

Briefing Paper

Comprehensive Spending Review, Recession and Deficit Reduction Plans: Implications for Housing

July 2010

Introduction

Government carries out Comprehensive Spending Reviews at three year intervals, the latest being in 2007. These reviews determine levels of public expenditure for the following three years and also establish the framework in which public money is managed. The 2007 Comprehensive Spending Review was characterised by lower levels of growth in public expenditure than have been seen in recent years but there was a significant increase in housing budgets - mainly to fund new affordable housing – with a smaller increase in funding for local authorities, mainly to provide funding for authorities with round six arms length management organisations.

Since the 2007 Comprehensive Spending Review the economy has gone into recession with government revenues falling and borrowing increasing to maintain the agreed programmes. In the case of new affordable housing the recession has made it impossible for the planned increased house building programme to be achieved because it was based on the assumption that development could take place with lower rates of social housing grant.

In view of the increased public borrowing it is generally considered that the next Comprehensive Spending Review, which is due in 2010, will feature significant reductions in expenditure.

Comprehensive Spending Review 2007

The Communities and Local Government budget for housing increased by 2.9% a year in real terms over the 2007 Comprehensive Spending Review period. This took the Department's total budget from £10.3billion in 2007/08 to £12.1billion in 2010/11.

The additional funding provided by the Comprehensive Spending Review settlement was accompanied by value for money reforms realising annual net cash releasing savings of over £880million by 2010/11.

The baseline expenditure and additions for housing are shown below:

	£ billion			
	Estimate		Projections	
	2007-08	2008-09	2009-10	2010-11
Housing UK	12.0	12.5	13.1	13.7
of which housing investment	8.1	8.7	9.1	9.5
Housing England	8.8	9.1	9.6	10.0
of which housing investment	6.0	6.4	6.7	7.0

Local authorities are supported in their regeneration role by the Homes and Communities Agency. In addition to its role supporting housing growth and delivering affordable housing, the agency will provide the powers, skills and resources to help regenerate some of the most deprived areas of the country. The agency has brought together housing-led regeneration programmes, building on work already underway through Market Renewal Pathfinders and Decent Homes, and will continue to use the Private Finance Initiative and stock transfers to improve the quality of housing.

The Effect of the Recession

The recession that started in 2008 has had a significant impact on the finances of public organisations including local authority housing services. The main economic effects have been:

- Restricted access to credit
- Falling property and share values
- Falling currency values
- Low levels of consumer demand
- Low inflation
- Low levels of economic growth
- Increased unemployment
- Government ownership of and guarantees for banks
- Low interest rates
- Bringing forward of public expenditure plans

The collapse of the Icelandic banks obviously had an impact on those organisations that held deposits there. Local authorities had £1billion on deposit there. One local authority that was especially badly affected pointed out, ironically, that they had diversified their lending to avoid falling victim of a banking collapse and had invested in four separate Icelandic banks. A concern about the safety of deposits is now widespread, giving a higher profile to Treasury Management, lending policies and the use and reliability of credit ratings.

A survey of local authorities by the Audit Commission in December 2008 found that demand for services had started to increase and this trend has continued. They found, for example, that 33% were dealing with increases in homelessness. This effect was especially marked in London, presumably because of the impact of the recession on the financial services industry. The demand for social housing is increasing. An increase in the number of family breakdowns has occurred. The number of home repossessions has increased thus increasing the demand for social housing.

Economists are predicting that unemployment will increase to three million and this will increase numbers claiming unemployment and other benefits including Council Tax Benefit and Housing Benefit. The numbers seeking financial and other advice have increased. The proportion of tenants eligible for housing benefit has increased during the recession.

There has also been a reduction in demand for some council services for which charges are made. These include garages and shops as individuals and businesses seek to reduce their costs and as businesses that rent premises cease to trade.

The recession is reducing the level of development activity with 80% of Councils reporting a reduction by the autumn of 2008. This includes development of social housing with housing associations being less able to access private funding at affordable levels, less able to use commercial development to cross-subsidise social and shared-ownership housing, and less able to benefit from the reduced number of section 106 agreements.

In November 2008 the Society of County Treasurers published a survey that showed that County Councils were experiencing reductions in land values of up to 50%. This was resulting in a significant reduction in capital receipts (typically from £17million a year to £11.7million) that was increasing the gap between the required capital and the level of resources available.

Councils borrow most of their money from the Public Works Loans Board and this has not been affected by the recession as much as borrowing in the private sector. Furthermore, borrowing rates from the Public Works Loans Board have reduced. The variable short-term lending rate fell from 5.5% in January 2008 to under 2% in December 2008 and has remained low. Interest rates on fixed rate loans have also been reduced. This means that Councils have access to cheaper financing than has been the case in the past, but in the case of the Housing Revenue Account this has been reflected in Housing Subsidy.

Reduced interest rates mean that Councils are receiving less interest on their balances. This is not a factor in the calculation of Housing Subsidy and so this represents a loss of resources to the Housing Revenue Account as well as to the General Fund. The Local Government Association calculates that local authorities' income has reduced by £600million a year as a result of reduced interest rates.

Contractors and Suppliers to Councils are also threatened by the recession meaning that Councils are potentially at risk from such companies getting into financial difficulty or going out of business.

The previous government had brought forward funding for some public works in an effort to stimulate the economy. This included some local government schemes including major repairs to council houses.

The Audit Commission suggested seven ways for Councils to help their communities through the recession: Supporting debt counselling, providing loans to struggling home owners, improving benefit take up, creating credit unions, addressing fuel poverty, helping local businesses to bid for council work and paying small businesses quickly.

The Audit Commission has suggested that public organisations should be proactive in managing their finances and that achieving better value for money is imperative. Clearly these things are important in enabling public organisations to meet increased need from limited resources.

Implications of the Recession for Housing

Gross Domestic Product fell sharply from the end of 2007 and by mid-2009 the economy had contracted by 5.7% over the previous year. The rate of decline has now levelled off. There was a return to growth at the end of 2009. However, the Bank of England's projections are for growth of between +6% and -1% between now and 2012.

Sectoral change is being experienced as follows:

- Financial and business services sectors, the construction industry and the retail sector have seen the largest fall in the number of jobs.
- Highest increases in claimants by occupation are in sales, elementary and administrative occupations and skilled construction.
- Private sector employment has fallen sharply, while public sector employment has increased slightly, although some of this relates to the public ownership of banks. Lloyds and the Royal Bank of Scotland are now classed as in the public sector

The housing market experienced a boom between 2002 and 2007 with house prices increasing faster than incomes increasing unaffordability. The boom was characterised by:

- Relaxation of lending criteria, sub-prime lending, self-certification, high loan to value ratios and new lenders.
- Migration driven demographic growth
- Investment including buy to let mortgages
- High prices and a decline in home ownership.
- Breaking the link between first time buyers' incomes and house prices.

The credit crunch and the recession have been characterised by:

- Credit Crunch – Loss of confidence by buyers, severe reduction in loan availability and rapid collapse of the new build apartment sector.
- Banks are only happy to lend where people have 40% to 60% equity.
- Falling house prices, but no relief on affordability. The fall is now levelling off.
- Reduction in sales turnover.
- Reduction in mortgage availability and worsening terms. This is likely to be a long-term issue. Mortgages are theoretically available but are not as accessible as before. It is now difficult to use equity to secure loans for home improvements.
- Mortgage repayment problems. These have been deferred in the short-term.
- Crisis in the development industry with a collapse in supply.
- Demographic demand is reduced but still strong.
- There are no longer improvement or renovation grants
- Individual planning applications are needed for extensions.

Declining house starts are feeding through to declining completions. Local authorities want to carry out their own developments and facilitate development in the private rented sector. The under-occupation of social housing, for example single people living in family homes, is seen as a problem.

Many areas are 'red-lined' as unaffordable and existing affordability measures are seen as being of limited use. The Homes & Communities Agency is under pressure to increase the number of new builds and / or to buy on the market.

Across the United Kingdom there are 903,000 households (5% of the total) in negative equity and a further 1,100,000 (6% of the total) with less than 10% equity.

It is important to separate out the long term issues relating to the restructuring of housing and labour markets from the short term challenges posed by the current recession.

Long term change includes:

- An increased reliance on market forces to distribute housing and meet housing need.

- A reliance on markets has been accompanied by increases in income and wealth inequality.
- A persistent decentralisation of employment and housing.
- New housing supply has developed a long term downward trajectory.
- Many regions have become more spatially polarised.

This has led to:

- The proportion of dwellings that are accounted for by the social rented sector is falling, and will fall faster in the next decade as new build will be restricted by the national crisis in public sector finance.
- Because of rising inequality in income and wealth, housing assets are being concentrated in fewer hands which mean a fall in owner-occupation and a rise in private renting.

Housing Supply shows the following characteristics:

- There is a positive but imperfect long term relationship between change in Gross Domestic Product and new housing supply.
- The long term trend in housing construction is downward.
- New housing development is not correlated with levels of employment or unemployment.
- Supply of new property is not responsive to increases in price. It is 'supply inelastic'.
- Supply is constrained by the business model adopted by the development industry and restrictions on the supply of land. There is a history of construction activity falling rapidly during a recession and being slow to recover afterwards. This was especially marked after the 1990/91 recession.

The economic context is as follows:

- Clear differences in economic performance between urban and rural areas.
- The areas worst affected by recession are the old manufacturing centres.
- The income profile in post-industrial cities is 'hollowing out' – with housing market impacts.
- Some areas are relatively unscathed by the recession – these have experienced real private sector employment growth and are located to the west and south of the conurbation.
- Areas disproportionately dependent on public expenditure, such as West Cumbria, will experience a further economic contraction

Recent housing market changes include:

- More economically resilient areas outside the conurbation are less hard hit by price and turnover falls as are commuter areas.
- Aspiration and income inequality are influencing price change even during a recession, reflecting how deep seated these drivers of change have become.
- The map of price changes reflects the changing economic geography of the country and could also act as a proxy for the distribution of income and wealth.
- There are vulnerable loans in major urban areas.

Short term policy issues include:

- The General Election result of 2010 and the new coalition government followed by the Comprehensive Spending Review that will cover the period 2011 to 2014.
- There is a clear need to secure a funding line in this review to support housing supply in regeneration areas and areas experiencing high demographic growth.

- The extent to which this should take precedence over refurbishment and other housing activity will need to be the subject of national debate.
- Housing strategies need to be reviewed in the light of both the long wave of change identified and the immediate crisis stimulated by the credit crunch and the associated recession.
- New models of delivery are needed and interventions to replace the traditional model of development that is partly driven by land speculation.
- The model for delivering affordable housing is broken, and we need alternatives after 2014 when public expenditure may be considerably lower.
- There will be a public sector recession in the period 2011-18 and understanding the impact of this on housing and labour markets will be key to implementing effective interventions to mitigate the negative outcomes.

Longer term issues include:

- Urban areas are vulnerable to further manufacturing decline against a backdrop of projected increases in population and households. This is an unusual set of circumstances.
- Owner occupation is unlikely to be sustained at its current level in these areas. Private renting poses challenges.
- Any major decline in owner-occupation will have an economic impact through a reduction in consumer expenditure, for example, on improvements and renovation.
- The Homes & Communities Agency is exploring public sector stimuli for the growth of the private rented sector via institutional finance to raise the quality and quantity of the sector through new build.
- The new build market in the conurbations will be influenced by economic success from within the BME communities. This is already evident.
- New and developing employment centres outside the urban areas may also attract developments for key workers.
- If the supply inelasticity continues alongside increasing demographic growth, the outcome will be an increase in the utilisation of the existing stock. For some communities, this will mean an increase in overcrowding, sharing and concealment.
- This confirms the need for greater integration between economic, planning and housing strategy and policy.

The North has traditionally had low demand. For the next ten years it will be very difficult to get funding in the North. New supply will get thinner on the ground. There is a need to make links with national policy agendas. The new government intends to delegate planning powers to local authorities and less development could result. There is a need to make better use of existing assets – for example, there are a large number of empty houses that could be brought into use.

It is reported that in Barrow, for example, there are between 2,500 and 3,000 private rented properties many of which are of poor quality and / or are badly managed. There are only two officers for enforcement and this is not sufficient. There is a need for additional funding for regulation.

It is not clear where demand to fuel growth will come from in future. In Cumbria, for example, there are a lot of micro-economies and in reality things are different from the regional spatial strategy. There is a recession and a lack of public funding. The Homes & Communities Agency is already spending in 2010/11 at a third of the level that it spent in 2009/10. In future, investment will be driven by the private sector that will only want to invest in growth areas. The question is how social housing could make the most of planning gain. In practice development will concentrate in growth areas and the likely effect in other areas is a concern.

Deficit Reduction

The government announced a package of savings in early June 2010 totalling £6.2billion but these are considered to be 'nothing' compared with what will come in the autumn with the Comprehensive Spending Review. Then, each secretary of state will begin outlining significant savings over the three years starting next April. Those figures are expected to dwarf this recent announcement, foreshadowing thousands of job losses and cuts in services.

But the government considers that a start has to be made somewhere, and Chancellor George Osborne MP has taken the first steps in rectifying what he called the "worst economic inheritance" any government has been given in the history of the United Kingdom.

Most of the cuts are being set in place to reduce Britain's £156billion fiscal deficit, which is now the highest within the European Union and leaves the United Kingdom with severe financial problems.

George Osborne MP, the new Conservative Chancellor of the Exchequer and his Liberal Democrat deputy, David Laws MP (now replaced by another Liberal-Democrat, Danny Alexander MP), declared that there was an urgent need to act as they outlined plans to scrap child trust funds and freeze civil service recruitment. The Conservatives and Liberal Democrats have clashed over the issue of spending cuts in the past, no more so than during the general election campaign with most of the differences coming over the idea of imposing £6billion of spending cuts this year from Whitehall 'efficiency' savings. These differences now seem to have been overcome.

David Laws MP, the chief secretary to the Treasury at the time of the announcement, (whose first act in office was to scrap his chauffeur-driven Jaguar) said:

"We cannot afford to continue to increase public debt at the rate of £3billion each week. Our huge public debts threaten financial stability and if left unchecked would derail the economic recovery.

"Public borrowing is only taxation deferred, and it would be deeply irresponsible to continue to accumulate vast debts which would have to be paid off by our children and our grandchildren for decades to come."

The proposed plans to cut public spending will lead to £6.243billion worth of cuts this year alone (2010/11). However, £500million of that will be reinvested in apprenticeships, further education and social housing. This means that the government intend on using around £5.7billion to pay down the fiscal deficit this year and giving Britain a sounder financial footing heading into 2011.

The Chancellor George Osborne said:

"We have conducted the fastest and most collegiate spending review in recent history. That is what this new government is all about.

"Rolling up our sleeves, getting on with the job, working together in the national interest, delivering on our promises, getting a grip.

"There were many who said it couldn't be done. That we alone in Europe were concerned about debt. That only cuts to frontline services were feasible because all the efficiencies possible had already been found.

"We have comprehensively demolished all of these arguments. I am not claiming that it has been easy. We have worked incredibly hard over the past week."

The new coalition government softened the blow by announcing that some areas had been protected in spite of the proposed cuts. Osborne had said that any savings identified in the NHS, defence and overseas aid budgets would be reinvested in those departments. That list was expanded later to include schools, Sure Start centres for young children and education spending on 16 to 19 year-olds.

The main areas of budget reductions are:

- Scrapping government contributions to the Child Trust Fund, saving £320million this year and £520million in the coming year. Contributions at birth will be reduced from £250 to £50 for better off families and from £500 to £100 for lower income families. Contributions at the age of seven will be stopped completely this coming August. From next January, all contributions at birth will be stopped.
- A civil service recruitment freeze will apply across all government departments and agencies. There will be one or two exceptions. These exceptions come in the form of the graduate fast stream which is already underway.
- Civil service pay remits for this year will have to be approved by the Chief Secretary to the Treasury. Any central government pay package above the prime minister's salary will have to be approved by the Chief Secretary to the Treasury. David Cameron MP's voluntary pay cut means the threshold will be reduced from £150,000 to £142,500.
- Ministers will be banned from having a dedicated chauffeur-driven car. The only exceptions will be on security grounds.
- Full first-class travel, which cost £45million in 2008/09, "should be avoided by public servants wherever possible". However, no definite sanctions against this have been put forward.
- Quangos will have their budgets cut by £600million in the months ahead.
- Efficiency savings that have been identified on behalf of the Conservatives by Sir Peter Gershon and Dr Martin Read, will lead to cuts of £1.15billion in discretionary areas like consultancy and travel costs.
- This will include £95million through savings in IT spending; and £1.7billion from delaying and stopping contracts and projects with the seventy major suppliers to government.
- £1.165billion savings from local government authorities which will be achieved by reducing grants to local authorities and their arms length organisations.
- The government says it will give local authorities greater flexibility over their budgets by removing restrictions on £1.7billion on grants in the 2010/11 financial year.

- This approach will have the effect of giving local authorities the task of deciding where the budget reductions will fall. There will be a net increase in their Revenue Support Grants but a reduction in their specific grants leading to a net reduction in funding in total. Government will argue that specific grants have been mainstreamed into Revenue Support Grant and that funding is still available for services. Local authorities will have to decide whether to continue to provide funding. Users of services where funding is reduced wont necessarily be able to identify whether this results from the decisions of national government or the local authority.
- The Treasury issued a list of cuts to the budgets of fifteen different Whitehall departments plus the devolved administrations in Scotland, Wales and Northern Ireland.

The new Communities Secretary Eric Pickles MP commented on the announced cuts in support of them saying:

"The spending decisions we have outlined today show our determination to help tackle the immense public deficit the new Government has inherited, whilst shielding council services like rubbish collections and social care.

"There will be no reduction to the £29billion general grant that local government receives every year meaning that they have the flexibility they need to protect the frontline.

"But this is also an opportunity to devolve real power to councils. By removing ring-fencing and red tape and freeing up resources councils will be free to focus on delivering essential services.

"Councils have already made big efficiency savings in recent years. Central government needs to follow that example. We are putting tough controls on Whitehall spending.

"A radical scaling back of the scope and interference of quangos and putting power with councils and communities will deliver significant savings, ensure services are meeting the needs of the people that use them and cut out waste."

Comprehensive Spending Review 2010

The first quarter of 2009 saw the United Kingdom economy contract by 2.4% (0.5% more than the Treasury's estimate of 1.9%) bringing the annual rate of contraction to 4.9%. Manufacturing output declined by 5.5%. This is the steepest decline in 51 years. Savings rates are down from 4% to 3%. There are fears that the economy will contract further when government support ends.

Recessions are always bad for public services and this recession will be especially bad because the measures to relieve the banks have created huge public liabilities at the same time as government revenues have fallen. The resultant high levels of public borrowing are considered high risk as they have the potential to impact on the United Kingdom's credit rating, it could become harder to sell government bonds and the impact on the value of sterling and on inflation could be adverse. The high level of public debt will have to repaid at a time when it is difficult for the government to raise revenues.

The next Comprehensive Spending Review period will start in 2011/12 and it is already clear that the government is planning reductions in expenditure during that period to allow for the repayment of the loans taken out during the recession. Revenue expenditure is expected to decline by about 25% and capital investment by an even greater amount. If the government maintains its commitments to the National Health Service this implies reduced resources for other services including housing. Furthermore, if the recession proves to be worse than the government anticipates this would result in even greater reductions in expenditure in 2011/12 and beyond.

In March 2009 it was revealed that the Chartered Institute of Public Finance and Accountancy and the Society of Local Authority Chief Executives had agreed to work together to look at how Councils could react to a collapse in the level of government funding. This would include new models of service delivery.

Roger Latham, then Vice President of the Chartered Institute of Public Finance and Accountancy was quoted in the 'Local Government Chronicle' as saying:

"We are talking about what happens if we lose 30% to 40% of the resources currently available in the long term... It is the scary end of the business, no two ways about it... There is a body of evidence that the recession could be longer and more sustained than the V-shaped one ministers are hoping for... If that happens, normal efficiency procedures won't deliver the goods. You need a completely different delivery model."

Conclusions

The Comprehensive Spending Review of 2007 set out the government's financial priorities, budgets and performance management arrangements for the years 2008/09 to 2010/11. It included increased provision for housing – especially for new build – and a more devolved approach to the management of local authority finance.

The recession has increased homelessness and the need for affordable housing while constraining the ability of housing associations to deliver. It has also led to a significant increase in public borrowing.

The 2010 Comprehensive Spending Review is expected to concentrate on making reductions in public expenditure in response to the need to repay public debt that has increased during the recession.

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July 2010