae/reduced complexity/less volatility
- more effective asset management

d) The current rules governing a local authority's HRA could take into account:
- the rules and regulations covering the HRA (e.g. use of the major repairs reserve) and any other accounting treatment issues and whether these have any inhibiting effect on the efficient running of services
- operation of HRA ring-fence and extent to which this should fund improvements to homes and/or estates

e) A fifth workstream will ensure the strategic integrity of the review.

14. The review will not consider the following areas:
- means testing on rents
- different rents policy for LAs and RSLs
- potential housing benefit policy changes
- changing the sub- market basis of social housing rents
- changes to the role of OFTenant

Governance and accountability

15. The review will be led jointly by CLG and HM Treasury, reporting to Caroline Flint, Minister for Housing and Planning at CLG and Yvette Cooper, Chief Secretary to HM Treasury.

16. The review will be steered by a Programme Board the members of which will include senior officials from CLG, HM Treasury and DWP. The Board will meet monthly and report into established CLG and HMT governance mechanisms.

17. Other government departments – DCSF, DoH and DEFRA – will be engaged as appropriate.

18. Stakeholders will be invited to contribute to the review at regular intervals during the process.

Reporting

19. The review will report to ministers in spring 2009, setting out options for the subsidy system including rents policy and to inform the next spending review.

20. The outcome of the review will be considered as part of the next spending review and any proposals emerging from the review will be followed by a period of consultation.

Annex C:

List of external research

1. *An evaluation of management and maintenance costs in local authority housing. Housing Quality Network, (2009)*

2. *A review of the major repairs allowance. Building Research Establishment, (2009)*

3. *An analysis of rents. Prof Steve Wilcox, University of York (2009).*

4. *Options for dealing with housing loan debt in the local authority sector, Tribal Consulting, (2009)*

5. *Tenant attitudes to council housing finance and rents policy. Housing Corporation Survey, (2008)*

6. *Summary of findings from tenant engagement work, CLG (2009)*

These are available on the CLG research publication page:

communities.gov.uk/corporate/researchandstatistics/research/researchpublications and

communities.gov.uk/publications/housing/councilhousingfinance

Annex D:

Glossary of terms

Actual debt	Actual HRA debt is unknown as authorities manage their debt portfolios in aggregate and do not keep track of loans taken out specifically for the HRA. The general fund meets all costs initially and receives a contribution towards them from the HRA.
Actual rent	The rent charged by an authority to its tenants.
Arms-length management organisation	An independent body established by, and outside, a local authority to manage all or part of the council's housing stock.
Capital receipts	Payment received on the sale of a capital asset, e.g. the 25 per cent un-pooled part of Right to Buy proceeds. Also receipts from LSVT, Social Homebuy or the sale of an authority's land, which are not pooled if used for specified purposes such as affordable housing.
(DoE) Circular 8/95	Circular that established the principle of the HRA as a landlord account. It is based on a 1990s outlook and needs updating to allow for change mechanisms and practices, and modern views on the widening role of the landlord, the services the landlord should provide and the appropriate allocation to HRA or general fund.
Consolidated rate of interest	The average interest rate for the year on all money borrowed by a local authority (not just relating to the HRA), including temporary borrowing. It is unique to each local authority and depends on the proportion and level of fixed and variable interest rates, the historical profile of borrowing and the local authorities' debt management policy over the years.
Core (landlord) services	Core or essential services include letting, rent and charge collection, maintenance and tenancy management. Non-core services include managing community facilities and open space, unadopted roads, housing register, community safety and family support. Examples of more grey areas are anti-social behaviour and routes into employment.

Decent Homes	Government defines a Decent Home as one which is weather tight, warm and has modern facilities. A universal set of standards is applied in the national programme to make all social housing decent, and Government expects around 95 per cent of social houses to be decent by 2010, with the rest following soon after.
Determination	The annually set package of allowances given by Government to each local authority for the management, maintenance and repair of council housing.
Formula rent	The rent arising from the application of the national formula, which is being implemented over a 10 year period from 2002. The formula is based partly on the relative capital value of the property, partly on local manual earnings and partly on the number of bedrooms.
Gap Funding	Where a stock transfer takes place with a negative value (expenditure exceeds income over 30 years) the RSL will require 'gap' funding. This can be met by the RSL, the local authority, the Regional Housing Board or, between 2004 and 2006, CLG.
General fund	This includes most of an authority's day to day spending and income, including some housing related elements (e.g. homelessness and maintaining the housing register). All spending and income relating to the management and maintenance of the housing stock is kept separately in the HRA, which is ring fenced from the general fund.
Gross Domestic Product	The value of the national aggregate production of goods and services in the economy over a time period, usually a year.
GDP deflator	An index used to estimate the real price of goods and services in the economy, calculated by dividing the total value of GDP by a measure of the real volume of GDP in the same period.
Guideline rents	The notional rental income of an authority, used for calculating HRA subsidy.
Housing Revenue Account	A ring-fenced local authority account of all housing income and expenditure that is required by statute.
Item 8	Item 8 of Parts I and II of Schedule 4 to the 1989 Act, requiring LAs to credit/debit their HRA using a formula. Credits are made for interest and debits for capital charges.

Large scale voluntary transfer	The transfer of all housing stock, following a positive vote by tenants, from a local authority to an existing or newly established housing association.
Leaseholder charges	Charges to leaseholder made by the owner of the freehold, e.g. by an authority to the Right to Buy owner of a leasehold flat, for the maintenance of common areas.
Limit rents	The maximum rent for which DWP will fund housing benefit.
Major repairs allowance	The annual allowance provided by the Government for an authority to meet the ongoing capital costs of maintaining the current condition of its housing stock.
Major repairs reserve	Authorities are required to set up a major repairs reserve and transfer into it a sum equal to the major repairs allowance. This reserve can be used for capital expenditure on HRA assets or to repay borrowing and unspent money can be carried over to the following year.
Management and maintenance allowance	A part of the notional expenditure element of the HRA subsidy calculation which represents an estimate of each local authority’s relative need to spend on the management and maintenance of its housing stock.
Negative subsidy local authority	One that makes payments into the national subsidy system that redistributes surplus rental income.
Notional debt	A separate version of the HRA debt which is used for the purpose of assessing an LA’s entitlement to HRA subsidy. This entitlement is the HRA subsidy capital financing requirement.
Opening debt, self financing	The level of an authority’s debt at the outset of self financing, after payment of the self financing settlement.
Options appraisals	To provide the investment needed to make all social housing decent, CLG gave all authorities three options. These were to establish an ALMO or transfer stock to an RSL or enter into a PFI contract. Some authorities have opted for a mixture of these, or to retain their stock and to make it decent using their own resources.
Overhanging debt	Where the net receipt from a large scale voluntary transfer is not sufficient to cover the authority’s notional housing debt, the shortfall, or overhanging debt, can be paid by the Government.

Pooling, of capital receipts	A proportion of capital receipts from the sale of housing land and dwellings is pooled nationally – 75 per cent of receipts from Right To Buy sales but not receipts from large/small scale voluntary transfers. For all other housing receipts, 75 per cent is pooled from sales of homes, 50 per cent from sales of land or other HRA property.
Pooling, of rents and service charges	In 2004 authorities were advised by Government to de-pool, or separate, service charges and rents. Authorities vary in the extent to which they have done so.
Positive subsidy local authority	One that receives subsidy payments from the national subsidy system that redistributes surplus rental income.
Prudential code	A statutory system that combines self regulation and external audit, to control levels of local government debt by means of cyclically set prudential indicators.
Registered social landlord	Government funded not-for-profit organisations that provide affordable housing. They include housing associations, trusts and co-operatives. They work with local authorities to provide new affordable housing and perform a landlord function for their own stock.
Rent restructuring	The process whereby social rents are adjusted over time, with a view to achieving target rents on completion. Policy has been to work towards fair and affordable rents that are similar for similar properties in the same area, by gradually reducing the gap between local authority and RSL rents, and between RSL rents, to achieve rent convergence by 2012. Formula rents take account of the size and value of the property as well as local earnings.
Retail prices index	The monthly Index in the UK that demonstrates the movement of retail prices. It effectively shows the cost of living as it tracks the prices of UK consumer goods and services, including mortgage interest and rent.
Subsidy system, HRA	The system whereby an authority's assumed housing costs and income are assessed annually and any surplus income or shortfall is paid into or drawn from a national redistributive system, with national surplus or shortfall going to or being met by Government.
Target rent	See *rent restructuring*.
Tenanted market value	A method of valuing housing stock by valuing the associated future income and expenditure needs.

Annex E:

List of acronyms

ALMO	Arms length management organisation
BRE	Building Research Establishment
CIH	Chartered Institute of Housing
CIPFA	Chartered Institute of Public Finance and Accountancy
CLG	(Department for) Communities and Local Government
CRI	Consolidated Rate of Interest
DFG	Disabled Facilities Grant
DWP	Department for Work and Pensions
GDP	Gross Domestic Product
HCA	Homes and Communities Agency
HMT	Her Majesty's Treasury
HRA	Housing Revenue Account
HRAS	Housing Revenue Account Subsidy
KLOE	Key Lines of Enquiry
LSVT	Large Scale Voluntary Transfer
MRA	Major Repairs Allowance
NHF	National Housing Federation
PFI	Private Finance Initiative
RPI	Retail Prices Index
RSL	Registered Social Landlord
SAP	Standard Assessment Procedure
TSA	Tenant Services Authority

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