

Briefing Paper

Council Housing: A Real Future – AWICS Response

July 2010

1. Summary

- 1.1 This consultation paper is generally to be welcomed. The housing revenue account financing system including the subsidy system as it currently operates is generally considered to be unfit for purpose. In particular it considered to be unfair to local authorities and council tenants; to be too inflexible and unstable thus making long-term financial and asset management planning difficult; and to leave local authorities with insufficient resources to provide and sustain decent homes and other appropriate services for their tenants. The current system prevents local authorities from best meeting the needs of their tenants and the communities that they serve.
- 1.2 We agree with Ministers that there is a need for a devolved system that puts local authorities and tenants firmly in control and gives them the financial freedom they need to make the best long-term decisions about their housing and communities. We agree that power and money should be returned to councils and communities.
- 1.3 While we recognise that this is essentially a technical financial paper, we are therefore disappointed at the apparent lack of emphasis that is given to tenants' interests and to value for money. We believe that these issues should be at the heart of thinking about the financial management of council housing.
- 1.4 We believe that these proposals represent an improvement on the current arrangements but that further thought should be given to the implications of the proposals. These issues are identified below

2. Council Housing: A Real Future

2.1 Introduction

- 2.1.1 Communities & Local Government published a prospectus 'Council Housing: A Real Future' on 25th March 2010 and invited observations. This paper is the response to that consultation by 'Adrian Waite (Independent Consultancy Services) Limited – (AWICS).

- 2.1.2 'AWICS' provides a full range of ethical management consultancy and training services, principally to those who are involved in social housing. Our mission statement is 'Independence, Integrity, Value'. We believe that we offer the best value for money that is available today! And we publish the popular free e-newsletter for housing – the 'AWICS Housing News'. We are big enough to make a difference – but are small enough to care! Further information about 'AWICS' is available on our websites at www.awics.co.uk and www.awics.eu.
- 2.1.3 We have worked with a number of local authorities on self-financing. Adrian Waite is a member of the CIPFA Housing Panel and was a member of the working party set up in 2008 by Communities & Local Government as part of the review of local authority housing finance. Our Associate consultants also have a wealth of qualifications and experience in social housing management and finance. The views expressed in this paper are informed by our experience but are the views of Adrian Waite and AWICS Limited and do not necessarily reflect the views of any professional bodies or clients with whom we are associated.

2.2 Detailed Response

Communities & Local Government has posed seven specific questions that are addressed below. The specific consultation questions and our response to each are as follows:

2.2.1 What are your views on the proposed methodology for assessing income and spending needs under self-financing and for valuing each council's business?

The proposed methodology, despite the differential uplifts that have been calculated, is based on the existing formulae for management, maintenance and major repairs allowances and therefore perpetuates current patterns of spending. Authorities that consider themselves disadvantaged by the current formulae – for example by having low management allowances because of the small number of flats in their stock – may consider that they would still be disadvantaged with the new formulae. Furthermore, the proposed increases in major repairs allowances fall short of those recommended following the research by the Building Research Establishment on behalf of Communities & Local Government in 2008.

On the other hand the methodology does not address how local authority landlord services could contribute to the government's deficit reduction plan by achieving economies through securing greater value for money. We consider that there should be scope for many local authorities to secure economies through greater value for money especially in their management budgets and also in their maintenance budgets. It may be appropriate to consider whether and how this should be reflected in the methodology and how the methodology could be designed to provide incentives for local authorities to optimise value for money.

The proposed methodology assumes that rents will increase by 0.5% a year in real terms after rent convergence. This has the effect of significantly increasing tenanted market value. There is therefore a significant risk to local authorities if a subsequent government were to change its policy on social rents. If a decision was taken, for example, to freeze social rents as a way of controlling housing benefit expenditure, local authorities would be faced with a need to make ongoing savings to balance their housing revenue accounts.

The calculations in the prospectus are based on an implementation date of 2011 and use stock details from 2009. However, it is more likely that self-financing would be introduced in 2012. Presumably, Communities & Local Government would wish to update the data to arrive at tenanted market values appropriate to a 2012 implementation date. This would be likely to lead to increased tenanted market values

The proposed methodology is based on a discount rate of 7% on the basis that this should enable local authorities to fund the building of new council homes; or 6.5% if this is excluded. This is presumably another assumption that would be revisited if the data was updated to 2012. It is also likely that local authorities would not be able to achieve the level of new build that is envisaged (see below) and this may affect the choice of discount rate.

The prospectus offers local authorities separate settlements on the 'revenue' side and the 'capital' side. Tenanted Market Value excludes the need for capital investment (excluding major repairs) and local authorities would therefore be obliged to rely on the proposed capital grants to fund the decent homes standard and any backlogs of work. The availability of these capital grants would be dependent on the outcome of the Comprehensive Spending Review in which they would represent a bid for additional resources by Communities & Local Government. The Comprehensive Spending Review is expected to result in significant reductions in housing budgets so the availability of funding for the proposed capital grants does not appear to be certain. This risk could be addressed by including capital expenditure in the calculation of tenanted market value (see section 2.2.7).

Authorities that have had arms length management organisation funding approved for future years will be looking for assurances that capital grants of the same amount will be similarly guaranteed.

The prospectus makes no reference to the funding of disabled adaptations, communal works or energy efficiency. The exclusion of these costs from the calculation of tenanted market value and from the proposed capital grants system would mean that local authorities would have no resources to address these matters. This does not seem to be appropriate – especially as addressing climate change is likely to become an increasingly important priority - and we believe that further consideration should be given to this.

The proposals generally expose local authorities to greater risks than at present especially regarding rents and interest rates. However, this is a natural consequence of self-financing and would place local authorities in a similar position to housing associations. Exposure to the risk that capital grants were not available would be a risk that is not faced by housing associations.

2.2.2 What are your views on the proposals for the financial, regulatory and accounting framework for self-financing?

The proposal to strengthen the housing revenue account ring fence is welcome although we believe that non-core services should be excluded from the housing revenue account immediately rather than in the long-term. The proposal to allow local authorities discretion to spend all their capital receipts locally is also welcome. However, the principle of ring fencing could be extended further and housing revenue account capital receipts could be ring-fenced to the housing revenue account as already occurs in Wales.

The proposal to limit borrowing by self-financed local authorities is disappointing and appears to be contrary to the principles of localism and decentralisation that are associated with the prudential borrowing system and self-financing and are being promoted by the present government. Local authorities have a good track record of acting prudently within the provisions of the Prudential Code and, as far as I am aware, the Treasury has expressed no reservations about the way in which local authorities have exercised their prudential borrowing powers since the system was introduced in 2004.

The prospectus makes few references to the place of tenants in the new financial framework. We consider that local authorities should place tenants at the heart of everything that they do regarding council housing. It may be appropriate to consider whether and how tenants should have a specific role in the financial and regulatory framework for self-financing. It will be interesting to see how many tenants' groups respond to this consultation and what their views are.

The proposal to establish a housing revenue account balance sheet is to be welcomed as a way of assisting local authorities to secure good asset management. We do not consider that this should be an onerous imposition on local authorities as they should already possess the accounting systems and data that would be required to prepare a housing revenue account balance sheet.

Further work is required to understand the implications of moving to a two or three pool approach or retaining a one pool apportionment for managing local authority loans. However, we believe that a two pool approach is the most logical, least complex and conceptually most understandable of the options.

Similarly, further work is required to understand how best to account for depreciation and make provision for major repairs in a self-financed system. We consider that depreciation accounting is the best measure of the consumption of fixed assets and can also ensure that resources are available for the renewal of fixed assets or repayment of debt.

There are a significant number of other detailed accounting issues that need to be addressed and all such issues will hopefully be resolved through the working party that has been established by Communities & Local Government, the Chartered Institute of Public Finance and Accountancy and the Audit Commission.

We believe that further consideration should be given to the impact of self-financing on the future of arms length management organisations. It would be fair to say that every authority that has established an arms length management organisation has done so to access the additional capital financing that has been available. If self-financing provides resources to authorities on the same basis whether or not they have an arms length management organisation this incentive to operate with an arms length management organisation is removed. However, many consider that the separation of housing management from strategic housing functions is appropriate and that most arms length management organisations have been successful. It may therefore be appropriate to consider whether Communities & Local Government should take any specific initiatives to encourage local authorities to retain their arms length management organisations or even for authorities to establish new ones.

We believe that further consideration should be given to the impact of self-financing on future housing stock transfer proposals. Our understanding is that it is envisaged that future housing stock transfers would be on the basis that the stock transfer housing association would have to accept all the housing revenue account debt of the local authority and that no additional resources would be made available by government. This could have the following implications:

- The stock transfer housing association would have no resources to meet costs that would fall on it in addition to those that would be borne by the local authority such as value added tax
- The stock transfer housing association would have no resources to finance improvements or backlogs of work in the stock, unlike a local authority that could have access to capital grants
- The stock transfer housing association would not be able to achieve the decent homes standard (unless it had already been achieved by the local authority), to make any improvements or to sustain existing levels of service
- This would effectively bring an end to the housing stock transfer programme in England.

However, there are local authorities and tenants who would like to consider a housing stock transfer. We are not convinced that Ministers would wish to create a financial framework that prevented this from happening and so would suggest that further consideration be given to the impact of self-financing on future housing stock transfer proposals.

2.2.3 How much new supply could this settlement enable you to deliver, if combined with social housing grant?

Doubtless individual local authorities will be providing their own estimates of this. However, we suspect that they would not be able to deliver the number of homes envisaged in the consultation paper because of the effects of the recession, anticipated reductions in the availability of social housing grant, constraints on prudential borrowing that are proposed in the consultation paper and self-financing business plan projections that show that during the initial years of business plans resources will often be fully committed to maintaining existing stock.

We consider that it would be appropriate for Communities & Local Government to carry out a fundamental review of the scope for building new affordable housing in the context of developing housing need and trends in the broader housing market following the Comprehensive Spending Review. It is clear that resources will be limited and will have to be focused and new models for service delivery developed. We are sure that Communities & Local Government is aware of this. It appears to us that the role of local authorities as enablers and builders of new affordable housing will only become clear after the Comprehensive Spending Review has been completed and its implications for affordable housing thought through. However, we believe that a 'level playing field' should continue to exist between local authorities and housing associations.

2.2.4 Do you favour a self-financing system for council housing or the continuation of a nationally redistributive subsidy system?

The housing revenue account subsidy system as it currently operates is generally considered to be unfit for purpose. In common with most people who have an interest in local authority housing, we therefore favour a self-financing system.

The prospectus is based on the assumption that there continues to be a role for central government in redistributing resources between the housing revenue accounts of different local authorities. It is proposed to achieve that by establishing different levels of housing revenue account debt in each authority. Our experience is that redistribution is generally but not universally supported. There are those who believe there is a case for the redistributive elements of the housing revenue account financing system to cease to operate and for income and expenditure to 'lie where it falls' as in Scotland.

2.2.5 Would you wish to proceed to early voluntary implementation of self-financing on the basis of the methodology and principles proposed in this document?

Doubtless individual local authorities will be responding to this but our impression is that most authorities would welcome the introduction of self-financing at the earliest possible opportunity.

2.2.6 Would you be ready to implement self-financing in 2011/12? If not, how much time do you think is required to prepare for implementation?

Doubtless individual local authorities will be responding to this but we consider that there should be no obstacles to local authorities implementing self-financing in 2011/12.

2.2.7 If you favour self-financing but do not wish to proceed on the basis of the proposals in this document, what are the reasons?

A number of local authorities and others have expressed support for the principle of self-financing while at the same time expressing concerns about the significant increase in debt that is proposed especially for authorities that are currently in negative subsidy and have low debt levels.

It is difficult to see how self-financing could be achieved without making significant increases in the debt of many authorities as long as tenanted market value (excluding capital expenditure) is used as the basis for introducing self-financing.

One way in which self-financing without such significant increases in debt could be achieved would be by including the cost of achieving the decent homes standard and backlog works (and perhaps other investment requirements) within the tenanted market value calculation. This would reduce the opening level of debt in the case of most authorities; would be consistent with the treatment of capital investment requirements in calculating tenanted market value for stock transfers; and would give self-financed local authorities greater certainty that resources would be available for them to finance the decent homes standard and backlogs. This approach could be considered preferable to that which is proposed in the prospectus although it would require agreement between Communities & Local Government and each individual local authority on the requirement for future capital works before the self-financing tenanted market value was calculated.

A more radical option would be to introduce capital charges in place of negative subsidy. This approach was considered in outline during the review of housing revenue account finance in 2008 but was not mentioned in the consultation papers of July 2009 and March 2010. The rationale for this option is as follows:

- Capital Financing costs are currently unevenly distributed between local authorities, reflect a complex pattern of past decisions and are generally met by central government through housing subsidy. It would therefore represent a significant simplification of the system to write off housing revenue account debt at the level of the subsidy capital financing requirement and to take the capital financing element out of the housing revenue account subsidy formula.

- Central government currently takes resources out of housing revenue accounts through the housing subsidy system and through charging local authorities interest on their housing debt. The justification for this is that there should be a charge in the housing revenue account to reflect the capital investment in council housing that has been made by the taxpayer. The most logical way to reflect this would be to introduce a capital charge that was directly and transparently related to capital values.
- The potential implications of using a capital charge in this way were considered by the Communities & Local Government review of housing revenue account financing and some calculations were made by Adrian Waite. These indicated that switching to a system of capital charges would result in a redistribution of resources between local authorities with London, Northwest England and Yorkshire & Humberside generally losing resources and Eastern, Southern and Southwest England generally gaining resources compared to the current position. This is because a system of capital charges would take resources from higher rather than lower value areas but would not redistribute resources to the same extent as the current housing revenue account subsidy formulae.
- Capital Charges would have their disadvantages but they could offer an option for introducing self-financing while writing off debt rather than increasing it. For this reason, Ministers may wish to give the option further consideration.

3. Conclusions

- 3.1 We would be pleased to assist Communities & Local Government with the development of proposals to improve the financial management of council housing. Please do not hesitate to get in touch if there is anything that you would like us to clarify or if there is anything that you would like to discuss.
- 3.2 We hope that you find these observations self explanatory and helpful.

Adrian Waite
5th July 2010