

Briefing Paper

HOUSING INVESTMENT PROGRAMME AND THE 'DECENT HOMES' STANDARD

Adrian Waite – July 2004

Introduction

In the government's statement on Housing Policy, made in December 2000, priorities for future investment in local authority housing were identified that included:

- Increasing local authorities' resources and giving them greater flexibility to adopt policies that meet the needs of their communities across all types of housing.
- Developing closer partnership working between the Housing Corporation and local authorities, in particular ensuring that investment in new social housing meets local priorities.
- Bringing all social housing up to a 'decent' standard by 2010. They have set a Public Service Agreement target to improve a third of the homes that don't meet that standard by March 2004.
- Ensuring that local authorities adopt a more businesslike approach to housing management and investment through a new financial framework.
- Increasing investment in affordable housing through the Housing Corporation's Annual Development Programme.

The 'Decent Homes' Standard

The government has set a target to deliver decent homes to all social sector tenants by 2010, and to reduce the number of social tenants living in non-decent homes by one third by April 2004, with most of the reduction taking place in deprived areas.

A decent home is one that meets the following criteria:

- Is above the current statutory minimum standard for housing.
- Is in a reasonable state of repair.
- Has reasonably modern facilities and services.
- Provides a reasonable degree of thermal comfort.

The Decent Homes Standard is not seen as an ambitious target by most housing practitioners. It represents a lower standard of housing than is allowed for in most housing stock transfers, and many tenants and local authorities aspire to achieving a higher standard.

However, studies of the condition of social housing at a national level suggest that a large proportion of social housing currently fails the decent homes standard and that this problem is particularly acute with regard to council housing. Furthermore, most councils report that their own stock condition surveys show that the amount of money that would be required to fund the decent homes standard is greater than the resources that they expect to have available. There are 1.5million council homes that are currently below the Decent Homes Standard and the total cost of bringing them up to the decent homes standard has been estimated at £19billion. According to the Office for the Deputy Prime Minister, 97 local authorities do not have sufficient resources to achieve the standard by 2010.

It has been seen that the government effectively controls the level of both revenue and capital resources that are available to local authorities. It therefore appears that the government has set a target for decent homes that implies the need for more expenditure than it is prepared to finance. This results in an 'investment gap' at national level that is reflected in most local authorities.

The government has instructed all authorities to consider their options for the future of their housing stock, and in particular to identify which options are likely to result in the Decent Homes Standard being achieved. In the case of many authorities the conclusion that has been reached is that the only way of meeting the 'investment gap' is to introduce private finance through the private finance initiative or a large-scale voluntary transfer or setting up an ALMO – an Arms Length Management Organisation. These stock options are considered in more detail below.

However, the government is also making changes to the way in which housing capital finance is distributed and this will have an effect on whether individual local authorities will be able to meet the decent homes standard. This is the subject of this section.

The Single Capital Pot

The 'single capital pot' was used to distribute capital resources to local authorities in 2002/2003 and 2003/2004. The allocation of resources within the single capital pot was based partly on indices of relative need and partly on a discretionary basis linked to assessments of authorities' relative performance. The need-based element of housing allocations was based on the generalised needs index. The discretionary element of the Single Capital Pot was a single allocation based on the quality of authorities' cross-service Capital Investment Strategies, their Asset Management Plans and performance in individual service areas.

The government's 2002 comprehensive spending review was announced on 15th July 2002. It represented the largest increase in government spending plans for many years, and included an overall spending increase of £93billion over three years. This will take the proportion of national income devoted to public spending from 39.8% in 2002/2003 to 41.8% in 2005/2006. Subsequently, it is intended to increase public expenditure in line with inflation and it would therefore fall as a proportion of national income.

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All spending departments gained from the comprehensive spending review, but the largest shares went to health and education. Housing's share was much smaller and was focused on addressing shortages of housing in Southeast England.

Housing is clearly not the government's main priority as the additional resources allocated to housing are small in relation to those allocated to services such as health and education.

For local authorities in particular, the comprehensive spending review offered little relief. There are no additional funds to address the backlog of repairs and improvements to the council stock.

The 2003/2004 Housing Investment programme allocations were announced in December 2002. They represented a considerable disappointment for local authorities with a total allocation of £800million being made compared with a £953million allocation in 2002/2003, representing a reduction of 16%. There was also a redistribution of resources following changes in the formulae – especially the discontinuation of the receipts taken into account adjustment.

The Communities Plan proposed that the Housing Investment Programme and the Housing Associations' Approved Development Programme should both be discontinued in favour of single regional investment 'pots' administered by new regional housing boards. This system is in place for 2004/2005.

Comprehensive Spending Review 2003

In September 2003, Paul Boateng, Chief Secretary to the Treasury, said:

"The days when (housing) felt relegated to the margins of social and economic policy are gone. Housing is now central to our agenda... By 2005/2006 we will have doubled, in real terms, our investment in housing from 1997/1998, but there is more to do. Additional resources need to be accompanied by significant policy reforms. Housing is a vital public service in which we need to ensure the taxpayer gets value for money. It needs to attract new resources. The comprehensive spending review needs always to make sure those are being applied effectively and resources are linked to reform."

Looking forward to the comprehensive spending review of 2004, Jim Coulter, the Chief Executive of the National Housing Federation, said:

"To date, the Treasury has not changed the framework for the key housing policy areas of stock transfer – although it wants to improve it – the private finance initiative and arms length management organisations. In fact it has ploughed more resources into all three areas to help councils invest in their sub-decent housing stock."

"The biggest question for the spending review is what the ODPM will prioritise if – as seems increasingly likely – the Treasury gives it a smaller settlement."

"Will it concentrate on stock transfer, where private finance is combined with public? Or will it plough more cash into ALMOs which are all publicly funded? I suspect the answer could well be the former."

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The Prudential System of Capital Controls

In July 2000, the government published a Local Government Finance Green Paper. This proposed a new "prudential" system of local government capital finance controls that were based on the conclusions of the Capital Programmes Working Party that had reported in April 2000. This prudential system would allow authorities to borrow freely for capital investment, subject to controls that would ensure that borrowing was affordable and consistent with the Government's fiscal rules. These proposals were finally enacted as part of the Local Government Act 2003.

The main elements of the new approach are:

- Councils to have freedom to borrow against the revenues in the Housing Revenue Account, subject to prudential limits, and excluding the Major Repairs Allowance.
- Councils that establish high performing Arms Length Management Organisations will be free to retain the proceeds of rent increases to fund borrowing to upgrade stock to the decent homes standard.

However, those authorities that make revenue contributions towards their capital outlay are often only able to do so because they can raise their rents above guideline without breaching the limit. It is therefore likely that the planned convergence of guideline and limit rents will lead to a significant reduction in the resources that local authorities can use at their discretion.

In view of the operation of the Housing Subsidy system, it is therefore very difficult to see where local authorities will find the revenue resources to use to support their borrowing under the new prudential system. For this reason it is likely that the only local authorities that will benefit from the prudential system will be those that establish Arms Length Management Organisations.

The Chartered Institute of Public Finance and Accountancy has developed the 'Prudential Code for Capital Finance in Local Authorities'. It includes:

- Locally determined prudential indicators, including the prudential limit for external debt.
- The process, by which the prudential indicators will be set, revised and monitored.
- Matters to be taken into account when setting or revising the prudential indicators.
- Key definitions for use in the new system.
- A small core framework of capital legislation including the power to borrow, and to regulate borrowing and 'extended credit'.
- A new power to set statutory prudential indicators.
- Continuing reliance on the statutory 'balanced budget' requirement and other prudential legislation.

The Local Government Act 2003 comes into force on 1st April 2004 and with it 'prudential borrowing' that will give councils power to borrow as much as they wish as long as they can afford to finance the debt.

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There is a new concept of the 'Capital Financing Requirement'. This represents the amount of borrowing that an authority has previously undertaken, plus a sum that the regional housing board considers is appropriate for the authority to borrow during the current year. This sum is known as 'Supported Capital Expenditure'. This data is then used to calculate the capital financing element of the housing subsidy calculation. As a result, an authority should find that it has sufficient revenue resources to support prudential borrowing at the level that has been calculated by the regional housing board.

There is a distinction between Supported and Unsupported Borrowing in that the government will provide authorities with housing subsidy to meet the costs of financing supported borrowing while authorities will have to identify a means of financing unsupported borrowing from within the housing revenue account. The government intends to discontinue supported borrowing over time but has accepted that Supported Capital Expenditure is needed in the short term.

Currently, debt levels for housing subsidy purposes go up for borrowing, and down for set-aside and Minimum Repayment Provision. In future, debt will be effectively "frozen" in subsidy terms as there will be no set-aside or Minimum Repayment Provision and no supported borrowing in the longer term. The Housing Revenue Account Capital Financing Requirement only changes for voluntary set aside and voluntary or prudential borrowing which are not reflected in the Subsidy Capital Financing Requirement, and therefore there is more flexibility, theoretically at least. In the new system, debt repayment is voluntary and the Major Repairs Reserve can now be used for this purpose.

The system will work well for projects that will achieve a financial return. For example, a Leisure Centre or toll road that will be able to generate sufficient income to meet capital repayments, or investment in information technology that will enable savings in salary budgets to be made.

However, prudential borrowing may not work so well for authorities that wish to borrow money to invest in the housing stock. This is because rents are controlled by government and are increasingly deducted from payments of housing subsidy.

The main implications of prudential borrowing are:

- No need for credit cover (Credit Approvals will no longer be issued)
- Additional borrowing can occur only where headroom within revenue resources
- There is a separate indicator for housing within the prudential indicators
- There are no longer credit ceilings

Regional Housing Boards

Regional Housing Boards have until May 2005 to provide their future funding plans following which the government will announce funding allocations for councils and housing associations for 2006/2007 and 2007/2008 in the summer of 2005.

Transitional protection for local authorities that ensures they receive at least 70% of previous capital allocations in 2004/2005 and 2005/2006 will not be continued.

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In 2004/2005, local authorities are guaranteed 70% of their current housing investment programme allocation, but studies as early as October 2003 suggest that regional housing boards are looking to start moving money between councils and registered social landlords. This follows the development of regional strategies for housing investment.

In Yorkshire & the Humber, the board is offering authorities 95% of their 2003/2004 allocations. However, in the East Midlands the regional board originally decided that local authorities would receive 75% of their 2003/2004 allocation, unless more was needed to meet the decent homes standard. In the case of Derby City Council, this would have meant 100% of the 2003/2004 allocation. However, following discussions with the ODPM the board revised Derby City Council's allocation downward.

The table below analyses how the 'Supported Capital Expenditure' has been allocated between regions of England, and compares this with the admissible basic credit approvals that were issued during 2003/2004. It will be seen that total government support for housing capital expenditure has been reduced in 2004/2005. However, the reductions have mainly been made in London, the Southwest, the East and the East Midlands.

	Adm BCA <u>2003/04</u>	SCE <u>2004/05</u>	<u>Increase</u>
East Midlands	41.08	35.03	-14.73%
Eastern	35.15	29.50	-16.07%
London	219.91	169.01	-23.15%
North East	31.64	31.79	0.47%
North West	73.49	78.85	7.29%
South East	39.18	41.09	4.87%
South West	21.90	20.10	-8.22%
West Midlands	54.20	55.42	2.25%
Yorks & Humber	54.95	59.18	7.70%
Total	571.49	519.96	-9.02%

The 'Blue Skies Debate'

The Office of the Deputy Prime Minister issued a paper on housing capital finance in August 2002. It included proposals for:

- Capital Receipts Pooling
- Local Authority Social Housing Grant
- Radical Options for Reform

The Office of the Deputy Prime Minister hailed its consultation paper as a 'once in a lifetime' opportunity to simplify the existing housing finance regime. Its call for a 'blue skies' debate has been described as the 'greenest consultation we could possibly have without circulating a blank sheet of paper'.

The government's objectives are:

- Stronger incentives for active asset management
- Encouraging better housing management

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- Simplification
- Fairness in allocating resources
- Fairness in allocating costs and risks between the Housing Revenue Account and General Fund
- Consistency with reform of General Fund finance

The ideas that were raised were:

(a) Grant funding capital investment

The Housing Investment Programme (HIP) process would be used to allocate grants that would finance capital investment. This would replace revenue support.

(b) Include an investment allowance with housing subsidy

A needs assessment would be made to allocate an investment allowance that could be used as 'headroom' in the prudential borrowing regime. Alternatively it could be used to finance capital expenditure directly.

(c) Debt restructuring

Debt would be restructured to allow councils to fund specified levels of investment without any housing element subsidy. This would mean increasing or reducing levels of debt to a level where future income streams would be sufficient to support prudential borrowing at the level that would otherwise have been supported by the Housing Investment Programme (HIP) process.

Councils would operate in a similar way to Registered Social Landlords, having maximum management freedom and certainty, producing a 'hands off' situation, and would:

- Retain the benefit of future rent increases
- Neither receive housing element subsidy nor pay over surpluses

However, councils would be exposed to greater risks and the option might only be available to high performing councils as a form of earned autonomy.

(d) Support for debt service costs

The ideas put forward were:

- To fix subsidy for debt charges based on the actual HRA debt at a particular time
- For Government to take over Housing Revenue Account debt

With the first idea, debt supported by housing subsidy would be frozen, and subsidy would not subsequently be adjusted unless there was a stock transfer. Receipts would be surrendered to the 'pool'. There would either be no allowance for the repayment of debt, or revenue support would exceed initial interest payments by an amount calculated to pay off outstanding debt after a specified period. Either idea would fit best with a capital grant or revenue allowance for capital investment.

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If government took over responsibility for debt, it may levy a capital charge on Housing Revenue Account assets.

It should be remembered that these are ideas rather than proposals and that none of them would be likely to involve 'new money'.

A system of capital grants would be welcome if the grants were sufficient to meet need and the local authority had discretion over how they were spent. However, there is no mention of increased resources, and it is possible that grants could be earmarked.

An investment allowance would not necessarily mean that local authorities would avoid central control. The government would determine the level of allowance given to each authority and the prudential borrowing rules would determine how much borrowing could be done as a result. Thus, the government would retain control of local authority borrowing.

The idea of restructuring debt could be seen as a way of creating a Registered Social Landlord by stealth within the Housing Revenue Account. It would be interesting to know how the government sees this idea relating to the proposals for 'Arms Length Management Organisations' - especially as it is an idea that the government sees as practical only for high performing councils. If 'Arms Length Management Organisations' were to be structured financially as a Registered Social Landlord there would be little practical difference between them and they could, perhaps, be brought within the same regulatory framework!

The removal of debt from the Housing Revenue Account may appear as a simplification, but could also be seen to be part of a process of 'nationalising' Housing Revenue Accounts. If government took responsibility for past debt it would be another step towards local authorities ceasing to control the Housing Revenue Account, and being confined to spending whatever the government gives them in Management, Maintenance, Major Repairs and other allowances.

It is also difficult to see how the proposal to make a charge related to asset values would work. If actual and guideline rents become the same, an authority could only meet the charge by reducing expenditure on management and maintenance below the level of the allowances. This would appear to be perverse.

Arms Length Management Organisations from the first and second rounds have met with the Office of the Deputy Prime Minister in 2003 with their proposals for freedoms but the Treasury is considering these. An announcement is expected in the 2004 Spending Review}

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Conclusions

The Decent Homes Standard is seen by many as the cornerstone of the government's policy on social housing. However, the level of capital resources that is available to local authorities is not sufficient to meet the decent homes standard at a national level. The proposed prudential system of capital controls is seen by some as a means of allowing local authorities to borrow more to achieve the decent homes standard. However, the scope for additional borrowing may be limited for authorities that do not establish Arms Length Management Organisations, and the total amount of borrowing that local authorities are allowed to do may not increase. The 'blue skies' debate may result in some more radical reforms of local authority housing finance, but in the meantime the housing service must continue to compete with other services for a share of available capital resources!

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July 2004.

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