



# **CLG-HMT REVIEW OF COUNCIL HOUSING FINANCE**

## **CIH SUBMISSION TO THE REVIEW**

### **SEPTEMBER 2008**

The Chartered Institute of Housing (CIH) is the professional body for people involved in housing and communities. We are a registered charity and not-for-profit organisation. We have a diverse and growing membership of over 21,000 people – both in the public and private sectors – living and working in over 20 countries on five continents across the world. We exist to maximise the contribution that housing professionals make to the wellbeing of communities.

#### **1. Introduction**

CIH has welcomed the government's commitment to a thorough review of the mechanisms for financing council housing in order to achieve a long-term sustainable system.

In 2005 CIH, with HouseMark and NFA, put forward a range of options for the financial future of council housing administered by arms length management organisations<sup>1</sup>. This led the government to establish a working group (to which CIH contributed) to consider self-financing for housing authorities. This led in turn to the current, wider, review.

CIH has previously highlighted the aspects of the system that cause concerns in the sector. In particular we have drawn attention to problems with the underfunding of allowances (both Management & Maintenance and the Major Repairs Allowances); the complexity and lack of transparency of the current system; and the fact that it makes use of prudential borrowing very difficult in the housing service compared to other services. To these concerns must be added the recent evidence that the overall Housing Revenue Account subsidy system has moved into surplus, resulting in money being lost from an already

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<sup>1</sup> ALMOs – a new future for council housing; CIH, HouseMark, NFA (2005) - <http://www.cih.org/policy/ALMOreportNov05.pdf>

underfunded system, and that the surpluses are likely to grow if the system remains as it is.

This submission to the CLG-HMT review builds on our previous work and arguments. It also supports government's aim to find a sustainable system of financing which contributes to several key policy imperatives, notably:

- Tenant involvement in decision making
- Devolution with appropriate controls and safeguards
- Transparency and simplicity.

## **2. Summary of response**

CIH is calling for:

- abolition of the national, redistributive, system for council housing finance
- a new system of council housing finance where councils retain all rental income and use it directly to fund housing services
- the new system of council housing finance to be introduced in one go for all local authorities
- a system that will not put local authorities in a position where they cannot retain ownership of their housing stock – CIH would oppose proposals that would deliver such a system
- historic debt costs which are now partly met by revenue cross-subsidy between local authorities, should in future be met by a capital settlement between local authorities based on 'need to spend' and 'ability to pay'
- housing finance to continue to be separate from other authority finances, either through an HRA ringfence or a housing budget sheet, but with locally agreed flexibilities
- further work on the potential for all future capital receipts to be retained at local level rather than being partially pooled at national level
- some flexibility for rent setting within individual housing organisations, governed by parameters set by the regulator
- use of the new regulatory system to put safeguards in place to enable meaningful reform of council housing finance to happen
- a strong focus on business planning overseen by the regulator to mitigate risks of reform
- focus on preparing local authorities to move into a new system successfully
- the finance system to provide incentives to meet standards and tenants' requirements
- housing finance reform that enables local authorities to participate fully in the housing reform agenda, offering more flexible services to tenants
- further consideration of European models that keep council housing borrowing outside the main measure of government debt.

### **3. Preferred approach to reform of council housing finance**

The current system should be replaced with one which has local control as its central driver, where rental income is retained locally to fund housing services. This will drive a more strategic and planned approach to housing investment and management by local authorities. It would also allow for greater resident/ tenant choice and influence over services received, and how these are funded through rental income. The system should also ensure that sufficient resources are available for *all* local authority landlords to provide and maintain an attractive housing stock that not only meets the Decent Homes Standard but goes beyond it to achieve wider 'liveability' and sustainability of the housing stock and the neighbourhoods in which it is located.

The new system should be introduced in one step for all stock-retaining authorities. This may require a transitional period to prepare for the changes, but the ultimate aim should be a one-off move to one system of housing finance. A new system should not be introduced by allowing a gradual opt-out from the national redistributive framework for authorities that choose it. A two-tier system which would be created if reform allowed some authorities (e.g. those in a stronger position in relation to debt) to opt out of the national system would not be acceptable because it would leave others in a system that would be difficult to resource. A one-step approach inevitably raises the issues of how to secure agreement from all authorities, how to protect the authorities that are most vulnerable to change, and whether the government will be prepared to impose a settlement if a minority do not want to opt out of the system.

Reform should not only aim to improve accountability to tenants and maintain an attractive stock. It should also seek to ensure that housing plays its role in the overall local authority place-shaping agenda and encourage greater community control over services delivered. Neither of these wider objectives is promoted by the current, inflexible financial regime.

The council housing finance system should enable local authorities to make effective links to the dynamic changes occurring in the policy context, in particular in relation to regulation and performance frameworks and the housing reform agenda.

Dealing with the issue of historic debt is vital to achieving a new system which is viable across the board for different types of authority, will not involve ongoing subsidy to authorities that still have debt that cannot be resourced from rents, and will be sustainable in the long term. CIH will not support a new system of council housing finance which only deals with the surpluses being generated by the majority of 'negative subsidy' authorities, and which does not resolve the historic debt currently supported (in part) by 'positive subsidy' payments to the minority of authorities. The review must lead to a viable future for all authorities on an equitable basis.

#### **4. Key elements that the proposed system should address**

##### **i. Flexible, tenant-focused services**

CIH strongly supports resident involvement in delivery and scrutiny of housing services. Our work on resident-led self-regulation and customer insights has been reflected in the policy shift to promoting greater attention to and choice for tenants as customers. The system for sustainable long-term housing finance should strengthen tenant focus, influence and accountability, and contribute to the wider place-shaping agenda of local authorities. The system should enable local authorities and their tenants to have meaningful discussion on what services they want to be delivered, and have the flexibility to respond with different rent levels. It should facilitate setting and achieving long-term ambitions for the area and for the housing stock based on a realistic modelling of future income. This would need to be set within certain parameters in order to ensure:

- a degree of certainty for national government of the implications of the exercise of local flexibility for Housing Benefit, and that
- the principle of 'similar rents for similar properties' is still broadly followed.

CIH therefore calls for a system which allows for rental income and surpluses to be retained by local authorities to enable them to agree priorities, services and rent levels (within parameters) with tenants, and to offer flexible service packages to individuals.

##### **ii. Rent setting**

Rent restructuring has delivered in terms of reasonable certainty for this element of business planning, but has effectively made tenant consultation on rent setting of little real use. It also precludes use of a menu of services for individual tenants. Following the end of the current rent restructuring system, the role of the Tenant Services Authority (TSA) will be important in setting parameters within which local authorities and tenants together can set the priorities and therefore the final rents to shape long-term services and investment. The future system of rent setting for local authorities and housing associations should support resident involvement and a menu of services.

The underlying principle of 'similar rents for similar properties' should be retained, in particular because of its importance in preventing local market distortions. CIH's preferred system could be set within the context of current rent restructuring policy and/or implemented via the coming role of the TSA in setting guidelines for affordable rents.

Within overall guidelines about affordability, which take account of the impact on housing benefit costs, the finance system must allow a degree of flexibility for local authorities together with tenants to set actual rents and agree service priorities. This would maximise the engagement of tenants with their landlords in agreeing how to ensure that the business plan can contribute towards the long-term vision for the area and stock, and the rental income needed to achieve that.

Within TSA rent guidelines, planned rent levels would be a key element in judging the robustness of business plans prior to leaving the HRA system. The TSA would also need to have an ongoing role in ensuring that longer-term investment in stock occurs. Although the new regulatory system to be operated by the TSA has yet to be established, it is clear that in order to support council tenants and housing finance reform the organisation will need to take a robust domain-wide approach which goes beyond the remit of the local performance framework.

### **iii. Dealing with historic debt**

Resolution of historic debt is a key element of the whole review, but clear and obvious ways to address it are hard to find. Historic debt is a major complication in the system and a cause of tension for councillors, officers and tenants of authorities (both those in positive and negative subsidy). Unless historic debt is resolved, local retention of income for all will not be viable. Because of the improvements offered for long-term planning and investment, many local authorities have expressed a preference for a one-off settlement of debt issues, however difficult to explain to tenants, rather than a continuation of ongoing annual 'subsidy' to service debt.

The new system must provide a resolution to the constraints imposed by historic debt to achieve future stability for long-term planning, as well as greater transparency and simplicity in the system.

CIH has some key priorities in relation to the treatment of debt, and would support the review team in modelling alternative routes to achieve them. The issue of debt should be resolved to:

- allow all authorities to be released from the current system, through a one-off settlement of debt
- enable all to fund fully ongoing management and maintenance of decent stock
- give local authorities more flexibility to respond to their own tenants' priorities.

This will involve:

- government taking over or redistributing part of the debt between authorities, based on some assessment of ability to pay
- removal of the safety net of a national redistributive finance system, with authorities taking on additional risk.

David Hall is doing some modelling for the review team to investigate approaches to debt resolution via a redistributive approach, and his work is seeking to establish how much debt the positive subsidy authorities can service and how to distribute remaining debt amongst negative subsidy authorities. This would necessitate clear and robust assessment of the income levels needed by authorities to maintain and run their housing fully, in order to assess accurately the level of debt each authority could retain or take on. CIH would support this approach to resolving historic debt if it can be demonstrated to provide for authorities:

- a final agreement which will release them from the current ongoing system of 'subsidy'
- adequate financing to maintain and manage their stock, and respond flexibly to future needs
- certainty that allows for long-term planning and local autonomy.

The modelling of the system will be vital in establishing what the actual redistribution of debt will be, in order to support debate and agreement with elected members and tenants. CIH would support further work on this model to establish levels of investment required and the amount of debt each authority can service from rental income.

Local authorities may need to commit to delivery of efficiencies or levering in additional resources in order to make this one-off redistribution work. There seems to be an appetite within local authorities to do this in return for an improved financial system. More work is needed to consider specific ways to achieve this.

Business plans will need to be revisited to assess investment needs, and should then be revisited regularly as a means to ensure that risk is being adequately managed. This should be a requirement placed on authorities by the TSA.

An alternative approach to resolving historic debt is to use the surpluses that would have accrued in the national HRA during the next spending review period to offset debt held by the positive subsidy authorities. Modelling could be used to explore whether this would be sufficient to reduce their debt to the point where they could, from then on, be self-sustaining and whether that would mean that, from the same date, the negative subsidy authorities could keep all their rental income (indeed, that all LAs could then keep their rental income).

A further alternative approach to the issue of debt is to ascertain the levels of new debt entered into by authorities in order to improve stock and treating this differently to previous historic debt, by attributing the full measure of the recent debt since the start of the Decent Homes programme (2000) to the responsible local authorities. Work commissioned by the review team to look into the composition of the debt could enable this idea to be explored further. This approach would allow authorities to keep responsibility for debt that has clearly delivered benefits recently, and to separate off the historic debt that is harder to understand.

The question of how to treat the remaining historical debt still stands. If this alternative were taken forward, the same principle of apportionment according to ability to pay should be applied to the remaining debt. A modification to this approach might be to use the reserved part of capital receipts to offset against the debt, subject to a separate exercise ascertaining the impacts of this (as discussed further under capital receipts).

#### **iv. Implications for Housing Benefit**

Currently, housing benefit for council tenants (in the form of rent rebates) costs about £4.5bn annually in England. This figure has fluctuated year-on-year but has been broadly at this level for about the last ten years. In contrast, the costs of housing benefit (as rent allowances) for private and housing association tenants have doubled over the same period, and are now about £10bn (across GB). Although it will be argued that the HA and private sectors have both grown over the ten years, it can also be argued that local authorities have had to increase rents in real terms under rent restructuring, yet this has not caused HB costs to rise above previous levels. Government does in any case acknowledge that HB costs fluctuate according to the state of the economy, by including them in the more flexible Annually Managed Expenditure (AME) category of public spending, rather than in the Departmental Expenditure Limits (DEL) controlled strictly in each Spending Review.

If the council housing finance review results in a settlement which allows authorities to raise rent levels, it may well have some impact on HB costs, but experience suggests this is not likely to be excessive. It could be that a broad 'affordable rents' policy, within which LAs would have some flexibility, would have no more impact on HB costs than the current rent restructuring policy has had. Although a settlement which acknowledges a greater investment need than is reflected in current MRA levels could push up rents, equally it would be open to the Treasury to settle more historic debt, therefore ameliorating the impact on HB costs. That is, rents would not have to go up just because current allowances are insufficient, because addressing debt issues will leave local authorities in a better financial position overall.

There is also a current constraint in terms of the rent rebate subsidy limitation which government might continue. However, CIH would favour ending this, as it is one of the complicating factors which reduce transparency and simplicity in housing accounts, and would presumably require the continuation of explicit 'limit rent' levels set for each local authority.

Rent increases in the future will be an important part of meeting the investment needs of the stock and the level of services required by tenants, and addressing the current underfunding. Whilst acknowledging that this will have implications for public expenditure on housing benefit, the underfunding of the current system would in any case have to be addressed over the long term, to ensure that the benefits from achieving the Decent Homes Standard are not lost, and to allow local authorities the flexibility to respond to and empower local tenants' choices.

Rent increases are of course a sensitive matter for tenants who do not use benefit to pay their rent, especially given the current economic climate. Although research in the CLG-HMT work streams shows that local authority rents are affordable, any increases need to be handled sensitively in conjunction with tenants, and they must be used strategically and to visible effect.

## **v. Surpluses**

A fully devolved system of local authority housing finance would mean that a local authority will keep all surpluses. By 'surplus' we mean the revenue remaining after maintenance and management of housing stock and servicing of agreed debt – given that our proposed system will allow for all authorities to be released from the current system with a level of debt which they can manage. The surplus should be used to develop services in response to local tenants' requirements and to fund future financial commitments. This could mean that some authorities become financially well off essentially due to an accident of history (low stock management costs compared to rental income). This is an acceptable consequence because all local authorities have housing needs that can be addressed using the surplus - the income is unlikely to be lost to housing or squandered on non-priority or unnecessary investment.

This approach of ending redistribution of surpluses across local authorities does carry a level of risk for local authorities because any underfunding cannot be propped up. However, resolution of the outstanding debt according to the model proposed should ameliorate the level of risk because income and expenditure margins should not be so close for most local authorities. Freedom to plan in the long term will also enable authorities to act more strategically and achieve efficiencies across their services which the current system does not facilitate.

The system will encourage local authorities to adopt a strong business planning approach and should encourage efficiencies, driven by greater accountability to and engagement with local tenants as well as the potential for enhanced service delivery due to income retention. To further support authorities in strengthening their business plans, there should be a template to ensure they are robust in assessment of the level of financing they require.

There should be a requirement for annual 'health checks' of business plans, audited on certain key measures (stock condition reappraisal, investment levels achieved, etc), required by TSA.

Concerns over the use of surpluses to support further borrowing (and the potential impact for public sector net debt (PSND) and Treasury's sustainable finance rules) can be addressed by local authorities voluntarily reaching agreement with Treasury on limits to future borrowing, as originally proposed under the self-financing pilots. These agreements would be based on the business plans at the time of exiting the HRA system.

Use of the surplus as revenue spending to avoid borrowing may be another approach, but more might be achieved by allowing the levering in of private capital to support long-term investment in parts of the stock.

It is also worth pointing out that the position of council housing in the public accounts continues to be anomalous. Its borrowing contributes significantly to overall public borrowing measured by the PSND, and there is currently considerable concern that the level of PSND will soon exceed the Treasury's limit (of 40% of GDP). However, if the deficit were defined in terms of the

rules followed in the Maastricht treaty and adopted by most other European governments, council housing (whether managed directly or through an ALMO) would be outside the more narrowly defined 'general government' sector. Its future borrowing potential would no longer have an impact on the measurement of government debt, and could be left to be governed by the 'prudential borrowing' rules alone. This wider issue should be addressed in the review in order to maximise the opportunities available for council housing finance reform.

#### **vi. Capital receipts**

In a devolved system, all housing receipts (from RTB, HRA land, garages etc) should ideally be returned to the local authority for housing purposes. It would then be open to the authority, in partnership with tenants, to determine the use of the receipts - for investment in stock, possible new council build and/ or offsetting of debt. This is what currently applies in Scotland.

However, council housing receipts do currently form an important part of the government's overall receipts from asset sales, which offset public borrowing or allow higher levels of spending than would otherwise be the case. If these were used instead to fund new investment at local level, this could have an impact either on national investment levels (through the National Affordable Housing Programme) or on national borrowing levels (expressed in PSND).

There should be a separate exercise, within the HRA review, to assess the feasibility and implications of devolving the spending power of receipts to local level, its impact on some typical authorities (including those now debt-free) and its possible implications at national level.

#### **vii. Incentives**

The use of incentives has been shown to drive continuous improvement. A devolved system should have in-built incentives for excellent performance.

If authorities meet financial performance levels set out in their business plans they will be rewarded by having the investment resources provided for in those plans. This should be a strong incentive (as it is with HAs) to maximise income by (for example) minimising voids and rent arrears. However, there will be a continuing need to incentivise non-financial performance (such as repairs response times and tenant satisfaction levels). Issues about action on such underperformance and a possibly failing housing service are discussed under the section on the 'Brave New World' below.

The role of the TSA and the new tenant-focused regulatory system should itself incentivise local authorities to drive up standards to meet tenants' requirements. The ability of local authorities to achieve these expectations under a new regulator will be greater if they have stronger, more effective control of their annual income, and the ability to plan long-term.

### **viii. Ring fence**

The requirement for a separate way of accounting for council housing finance (the local HRA ring fence in the current system) should be maintained in the new system. The ringfence has been widely supported in the current system as a way to protect housing spending. In future, separate accounting could be achieved through a ringfenced HRA or a housing balance sheet in order to clearly reflect flows of money within the authority. What spending is inside and outside the ringfence should be nationally defined in a way that gives local flexibility alongside accountability.

The TSA will establish the core housing elements for regulation, and spending on these elements should form the core of spending activity within the ringfence - the primary aim is maintaining and improving the decency and quality of stock.

There should be the opportunity for inclusion of spending on additional non core elements, which will allow for negotiation and agreement with tenants and the wider community around how certain services are paid for – through the LSP and setting the LAA. It should be clearly monitored and accounted for, so that there is transparency over what is being funded with what monies, and how tenants have been engaged in these discussions. This should only be possible after meeting the core housing elements, and the TSA should have a role in ensuring local authorities are held to account on the ongoing investment into their stock, and accountability to tenants on the use of housing monies for non-core elements.

There is an issue about whether capital should be ringfenced in the same way as revenue. This might be appropriate if authorities were – as suggested – to be allowed to retain all their housing receipts. In the future, with the ending of the national HRA system, it would be logical for capital investment to be financed by a combination of prudential borrowing (based on rental income), receipts from sales of housing and housing land, and grant (e.g. Social Housing Grant). It would be appropriate to maintain a housing capital balance sheet, so that the assumption is that housing receipts would be reinvested in housing, although this would not preclude a specific decision (e.g. to finance a community centre on an estate by selling some land) that would take capital away from housing. However, having a separate housing capital balance sheet would make such decisions transparent and open to discussion with tenants.

### **ix. Risks in a brave new world**

There are risks in the devolved system proposed. In particular this could arise if the business plan is flawed and the LA experiences difficulties keeping its HRA 'solvent' and maintain standards. With the removal of a national subsidy and redistribution system, there is not the same capacity to support an authority that is unable to match directly raised income to spending needs. However, authorities *have* always had to deal with the realities of managing the resources available to them and facing the penalties of poor performance.

It is not acceptable to create a risk that (in the early days) the new financial system forces stock transfer. Risk must be mitigated by local authority behaviours and regulation. There is a need for robust audited business plans, with annual 'health checks' as proposed previously in the paper, and a strong domain regulation by the TSA that goes beyond the Local Performance Framework.

There should also be a clear action plan developed in the short-term to build capacity within local authorities to prepare for this changed approach, and the requirement to plan strategically, develop robust business plans, and actively engage tenants in the process.

Where a housing association experiences difficulties, it is normal that it has to be more closely supervised (currently by the Housing Corporation) and then possibly may have to merge with/ be taken over by another association. In a policy framework that is seeking customer focus and service excellence, the regulatory system must contain ways to deal with failing local authorities. As set out in our submission to the Cole working group on regulation, the options for a 'rescue plan' for local authorities where performance rather than the finance system is the problem could include:

- Peer support – working to an agreed action plan with help from others in the sector
- A management rescue using expertise from a high performing ALMO or authority
- The authority could voluntarily undertake a further ballot of tenants on options and possible transfer to housing association
- A transfer of management of stock in response to tenants' and TSA's intervention.

The self-financing project set out some proposals for measures to be taken in the event of a financial crisis in an authority, in section 9.8 of the final report. There might be some potential in considering an insurance system and CIH would support further investigation into this, including the possibility of any international examples of such systems.

## **5. Summary**

CIH is calling for an end to the current HRA subsidy system, and its replacement with a finance system for council housing which fully devolves finance and control to local authorities.

To achieve this there needs to be an agreed resolution of the historic debt. As long as modelling already underway demonstrates feasibility, debt resolution should involve all authorities taking on some proportion of overall debt, based on an assessment of ability to pay following robust assessment of investment needs.

A move to a new finance system along these lines will entail the transfer of additional risk to local authorities, and steps will be needed to mitigate these

risks. Local authority business planning and efforts to seek efficiencies, alongside oversight by a domain regulator will be key in risk mitigation.

Despite this risk, this new system will empower local authorities to work more effectively with their tenants in setting future priorities for their stock that meet local needs. It will enable them to act strategically and plan robustly for the future. And they will be able to respond positively to the dynamic and changing policy context in which housing is operating, including moves to customer-focused regulation and the wider housing reform agenda.

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