Chartered Institute of Housing in Scotland

HOW DO WE SECURE MORE INVESTMENT FOR COUNCIL HOUSING IN SCOTLAND?

Taking the debate forward

A CIH in Scotland Policy Paper

May 2002

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Written by John Perry

Chartered Institute of Housing in Scotland

The Chartered Institute of Housing in Scotland is the professional organisation which represents people who work in housing. Our purpose is to take a leading and strategic role in encouraging and promoting the provision and management of good quality, affordable housing for all. The CIH has over 16,500 individual members working for local authorities, registered social landlords, educational establishments and the voluntary and private sectors.

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Foreword

The Scottish Executive's policy for investment in council housing has focused on the large-scale transfer of housing, to attract additional resources from private sector funders and to move to community ownership of the housing stock. The policy reaches a critical stage as key local authorities put their proposals for stock transfer to their tenants during 2002.

The results of these ballots will establish whether authorities will or will not be able to proceed with transfer to community ownership. These decisions will clearly have an important influence on the whole future of council housing in Scotland.

The Scotland National Committee of the CIH has produced this paper to examine the options for securing future investment in council housing against the background of current policy. An initial draft was published early in 2002 following the successful transfer ballot for Scottish Borders Housing Association but before the result of the transfer ballot in Glasgow in April. Following two seminars with experts in the field, and with the benefit of their views, this final version is being published after the Glasgow ballot.

It is hoped that the paper will assist policy makers to develop options for investing in council housing and will influence the policy agendas of political parties in the run up to the Scottish Parliament elections in May 2003.

Lynn McCulloch
Chair, Scotland National Committee of the CIH

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How Do We Secure More Investment For Council Housing In Scotland? – The Key Arguments

The future of council housing in Scotland is a key political issue, especially given the recent votes on the transfer of housing to new, community-based organisations which will be able to raise the investment required to tackle the backlogs of improvement and repair work. Yet despite the 'yes' votes supporting transfer – earlier this year in Scottish Borders, and in April in Glasgow – many councils and tenants groups are either opposed to transfer or not actively pursuing it. Unless the Executive encourages other options, there is a real danger that poor conditions will continue in many areas and tenants will not see the new investment in their homes that is urgently needed.

CIH has looked at the background to the Executive's policy of supporting transfer and what it is trying to achieve. It has looked at the response of local authorities – only a small proportion of which have so far taken steps to transfer all their housing stock. It has considered what the aim of policy should be – to provide the best housing service for tenants that we can – and how this aim can be turned into an achievable target for Scottish council housing. To achieve this aim, CIH puts forward some new options which it believes the Executive should make available so that councils and tenants have a wider choice.

Investment, standards and targets

Public investment in council housing is barely increasing, and is based on levels inherited from before devolution. No proper assessment is available of the scale of investment needed to tackle poor conditions. Such an assessment is urgently needed. It should be based on a clear standard – a Scottish Decent Homes standard – which sets out what tenants should be able to expect from their housing in the twenty-first century. Every council which owns housing should have to prepare a business plan showing how this standard will be achieved, and the Executive should decide on a target date – we propose 2013 – by which the standard will be met. This target should apply to all housing in the social rented sector and therefore housing associations would also be asked to demonstrate how they propose to meet the 2013 deadline.

Involving tenants

Each business plan should aim to answer the question 'how do we provide the best housing service?' It cannot do this without taking into account the views of tenants, and tenant groups should be involved in preparing the plan and considering the options available to achieve the investment required. There should be new options allowing councils to retain their housing stock in certain circumstances, as well as wider options involving stock transfer.

Our recommendations are set out in detail in section 5 of this paper, and are summarised below.

Options for councils to retain their housing

Where a council's business plan favours keeping the housing stock, it should be able to:

- Operate a 'prudential borrowing regime';

- Keep capital receipts from council house sales, where this is financially prudent;
- Separate its council housing accounts more effectively from the rest of the funding of the authority;
- Get more effective revenue support from the Executive, and be able to use this support for the borrowing it requires.

The business plan would have to demonstrate that with these options the council could achieve the ten-year 'decent homes' target.

CIH would also like the Executive to consider how 'arms length companies' and resource accounting could be introduced in ways which help councils wishing to retain their housing stock.

The future for stock transfer

Councils should be able to consider partial transfers or a phased approach to transferring their stock, as well as the 'big bang' approach planned by Glasgow and Borders councils. This would mean a clearer commitment to service debt for partial transfers.

Councils considering transfer should be encouraged to involve tenants more closely in the process from the earliest stages, leading to 'community ownership' developed with (not delivered to) tenants. Community ownership should be a vehicle not just for improving the houses but for securing the wider community regeneration needed in many areas, and without which neighbourhoods may well decline even if peoples' homes are improved.

Rents and regulation

CIH believes that the Executive should have a clear policy on rents and affordability, to guide councils in deciding to what extent they can use rents to raise the investment required.

Communities Scotland is charged with the task of regulating social housing and securing a good quality housing service. The way it exercises this role will be crucial in ensuring that the benefits of more rigorous business plans, and of stock transfer itself, are actually secured and that tenants receive the housing service they deserve.

Next steps

Following the Glasgow ballot, but in light of the limited interest amongst the majority of councils in pursuing stock transfer, the Executive should reconsider the options available and consult councils, housing associations, tenant groups and housing professionals on its policy for ensuring that council housing delivers the best service to tenants. CIH calls on the Executive to do this before the elections of May 2003.

1. The Executive's Current Policy – 'Community Ownership'

Background and history

1.1 During the 1980s and 1990s, campaigns highlighting the inadequate level of resources available to maintain and modernise council housing were a key part of the political debate about Scottish housing. Partly as a response to this problem, the pre-1997 Conservative Scottish Office administrations encouraged local authorities to adopt stock transfer as a means of levering in additional investment outwith traditional public resources. Despite this, only one authority, Berwickshire, put forward large-scale transfer proposals. This resulted in a successful transfer to Berwickshire Housing Association. During this period the Government also instigated the process of transferring Scottish Homes' stock.

1.2 Recognising that there was a serious problem with the scale of resources available to Scottish councils for housing, given the limitations on traditional public sector borrowing, the 1997 Scottish Labour Party manifesto committed an incoming Labour government in Scotland to the principle of New Housing Partnerships. These Partnerships would bring the public and private sectors together to develop innovative responses to the investment crisis in Scottish council housing.

1.3 In 1998 the Scottish Office set up a New Housing Partnership Fund and encouraged local authorities to put forward proposals to address the need for investment in new building and for repair, maintenance (and in some cases demolition) of existing property. An important incentive was the offer to service debt payments following stock transfers. (The incentive was clear in relation to whole stock transfers, but many commentators believe that it was insufficiently precise in relation to partial transfers).

1.4 Through their NHP bids a number of local authorities developed new housing companies aimed primarily at developing new stock in areas where demand was high. Other authorities examined stock transfer to tackle the combined problems of high housing debt, poor quality stock and high rents.

1.5 The 1999 Green Paper *Investing in Modernisation* developed the concept of "community ownership". Increasingly the government wished to draw on the lessons of Scottish Homes' stock transfers during the nineties, and earlier small-scale local authority transfers to community-based associations, to promote the benefits of transfer as a way of giving power and control back to local communities.

1.6 Following the Scottish Parliament elections in 1999 the new minister, Wendy Alexander, continued to emphasise the need for local authorities with major investment problems to look at whole stock transfer as their main option.

1.7 In response, local authorities have undertaken options appraisals to examine the feasibility of stock transfer as an answer to their investment needs. Broadly these appraisals, where they were carried out, did two things. The first was to make an assessment of the current and predicted future condition of the existing council stock (information woefully lacking in many authorities). The second outcome was to make an assessment of the investment required to improve and maintain the stock and an examination on how that investment could be funded. Some authorities – but probably not all – are believed to have involved tenants in the options appraisal process, in some cases extensively.

Progress towards community ownership

1.8 In a recent study for the Housing Quality Network[1], Hal Pawson of Heriot Watt University surveyed the progress which councils had made through stock option appraisals.

1.9 Progress towards transfer has been less rapid than perhaps first anticipated. Following stock option appraisals many councils have elected to retain their stock largely on the basis that repairs and improvements and long-term maintenance can be funded from existing rental income and anticipated borrowing consents.

1.10 Of the seven councils originally interested in stock transfer only Scottish Borders, Dumfries and Galloway, Glasgow and Shetland continue to be committed to it. Argyll and Bute Council intend to progress with a more detailed appraisal of the transfer option. Scottish Borders Council tenants and now Glasgow tenants have returned 'yes' votes in recent ballots.

1.11 But what of the other local authorities which have not committed to transfer? In the Pawson survey, 22 out of 24 authorities returning completed surveys had carried out stock option appraisals since 1998. Of these, 16 had completed them. Another six authorities were in the process of carrying out the appraisals.

1.12 From the 16 completed appraisals only one authority, Argyll and Bute, had opted, in principle, for full stock transfer and one had opted for a trickle transfer approach. The majority (ten) had opted for stock retention, albeit five of these had identified the need to include a higher than current standard of repairs and modernisation and /or day-to-day landlord services – "stock retention plus".

Reasons for retaining stock

1.13 One of the most interesting outcomes of Pawson's research is the relative weight given to financial and non-financial factors in the appraisals by the ten authorities which have opted for stock retention. Only two authorities selected stock retention because it was "overwhelmingly advantageous in purely financial terms". While in four it was marginally advantageous in financial terms, retention was clearly preferred on non-financial grounds. Another three opted for retention principally on non-financial grounds and one did not respond to this question.

1.14 What is not clear from the survey are what constitutes "non-financial grounds". It is difficult to judge how much these relate to concerns over service performance or quality of accommodation as a result of transfer, and how much they relate to authorities' political preferences to retain ownership. It is also unclear whether authorities are reflecting known views of tenants.

1.15 Such concerns are understandable. Although Scottish Homes managed a very successful transfer programme (at least in terms of increased customer satisfaction) there is no track record in Scotland of local authorities undertaking wholesale stock transfer. Only one authority, Berwickshire, has ever transferred all its housing stock to a single body, and under very different circumstances.

1.16 The political risks for councillors and senior managers are significant particularly if a ballot is unsuccessful and an authority has recommended transfer to its tenants. What is not clear is

[1] Pawson, H. *Assessing Stock Transfer in Scotland*. Housing Quality Network, 2002.

how much and to what extent local authorities are opting to retain their stock until the results of planned ballots elsewhere are known, and they know whether alternative options are likely to emerge.

Who chooses?

1.17 A common argument against transfer is that central government, by not allowing local authorities to borrow freely, is denying tenants a real choice over their landlord – a common argument during the Scottish Homes transfer process. However by opting for stock retention, where stock transfer would be a feasible alternative, it could be argued that local authorities are effectively denying tenants the choice of transfer. We return to this point later.

2. What is driving the policy?

Generating the Investment Needed in the Housing Stock

2.1 A primary aim of community ownership through stock transfer is to create a new vehicle which has greater financial freedom and control over its assets than is available to a local housing authority. The new body – a housing association or RSL – can borrow directly on the revenue stream from its housing stock, and such borrowing is not constrained by having to be counted as public borrowing. The limitation on its borrowing is a commercial one – how much a lender is willing to lend – rather than being the subject of the controls that apply to public sector bodies and which often limit their borrowing to a much lower level than their income stream or asset base would otherwise sustain.

2.2 This means crucially that the ability of the new body to borrow more is related to its needs, rather than to outside factors which are not based on its needs. Private lenders are not only willing to finance the backlog of improvement work which the new body will inherit, they will positively require it as a necessary move to strengthen the asset base and hence the revenue flow. This does not mean, however, that borrowing is unconstrained. Lenders will require clear business plans and take their own view of the sustainability of loans. Replacing public borrowing rules by private ones does not open a treasure chest, it simply enables the organisation to borrow amounts which depend on its ability to service the loans, rather than on external limits which are decided by other factors which have nothing to do with local circumstances.

2.3 Borrowing on the private market is also likely to be cheaper *at the present time*, not because an RSL can get better terms than a public body (it can't), but because the loan will be specifically for the transfer and subsequent improvements. If the same loan were to be raised by the local authority, the HRA would be charged not with the costs of the new loan but with a share of the costs of the authority's consolidated loans fund. At a time of falling or historically low interest rates, a separate loan raised by an RSL, albeit at a higher rate than an equivalent LA loan, may in practice cost a lot less than the share of wider loan costs that would be charged to an HRA.

2.4 Along with their freedom to borrow outside public sector constraints, RSLs enjoy other financial freedoms (or, at least, are less constrained than local authorities). They can capitalise the benefit of future rental streams to make new investment now. They can also build up surpluses for the same purpose. They have more freedom to dispose of assets and re-use the proceeds. In other words, they are much more like 'social businesses', albeit regulated, receiving public subsidy which is either automatic (housing benefit) or scheme specific (grants) rather than subsidy which is tied into the workings of their revenue accounts.

2.5 In pursuing transfer, councils are really aiming to secure a complete package of business freedoms for their housing operations, not just the freedom to borrow. An important freedom which is not directly financial but has a significant impact on the costs of the housing operation is the ability to procure services such as day-to-day repairs, legal advice, personnel advice, etc outside the local authority. This may also reduce running costs and enable better value to be obtained from a given level of rents.

2.6 The ability which the new landlords resulting from transfer have to make massive 'up front' investment to address the backlogs of improvement work in the housing stock are therefore the result of a number of advantages which RSLs have, post-transfer, compared with pre-transfer local authorities:

- Ability to borrow outside public sector borrowing controls and (only at a time of low interest rates) at a lower cost
- Ability to use their revenue stream from rents wholly to finance new borrowing, without regard to the costs of old debt
- Ability to use their revenue stream more flexibly, notably to allow them to borrow against future revenue to enable them to finance investment now
- Ability to get better value out of their revenue stream by procuring services more efficiently.

[NB. these advantages apply unequivocally only to whole stock transfers under current policy where old debt is effectively written off]

2.7 The advantages mean that any increases in rents can be directly related to improved services to tenants, whereas for the pre-transfer local authorities they are often determined by the rising costs of servicing old debt. RSLs are of course subject to the disciplines of the private market. Lenders will expect RSLs to manage their assets properly, and to relate their assets to demand for them. Problems of unsatisfactory housing and low demand will therefore have to be faced.

The Importance of Dealing with Housing Debt

2.8 The cost of housing debt is a very important factor in the running costs of housing authorities and in the arguments for stock transfer. Total HRA-related housing debt in Scotland is £3.67bn, or about £6,400 per house. This has an obvious impact on the costs of running council housing. Glasgow is paying in the region of £100m per year in loan charges, whilst Edinburgh and North Lanarkshire are paying one third of this amount, and other authorities rather less. Since 1997 changes in the HRA have led to reductions in debt levels overall, but not in some authorities like Edinburgh. If the Executive responded to calls (eg from COSLA) to allow all RTB receipts to be re-used, the debt burden would simply grow again.

2.9 Perhaps surprisingly given the focus on the 'debt' issue, levels of debt in Scotland are comparable to those in England. Manchester is paying out similar amounts to Glasgow and many larger authorities have bigger loan charges than Edinburgh[2]. Average debt in England is less than Scotland but not massively so. The significance of debt levels in Scotland is partly because until recently they have been rising (whilst in England they have been falling), but more importantly because of the way debt is dealt with in Scottish HRAs compared with English ones. Scottish authorities generally get no specific subsidy towards their loan charges, unlike their English counterparts, and the costs are met largely from rental income[3].

[2] This assessment disregards the very high debt levels per property in certain Islands councils.
[3] English LAs only get subsidy on their debt because of the way it is linked to housing benefit payments and the new Major Repairs Allowance within their HRAs. Without those, as in Scotland few LAs would get subsidy towards debt charges. These factors are amongst a range of differences between Scottish and English HRA rules which are not dealt with here.

The costs of servicing debt are therefore a major factor particularly where stocks are declining.

2.10 This results in an important difference in the motivation for transfer between Scotland and England. In England (and indeed Wales), councils are seeking greater control over their income streams in a different way from that which applies in Scotland. English LAs are primarily looking to have more direct control over their finances and the freedom to use the income stream from rents to raise investment finance.

2.11 In Scotland, however, LAs already receive full Housing Benefit payments from government. They do not, though, generally receive any other revenue subsidy. The scale of local authority housing debt and the costs of servicing debt payments are therefore the major concern because they have to be met from rents. The 'writing off' of debt, which has become an integral part of the Executive's strategy for whole stock transfers, is at least as important as the ability of the new landlords to borrow outside public sector controls for many (but not all) Scottish local authorities. Whilst burdened with debt, many authorities could not fund the costs of major new investment in their stocks, unless housing support grant was to become much more generally available.

2.12 By the same token, however, some local authorities who can more readily meet their loan charges from existing revenues may have the ability to raise investment funds *without* having to consider transfer. In such cases, transfer would still result in the wider financial freedoms referred to above, and the possibility of a useable capital receipt, but is not driven by the need to resolve the debt problem which is the main motivation for others.

2.13 Whether an authority is strongly motivated by the debt problem will obviously depend on how big the debt is, whether it is growing and what the relationship is between debt costs and the HRA. The picture varies widely amongst the 32 authorities. Whereas Glasgow's debt payments, at around £20 per property per week, are a strong driver towards transfer, the same is not the case in (say) West Lothian where charges are about £9 per week.

2.14 Whilst it might be thought that the debt problem might be diminishing because of falling interest rates, there are two important reasons why this may not be the case. First, whilst the marginal cost of borrowing has been falling, changes in the consolidated loan fund rate of a local authority are much slower (depending on its debt profile). Second, even if overall debt costs fall, the debt per property can remain static or even rise if stock is being lost rapidly through either right to buy or demolition or both. (The average debt payment of £14 per week did not fall between the last two financial years, because the drop in debt payments was matched by a similar drop in the number of dwellings.)

The Effect of Transfer on Rents

2.15 What impact transfer has on rents will depend on the combined importance of old debt payments (which will now cease) and new debt payments, which depend on the scale of new investment needed in the stock. Some authorities may potentially find that paying off their debt would create sufficient spare capacity in their finances that the new bodies created through transfer will not have to make major rent increases to finance the investment needed. Others will have to make significant rent increases, but can at least hope to persuade tenants that the increases will lead directly to improvements in the quality of accommodation. For the reasons mentioned earlier, the new bodies may also be able to use rental income more effectively than before and hence promise more improved services to tenants.

2.16 The Executive's policy on transfer has not, however, addressed the issue of the chaotic pattern of social sector rents or the issue of affordability. By taking current rents as the starting point, transfer will tend to perpetuate the confusion. Also, there is no explicit Executive policy on affordability and therefore no way of judging whether rent levels which result from transfer are affordable. We return to this point.

Wider Effects of Transfer on the Public Finances

2.17 What advantage does the Treasury get from transfer? Although rents may go up, and therefore housing benefit costs, the effects on public expenditure are mitigated by the capital receipt and the consequent reduction in public sector debt. Transfer is an attractive option for the Treasury mainly because of the 'lump sum' effect of the transfer receipt either wholly or partly clearing the debt and the effect of spreading the public expenditure consequences of the new landlord's increased investment by virtue of its being paid for by on-going HB payments. In contrast, pre-transfer local authorities are both saddled with debt (which counts as part of the total UK public sector debt) and require on-going capital allocations which add to the PSBR. Even though there is a Treasury commitment to pay off debt when transfer takes place, this is not unattractive as the payment is neutral in PSBR terms, although it leaves a future liability to the Treasury for any additional borrowing needed to support the debt repayments.

2.18 Pushing the increased costs of new investment out of the HRA and onto HB payments is also attractive for other reasons. The obvious point is that these extra costs fall to be met from general taxation and do not count against the Scottish block. They therefore effectively move from Holyrood to Whitehall.

2.19 These advantages of transfer to the public finances do, however, tend to concentrate on the comparison between transfer and a status quo in which debt payments are high and new borrowing approvals inadequate to meet needs. As the CIH has shown in earlier work[4], a starting position in which debt is treated in the same way for stock retention as for transfer could result in a lower 'cost to the public purse' (as opposed to 'impact on the PSBR') if all the costs are taken into account, including HB costs, because of the lower cost of public borrowing and other factors. Interestingly, Scottish councils were asked by the Executive at an earlier stage to carry out assessments of the prospects for their stock if it were retained in public ownership: it would be interesting to see the results of such assessments.

The Push towards Community Ownership

2.20 One of the distinguishing features of the Scottish transfer debate is the major emphasis given to the improvement of the quality and management of housing stock through community ownership – the transferring of ownership of the assets and to a large extent the control of housing to tenants and local communities. This has led to the development of local housing management organisations in the Glasgow proposal and an important role for tenant representatives on their boards and management committees.

[4] Moody, G. *Council Housing – Financing the Future*. CIH, 1998.

2.21 The transfer of Scottish Homes stock to community ownership over the last decade has been viewed largely as a success. Scottish Homes' surveys of tenant opinion post transfer have shown a high degree of satisfaction among transferring tenants including those who had originally voted against transfer. Significant new investment by RSLs for improvements and repairs has been generated from private funders – investment which would not have been available from public sources.

2.22 Some authorities may argue that improving service quality and bringing services closer to tenants can be achieved whilst retaining council ownership of the stock. Moves towards greater tenant control through local boards, tenant-led inspections, letting agreements, etc by authorities retaining their stock could lead to significant service improvements, especially where stock condition and lack of investment are not overwhelming issues.

2.23 But it is the perception that community ownership leads to better investment decisions as well as improved and more responsive services which is especially attractive to the Scottish Executive and, to be fair, to some local authorities. There is an argument about whether this improvement is because of increased investment or through the new management structures and models provided by housing associations and RSLs.

3. Obstacles to the Current Policy

Councils preferring to retain their housing stock

3.1 The clear message from Pawson's research is that only a handful of local authorities to date have dipped their toe in the transfer pool despite the incentives on offer from the Scottish Executive.

3.2 The transfer of council housing to new landlords faces significant difficulties. Organised tenants groups and individual tenants are understandably suspicious of the motivations of central and local government and of the proposed receiving bodies.

3.3 Local authorities, particularly local councillors who have opposed stock transfer during the Scottish Homes transfer process, express fears over giving up control over a major area of council activity – being a landlord to a large number of constituents. As noted earlier in this paper, councillors and senior officers also face huge political risks in committing themselves to recommend transfer to their tenants. Not only is there the risk of tenants rejecting the transfer option in a ballot but a genuine fear of whether the transfer process will result in better services for tenants – a result of the relative lack of experience of large scale local authority transfers in Scotland.

3.4 Many local authorities, while adopting stock retention at this stage, may well be taking a wait and see approach. The results of ballots and the early implementation of improvement programmes where ballots lead to a successful transfer may well lead to some authorities reconsidering their position on transfer, albeit that this may not happen for some years. The Glasgow ballot result may be particularly significant given the political context and the 'no' campaign which unsuccessfully opposed transfer.

3.5 There are three broader factors about the Executive's policies which are highly relevant to local authority decisions about their stock. First, public investment in council housing is barely keeping pace with inflation. Assessments of overall investment in the HRA stock show that it has hardly changed over the last four years[5]. If this continues, councils are likely to have to look increasingly to other ways of dealing with the investment backlog.

3.6 Second, reflecting the lack of any significant increase in direct investment, there is no explicit target set by the Executive about the standards which the housing stock should meet, or a timescale over which the investment backlog should be addressed. In the absence of such targets, there is no outside pressure on councils to address their investment backlogs comprehensively and address the future of their housing stocks.

3.7 Third, the option of transfer cannot be compared with any other government-supported investment options like arms length companies or PFI models (in part because there is no additional public investment available to support such models). Transfer has been put forward on a 'take or leave it' basis. The fact that, at present, only whole stock transfer appears to be a viable alternative may have encouraged councils to take a 'wait and see' approach in the hope that other options might emerge.

[5] See Wilcox, S (2001) *Housing Finance Review 2001/02*, CIH/CML 2001, table 76.

3.8 It is worth noting that in England the emphasis of recent government policy has not been on the delivery mechanism (transfer) but on the objective - achieving a specified 'decent homes' standard by 2011. Policy has shifted towards making this the key requirement, and the options available to councils are being strengthened accordingly. Additional capital and revenue support has been given to councils, albeit not sufficient to enable all of them, or even the majority, to achieve the ten-year target without at least partial transfers[6]. Investment policy in Scotland, for both local authorities and central government, lacks the focus which would be given by an explicit objective of improving quality and management in council housing to defined standards over a ten year period. We return to this point.

Experience and options

3.9 There are two things that may help overcome resistance to transfer as an option for council housing in Scotland. The first is that those pursuing a 'wait and see' approach can now see the results of early transfer ballots. There may now be less fear of 'no' campaigns and adverse reactions from tenants. There will be fewer political risks for local authorities – indeed there is likely to be further pressure upon authorities to give tenants the option where they have not previously done so.

3.10 Another factor which could encourage local authorities to consider transfer and indeed put options to their tenants would be for the Scottish Executive to open up the investment options available to them. However it would be wrong to suggest that options which might provide an alternative to transfer are a panacea for the investment problems faced by an authority which wishes to retain its stock. Most alternatives require some form of additional public subsidy – resources which would have to be made available from the Scottish block. At a time when Executive spending commitments to "popular" policies continue to mount it is difficult to see how these options could be supported. Nevertheless, the next section looks at some of the possibilities.

[6] See the recent assessment by Graham Moody Associates for CIH, available on the CIH *website [http://www.cih.org/section6/sub4/briefing01.htm]*.

4. What Options might be developed for Council Housing apart from Stock Transfer?

4.1 In this section we consider what changes might provide the necessary resources for investment in council housing without transfer, or in addition to the current policy of promoting whole stock transfer. We consider the constraints and opportunities in relation to the current and future political and economic environment in Scotland and the UK, and what might be done to make other options more attractive to the current or future governments.

4.2 In section 2 of this paper the reasons behind transfer – especially those relating to resources – were identified. Is it possible to contemplate changes that might allow local authorities to gain these advantages of transfer, but without having to 'lose' their stock?

4.3 The advantages set out in section 2 can be summarised as:

- Ability to borrow outside present public sector borrowing controls and (at a time of falling interest rates) at a lower cost
- Ability to use their revenue stream from rents wholly to finance new borrowing, without regard to the costs of old debt
- Ability to use their revenue stream more flexibly, notably to allow them to borrow against future revenue to enable them to finance investment now
- Ability to get better value out of their revenue stream by procuring services more efficiently.

We will consider some other options for authorities that the Executive might consider which would give them some of these advantages without transferring all of their stock.

Changes to Present Public Sector Controls

4.4 Local authority borrowing is by definition part of PSBR and is therefore always likely to be controlled to some degree by the Treasury, because of its impact on levels of public sector debt. The proposals made in 1995 by CIH for *local housing corporations*[7] overcame this difficulty by arguing that stock should be transferred to new bodies actually owned by councils, and that the Government should at the same time begin to move away from the PSBR as its main measure of the public finances, towards an alternative (GGFD) most commonly used in continental Europe. However, although the Government has changed its fiscal rules, it has not gone as far as we wanted. This means that the original idea of local housing corporations cannot yet be implemented. (It has also meant that other candidates for a more liberal borrowing regime, such as the post office, air traffic control, the London tube, Scottish water companies, etc. have also made little progress.)

4.5 Two moves by Government go some way towards the 1995 proposal and warrant consideration. First, councils in England can now set up 'arms length companies' (ALCs) to be responsible for management of their stock, and gain access to extra resources. Insofar as

[7] Hawksworth, J and Wilcox, S *Challenging the Conventions – Public Borrowing Rules and Housing Investment*. CIH, 1995.

councils will wholly own the new companies, they resemble the 1995 proposal, but in other respects they fall very short of it. Their borrowing will still be public borrowing, and will be dependent on extra HRA subsidy. The companies will run the stock and its finances, but not own them. Arms length companies therefore offer considerable advantages to councils that can set them up and gain access to the additional subsidy, as they can bring investment in without 'losing' the stock through transfer. Crucially, however, they are dependent on Government decisions about the subsidy available and rules for gaining access to it. The first ALCs have come into operation in 2002/03 and the Government is now considering a second round of 'bids' for ALCs.

4.6 The second change, announced in the December (Whitehall) local government white paper, is greater borrowing freedom for local authorities. This would enable councils to borrow outside central government controls (credit approvals) if they follow prudential rules and where the costs of borrowing can be met from revenue. The main intention appears to be to enable councils to invest in facilities like sports centres which generate new revenue which can pay loan costs.

4.7 The Executive has responded to the white paper with its own proposals, R*enewing Local Democracy: the Next Steps*. However, whilst agreeing that a prudential borrowing regime should be introduced for local authorities generally, it steps back from applying it to local authority housing. It says[8] that 'this is not the right time to introduce such a fundamental change to housing finance'.

4.8 Paradoxically, the position of housing revenue accounts in Scottish local authorities may favour a prudential borrowing regime to a much greater extent than is the case in England. The main issue is whether any council could generate enough 'spare' income to service additional borrowing, given the absence of subsidy and the significance of historic debt charges in most cases. The question can only be answered by asking particular councils with lower debt levels and the potential to raise rents to model the levels of borrowing they could sustain under a prudential regime, and compare them with the amounts required to modernise their stock (and which could be generated through transfer). It is not known at this stage whether any current stock options analyses have considered this possibility in any detail. However, it certainly warrants further investigation as some councils may have significant borrowing potential if a 'prudential' regime were to be introduced.

4.9 There is also the question of whether (apart from the issue of debt – see below) there are other changes which could be made to Scottish council housing finance which would facilitate more borrowing. Two possibilities are worth considering:

- At present, authorities receive allocations of £180m annually for HRA-related borrowing, about £300 per dwelling. Could this be made available instead as revenue subsidy (housing support grant)? This extra subsidy, combined with a 'prudential borrowing rule', may enable some councils to finance the improvements to at least parts of their stock without having to transfer it (or all of it).

- Given that HRAs are already ring-fenced in many respects, is there a case for extending the ring-fence to include debt? This could be done in a way which facilitated new borrowing, by providing for the HRA to be charged at the pool rate for existing debt, but allowing new debt to be raised directly against HRA income. Given current low interest rates, this would enable borrowing to be done more cheaply.

[8] *Renewing Local Democracy*, chapter 5, para.79.

4.10 Clearly, the major change that would allow councils to retain and improve their stock would be for debt costs to be dealt with in a way which did not bear directly on current revenues. This would require *either* the writing off of debt, as with transfer, *or* a major increase in housing support grant to cover all or part of the costs of the debt. Presumably in the current climate neither of these is likely to happen. However, the Executive could at least consider a more specific arrangement on debt for *partial* transfers, equivalent to that applying to full transfers. This would provide councils with a wider range of realistic options, especially if combined with a prudential borrowing regime.

4.11 Implementation of the prudential borrowing regime depends on Westminster legislation. However, CIPFA has already published a draft code of practice[9] intended to apply once the legislation takes effect, and this code will apply in Scotland if approved by the Executive. It would be worthwhile for some authorities, perhaps those currently resisting transfer, to model the possibilities of a prudential regime to ascertain whether it could offer a real alternative to transfer and mobilise similar levels of investment if the option were available to them.

Options that May Require more Resources

4.12 Although Arms Length Companies were mentioned above, in the context of changed borrowing rules, they need to be fully considered under this heading, along with other options which would require further resources. The options that we will (briefly) consider are:

- Full introduction of resource accounting for local authority housing, including new subsidy arrangements to deal with future improvement and maintenance requirements;
- Arms length companies (ALCs), with additional subsidy within a prudential borrowing regime (see above);
- PFI, with additional subsidy made available through special PFI credits.

The options are described in the boxes.

Resource accounting

Resource accounting involves major technical changes to the way that councils account for their council housing operations, but the essence of these changes is to take account of the life of the assets – the houses – and the long-term nature of the investment made in them. The cost of capital is recorded as it is 'used' rather than when it is paid for. Resource accounting forces councils to consider the true cost of their housing operations and whether their assets are providing value for money. By making explicit the maintenance costs of low grade assets (houses in poor repair), it draws attention to any failure to invest and acts as a stimulus to longer-term planning. In England, this aspect has been reinforced by the introduction of a Major Repairs Allowance to councils to help provide for future repairs.

[9] Available on the CIPFA website *[http://www.cipfa.org.uk/pt/pt_details_c.ihtml?news_id=11491]*

Arms length companies

Councils are already able to set up arms length companies which they own, to carry out services. Because the constitution is decided by the council, they can be set up so as to provide for a stronger role for tenants than is the case with a local authority housing committee. The ones set up in England have typically had a board with one third councillors, one third tenants, and one third other community representatives.

ALCs do not in themselves have any special financial advantages. For example, borrowing still counts as public borrowing. In England, the government is planning to give ALCs more borrowing freedom, and additional subsidy, providing the councils setting them up meet certain tests. The most important ones are:

- having proper business plans
- having a good quality housing service (as assessed by the English housing inspectorate), and
- consulting tenants.

Several English councils have held tenant ballots before setting up ALCs.

PFI

PFI in council housing involves a contract to provide for the maintenance and improvement of the housing stock which is paid for over the 30-year life of the contract, rather than as a lump sum up front, thus spreading the costs over a long period of time. This avoids the need for borrowing, but the costs of the work are normally more than can be afforded from rents, so additional subsidy is needed. Tenants remain tenants of the council. The work is done by a 'special purpose vehicle' – usually a partnership between a housing association, a construction firm and a facilities management company.

In England, 19 councils are at various stages of establishing PFI 'pathfinders' for their council housing stock. The first contract is not expected to be let until June 2002, however, and there have been considerable delays.

4.13 Each of these options poses the major obstacle of requiring extra public spending. For this reason they have been largely rejected in Wales, where the National Assembly has not prioritised housing investment and is following Scotland in its emphasis on transfer. Any of the options, particularly the first two, could however become an option in Scotland in a changed political environment with a greater willingness to increase publicly-funded housing investment.

4.14 There is a theoretical possibility that PFI could prove possible in Scotland without additional PFI credits, for some authorities that could fund it through their HRAs or through raising rents. This may be worth investigating, but we are hesitant to recommend it because the planned PFI housing projects in England have been slow to get off the ground: none has yet reached the stage of being contractually committed after around three years of preparation.

4.15 Another possibility that may be worth developing in Scotland is a version of ALCs, based not on increased subsidy (though that remains very desirable) but on providing new bodies with some of the freedoms set out in 4.3 above that authorities currently aim to achieve through transfer. Thus a Scottish ALC regime might allow councils to create ALCs, if they meet certain conditions, that would have the abilities to borrow prudentially, procure services outside the authority, or have some of the other freedoms set out above. It may be worth developing this proposal in more detail, linked closely to proposals for an overall objective for social housing and for proper business plans (see below). However, the financial viability of such an option may not be significantly greater than the option of a more generous borrowing regime for councils, discussed in paragraphs 4.1 - 4.11.

Stock Condition, Business Plans and a Target for Achieving Quality in the Social Housing Sector

4.16 Perhaps the biggest change to have been made south of the border, which may have important lessons for Scotland, is the way that increased resources have been linked to a drive towards more rigorous assessments of the state of the existing stock and what is needed to modernise it, and careful assessments of demand and the future viability of the stock. These have provided the basis for the preparation of proper business plans for each council's stock, which show its investment needs over 30 years and how the council plans to meet them. This process is in its infancy, and is far from fully developed, but it is beginning to focus the minds of housing professionals, councillors and tenants on the future of their council housing and how to ensure its viability. Set against the background of the Best Value regime and the work of the Housing Inspectorate, there is now an environment in which simple acceptance of the *status quo* is not acceptable and councils have to show how their stock and the service associated with it will be improved.

4.17 Accompanying this at national level is the new definition of what constitutes a 'decent home', together with a target (Public Service Agreement) for this to be achieved and the repairs backlog eliminated by 2010. Work by the CIH and Graham Moody Associates[10] has shown how this can be done, by a combination of direct public investment and the transfer of about half of the remaining 2.8m English council houses, given the continuance of current spending levels. From a situation in 1996 where there was a massive £19bn repairs backlog, English council housing is now in the process of being transformed to a state where - even if the backlog is not actually eliminated - it will have been substantially dealt with in the present decade.

4.18 Scotland currently lacks both the resource input to council housing that has taken place in England and also - crucially - the new regime of business plans and resource accounts at local level and the clear 10-year target and definition of a decent home at national level. Arguably the first would not have been possible in England without the second - a regime to secure better performance by the sector was a precondition of the Treasury allowing the extra resources and flexibility needed. The Executive has the freedom to put extra resources into council housing in Scotland or to give authorities some of the freedoms enjoyed by housing associations, with less Treasury constraints than apply in England. Whether it should do so without similar changes that would help to guarantee improved performance is, however, debatable. Its present commitment to stock transfer and the associated cost of dealing with the debt issue also give the Executive little room for manoeuvre.

[10] See footnote 6.

5. The Way Forward

Investment in council housing

5.1 Investment in Scottish council housing from public funds has been static for the past four years. Whilst the problems of council housing have received a lot of political attention in this period, there has still been no national assessment of the investment needed in more than 500,000 council homes. Such an assessment of the scale of need is imperative if resources are to be mobilised - whether from the public or private sectors - to tackle the backlog of improvement and repair work. Once an assessment is available, forecasts can be made of what proportion of the requirement might be met from private sources. This will enable the Executive to make more informed decisions about the levels of public subsidy required, instead of maintaining what is essentially an arbitrary level of funding inherited from the Scottish Office. (An interim assessment could be made based on the option appraisals which councils have already carried out; but this should not substitute for a national appraisal based on consistent criteria.)

A new standard for social housing

5.2 As well as the knowledge gap about the scale of the problem, there is no explicit target as to when and how it should be put right. Apart from the very basic 'tolerable' standard, there are no nationally-set standards for social housing in Scotland, nor targets for achieving higher standards. The national assessment called for in 5.1 should take place against a yardstick - we might call it the Scottish 'decent homes standard' - that expresses in a form applicable across Scotland what social housing should aim to provide in terms of physical conditions, home amenities, environmental standards and accessibility. Work should begin immediately to establish such a standard and to consult landlord, tenant and professional bodies on what it should include.

Business plans for council housing

5.3 The setting of a standard then provides a basis for local authority business plans for council housing which will indicate how the shortfall in investment is to be tackled. At present there is no requirement on councils - as against the funders' expectations of RSLs - to produce such business plans. Every authority which has housing stock should be expected to prepare a business plan and to update it annually. In establishing this requirement, the Executive will need to set a date by which each authority will have to have assessed the state of its stock against the 'decent homes standard' and quantify the investment needed. As part of this assessment, the authority will need to consider the long-term demand for its stock and the extent to which it will have to be reconfigured so as to better relate to this demand.

A target for dealing with poor housing

5.4 A further step is for the Executive to set its own target date by which social housing should meet the standard. CIH believes that the aim should be to meet it within ten years. To complement the 'bottom up' assessment of resource requirements at local level which will emerge from business plans (5.3 above), the Executive will then be able to turn the 'top down' assessment of overall investment needs (5.1 above) into an annual requirement for public and private funding. Obviously, the split between public and private will reflect a political view as to the levels of public funds that can be devoted to social housing, as against other spending priorities.

A quality housing service, involving tenants

5.5 Local authority business plans should not be narrowly confined to the physical improvement of the stock. The Executive should require them to address the issue of how to provide a quality housing service, responsive to customer needs and priorities. It goes without saying that tenants should be fully involved in this process. Authorities where tenant involvement is well developed have found that the business planning process can be the catalyst for building a consensus about the future of the service.

5.6 Business plans would then be the vehicle for considering the options for the future of the housing service against the target set by the Executive for achieving the 'quality homes standard'. In considering the options, the fundamental question is not 'how do we retain the housing stock?' or 'how do we manage within available finances?', but 'how do we provide the best housing service?'

5.7 Business plans should consider whether stock retention and development of the service within the council's ownership can deliver the best service, whether this could be better achieved through stock transfer, or whether a mixed approach is feasible. CIH wishes to advocate a range of changes to the options currently available so that in future more real choices can be made than is currently the case.

Options for stock retention

5.8 Where the outcome of the business planning process is that stock retention is the favoured strategy, the Executive should consider ways in which this can be achieved financially in a more 'business like' way. This could include:

- a 'prudential borrowing regime', based on a proper assessment of levels of sustainable borrowing in the business plan, at least for those councils which can show that their existing debt can be repaid within, say, five years;
- ability of authorities to retain capital receipts, where this can be shown to be financially prudent;
- greater separation of the HRA from the general fund in LA accounts (there may be a case for compensation mechanisms to allow this separation to take place without disruption to wider services);
- more rational resource distribution in support of HRA housing, including consideration of replacing capital allocations with on-going revenue support, against which the authority could borrow.

One potential obstacle to a new borrowing regime would arise if any resultant increase in borrowing were to count against the Scottish block. The Executive should argue for arrangements no less favourable than those which will apply in England.

5.9 There are two more significant ways in which policy could be changed to allow stock retention to become an option more likely to achieve the best housing service. The first would be to allow, encourage or even require authorities retaining their stock to set up arms length companies for its management and improvement. This would provide the basis for a radical improvement in services, move retained stock closer to RSLs in terms of the freedoms set out earlier in this paper, and create a platform on which further financial and business freedoms could be awarded as the companies proved themselves. ALCs should be constituted in such a way as to encourage a much greater level of participation by tenants in managing council housing. To ensure that a decision to retain stock has the backing of tenants, setting up an ALC could require a tenant ballot.

5.10 The second reform based on stock retention could be the introduction of resource accounting for council housing. This would be a logical development from (or, looked at another way, the basis of) business plans. The case for resource accounting as the way forward for councils retaining their stock is very difficult to refute in principle, because it focuses explicitly on the long-term resource requirements and likely financial flows. It is both an obstacle and an advantage in that it exposes any gap between the two.

The future for stock transfer

5.11 Stock transfer is an incomplete option at present, because whilst the advantages of wholesale transfer are strong and clear-cut, the arrangements for partial transfer are much less so. Yet partial transfer may be potentially a much more 'saleable' proposition than full transfer - and indeed if there had been a 'no' vote in Glasgow the Executive would surely have had to consider more favourable arrangements for it. Reforms which should be considered for full and partial transfers are:

- a clear commitment to servicing debt attributable to partial transfers, on the basis of the costs shown in the business plan for the retained stock;
- considering whether the real costs of 'disengagement' of the HRA from the general fund warrants temporary subsidy so as to facilitate transfer;
- encouraging best practice by authorities in providing for much greater tenant involvement in management of their stock, which can be the precursor to transfer based on real 'community ownership' developed with (not delivered to) tenants;
- ensuring that community ownership is a vehicle not just for getting better housing conditions but for wider social regeneration **which is often essential** in the neighbourhoods where transfers take place.

5.12 The fact that stock transfer has its own considerable resource costs to the Scottish block cannot be ignored. The costs of future transfers could absorb a considerable proportion of available housing funds. This reinforces the need for an overall assessment of the resource requirements called for earlier.

Policy on rents

5.13 A more rational basis for deploying resources both nationally and locally requires a view to be taken on rents, both in terms of the income stream which they provide and in terms of their long-term affordability and sustainability. Local authorities will have to do this as part of their business plans, but it will be difficult for the Executive to continue to avoid taking a view of and giving guidance on this issue. This is not least because a considerable proportion of rental income is dependent on housing benefit, which may well be restructured in the next five years or so in ways which will affect the sustainability of the high rent levels which apply in some areas and which might be driven higher to finance the investment needed. Robust long-term business plans require a framework of guidance as to rent levels which can be reliably charged, in the context of developing government policy (whether in Holyrood or Whitehall).

5.14 National guidance on rents would allow local authorities to take a much firmer view on local rents policies. For example, holding rents down to affordable levels may be the policy driver where rents are high (as in the Glasgow transfer). In other areas, making a judgement about the potential for rent increases whilst staying within affordability guidelines may be important in deciding what level of extra borrowing can be sustained.

Policy on regulation

5.15 Whether council housing stays in council ownership or is transferred, the new role of Communities Scotland in regulating the housing service will clearly be crucial in ensuring that a high quality service is secured and maintained. What has been advocated in this paper is a set of changes to the overall policy towards council housing, intended to widen the options available to councils but aimed at the goal of achieving the best housing service for tenants. Establishing standards, setting targets, and requiring councils to prepare business plans are part of this process. It is vital that the way in which Communities Scotland carries out its regulatory duties reinforces this process of change.

Next steps

5.16 Following the Glasgow ballot, but in light of the limited interest amongst the majority of councils in pursuing stock transfer, the Executive should reconsider the options available and consult councils, housing associations, tenant groups and housing professionals on its policy for ensuring that council housing delivers the best service to tenants. CIH calls on the Executive to do this before the elections of May 2003.

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