

Briefing Paper

Housing Revenue Account Review

July 2009

Introduction

In December 2007 the government announced that Communities & Local Government and HM Treasury would jointly carry out a review of the financing of the Housing Revenue Account. The review had a particular focus on the option that had earlier been piloted in six authorities of making the housing revenue account self financing based on a redistribution of debt.

Four working parties were established to consider aspects of the study and Adrian Waite was invited to be a member of the working party that considered the future mechanisms for the funding of council housing. On 29th June 2009 the Minister of Housing, John Healey MP, laid a written statement before Parliament that announced his conclusions from the review of council housing finance.

The announcement included:

- A consultation document will be published before parliament rises for the summer on 21st July 2009
- An intention to dismantle the housing revenue account subsidy system and replace it with a devolved system of responsibility and funding
- A proposal to introduce self financing with an end to the redistribution of income
- A one-off initial redistribution of housing debt that would leave councils with levels of debt that they can afford and manage themselves
- Councils would finance their own business from their own rental income
- Councils would retain all housing capital receipts
- A range of stock options would remain available
- There would be a continuing strong role for arms length management organisations

Under these plans, councils will be able to keep all their rental income and gain the freedom to manage their housing to meet local need. The government intends to dismantle the housing revenue account subsidy system, replacing it with a system that will give councils greater independence and freedom to manage their own housing resources. The Housing Minister confirmed that he would consult before the summer on proposals for councils to become self-financing and free to manage the needs of their housing stock as well as provide more efficient services for their tenants. Responses to the review showed strong support for a more devolved approach to financing council housing.

John Healey MP, Minister of Housing, said:

"A fully self financing locally devolved system cannot be implemented in a single step but I want to move as rapidly as possible to put these reforms in place and the consultation document will set out my proposed timetable.

“However, there are steps we can take without delay so I am announcing that from today we will exclude all new build council housing from the housing revenue account subsidy system which means that councils will retain in full the rent and capital receipts from these homes.

“I want to provide more flexibility in finances and more transparency in the operation of the system. I want to devolve control from central to local government.

“And, in return, I want to increase local responsibility and accountability for long term planning, asset management and for meeting the housing needs of local people. The current system makes this difficult to achieve.”

This announcement came after the Prime Minister, Gordon Brown MP, announced a £1.5billion additional funding package to enable councils and housing associations to build more homes across the country, part of an ongoing drive to support the housing industry, reduce waiting lists and make sure young families and those seeking to buy their first home get the affordable housing they need.

On the following day, Simon Connell of ‘Communities & Local Government’ wrote to Adrian Waite, Managing Director of ‘AWICS’ to say:

“We would like to thank you again for all the hard work that you put in and for your patience over the last few months whilst we worked on the emerging models. Completing the review would not have been possible without your knowledge, contribution and keen interest. And we look forward to hearing your views when the consultation document is issued.”

The full text of the ministerial announcement is appended to this briefing paper.

Self Financing

It had been expected that the government would propose a limited scheme whereby local authorities could apply to leave the housing revenue account subsidy system on an individual basis as this had been provided for in the Housing and Regeneration Act 2008. However, this announcement goes further than that and proposes a universal system of self financing.

As expected the self financing system is to be based on a redistribution of housing revenue account debt following which local authorities will be allowed to keep all their rental income and use it to meet the costs of management, maintenance and capital financing. Redistribution is justified in the announcement as follows:

“There is a clear rationale for the current redistributive housing revenue account subsidy system. Councils have different spending needs and different capacities to raise income. Without redistribution, some councils would have to charge higher rents or deliver lower quality services. By redistributing money, all councils should be able to deliver a similar level of service while charging a similar level of rent.”

The government’s wish to redistribute resources between local authorities will be achieved by increasing the debt of local authorities that are currently in negative subsidy and reducing the debt of local authorities that are currently in positive subsidy. Authorities that currently complain about high levels of negative subsidy will find that negative subsidy will be replaced by increased capital financing costs that may be different to the level of negative subsidy.

The announcement does not make clear how the government proposes to calculate the level of debt that would be allocated to each local authority. In the past the Treasury has made it clear that introducing a self-financing system would have to be cost-neutral to the Treasury. If this is still the government position it follows that the total amount of housing revenue account debt would have to increase at the point that councils become self financing to reflect the fact that the Treasury would no longer benefit from taking the 'national surplus' out of housing revenue accounts. However, the announcement suggests that the opposite may be the case.

In the pilot studies, levels of debt were calculated with reference to projections of future subsidy entitlements. Consequently, if an authority was in an adverse subsidy position at the outset and pessimistic assumptions were made about future subsidy entitlements the authority ended up with an unsustainable housing revenue account. The pilot studies also showed that, as housing subsidy positions are projected to deteriorate, the switch to self financing would be likely to increase costs to local authorities in the short term but give rise to long term gains.

The announcement states that:

"The value placed on the stock in a self-financing agreement and a transfer deal will be based on delivering the same standards of service at a comparable cost."

This implies that the level of debt allocated to an authority may be calculated by assessing the need to spend and likely revenue streams over a thirty year period, using the level of debt as the 'balancing figure' in the same way as 'Tenanted Market Value' is calculated in stock transfers. As most stock transfers are based on achieving a higher level of investment than the decent homes standard and making improvements to services, the use of such a calculation for self-financing would result in government having to write off a significant proportion of housing revenue account debt.

An alternative way to achieve this 'level playing field' between self financing and stock transfer would be to place constraints on the expenditure that could be assumed in stock transfers. The possibility of this occurring is suggested in the announcement that includes the statement:

"Further transfer proposals will not gain any financial support beyond what would be provided under self-financing."

Placing constraints on expenditure in future stock transfers, most of which are likely to have negative valuations or overhanging debt, would reduce the government's commitment to write off debt. Self financing would also do this by reducing the levels of debt in positive subsidy authorities many of which have negative transfer values.

Presumably the consultation paper will outline how the government intends to calculate an appropriate level of debt for each authority. However, the announcement clearly implies that the government is prepared to increase the funding for housing revenue accounts as part of the self financing regime. This appears to be 'too good to be true'. Local authorities will be looking at the consultation paper closely to assess the implications for individual local authorities and for local authorities nationally.

At present around £17billion of housing debt with annual servicing costs of around £1.1billion is spread across the 202 councils in the system.

Value for Money

John Healey MP, Minister of Housing, said:

“I want to ensure that our reforms to the council housing finance system have strong incentives for improving efficiency, which will benefit councils and their tenants.”

The form that these incentives will take was not stated. However, it is possible that the calculations behind the redistribution of debt will assume that councils will be able to make ongoing efficiency gains.

Decent Homes

John Healey MP, Minister of Housing, said:

“We remain committed to completing our comprehensive decent homes programme and to maintaining this standard. The reforms I propose will safeguard this commitment. Capital funding will be provided to support this. We also intend to complete improvements required to common areas of estates and will ensure that there is sufficient funding in the system to maintain them in the future.”

“Our aim in setting up the self-financing system is to ensure that it delivers the investment needed to sustain and maintain the existing stock of council homes.”

These statements are significant in that they imply that additional capital resources will be made available to local authorities that cannot achieve the decent homes standard within existing resources without them having to consider stock options. This would be a significant change in government policy and would require additional resources to be found. Additional resources are also proposed for common areas of estates. In view of the overall position of the public finances it is difficult to see where the additional resources will come from.

Most authorities are currently reporting that their stock condition surveys show that the need to invest to maintain the decent homes standard is greater than the current levels of the major repairs allowance. It has been calculated that, at national level, major repairs allowances fall 43% short of needs. This proposal therefore implies a significant increase in major repairs allowances. Again, in view of the overall position of the public finances it is difficult to see where the additional resources will come from.

The announcement refers to future borrowing by local authorities but is non-committal about the extent of borrowing that would be allowed, saying:

“In the future within this self-financing system, local authorities may also wish to borrow to fund investment. Government are currently considering whether and how any local flexibilities for new investment could be reconciled with the need to ensure that the overall fiscal position for Government is not undermined.”

The overall fiscal position for government is currently considered to be weak.

Arms Length Management Organisations and Housing Associations

The announcement is supportive of the future role of arms length management organisations, saying:

“We see a strong future role for ALMOs which are valued by their tenants. We would expect ALMOs to continue to develop their housing management capacity and to look for opportunities to extend the range of services they offer, including to other landlords, where this would improve efficiency and effectiveness.”

In contrast the announcement appears lukewarm about stock transfers, describing them merely as:

“An option that council tenants can choose.”

New Build

The government has already decided to exclude new build council houses from the housing revenue account subsidy system and from the capital receipts pooling arrangements. This will make it easier for local authorities to build new council houses.

In the past, if a council built a new council house, the housing subsidy system meant that it would have to give 25% of the rent to the government; and if the tenant bought the house under ‘right to buy’ the council would have to pay 75% of the proceeds into the national capital receipts pool. This meant that a council would have insufficient revenue income to fund sufficient prudential borrowing to finance the building of the council house and after it was sold it would have only 25% of the proceeds while it retained 100% of the debt.

However, it is not clear how many new council houses will be built following this announcement as local authorities could already avoid housing revenue account subsidy and capital receipts pooling by developing outside the housing revenue account using a special purpose vehicle. The recession is also having an adverse impact on the ability of local authorities to develop new council housing.

Of more importance is the increase in the government’s budgets for affordable homes. On 28th June 2009, in his housing pledge, Gordon Brown MP, the Prime Minister, announced an additional £1.5billion for affordable homes funded from savings in other government budgets. This included increased funding for local authorities that are now able to access Social Housing Grant in the same way as housing associations. At the time of the budget the government allocated £100million to fund 900 new council homes. In the housing pledge this provision was quadrupled. However, this is still a small number compared to the homes that it is planned to provide through housing associations and in his announcement, John Healey MP, Minister of Housing stated that this funding would only be available where ‘councils can act rapidly and offer good value for money’.

It is expected that the Homes and Communities Agency will confirm the initial allocation of Social Housing Grant to local authorities in September 2009.

These could be considered to be modest changes in comparison with the level of need.

The announcement also refers to local housing companies and acknowledges that current market conditions create difficulties. It states that:

“The consultation document will confirm how we will assist the establishment of viable local housing companies as quickly as possible.”

Rents

The announcement was silent on the issue of rents. During recent years the government has backed away from its rent restructuring policy under pressure from council tenants who are concerned at the extent of rent increases that rent restructuring would require. Rents were reviewed as part of the review of the financing of council housing but the minister made no reference to them in his announcement.

Technical Issues

These proposals clearly raise a range of technical issues, not least regarding the design of the formulae to determine the redistribution of debt that would precede self financing. The Housing Panel of the Chartered Institute of Public Finance and Accountancy, of which Adrian Waite is a member, has offered ‘Communities & Local Government’ their expertise in helping to develop the detailed financial provisions.

Legislation

It had been thought that the Housing and Regeneration Act 2008 contained provisions that would enable the Secretary of State for Communities & Local Government to introduce self financing through bilateral agreements with local authorities. However, the announcement states that:

“Change on this scale is complex and will require primary legislation.”

And, while appearing at the ‘Communities & Local Government’ select committee, John Healey MP, Minister for Housing stated:

“It is necessary to have legislation in place to require some who may not wish to accept the changes to do so.”

The legislation is therefore required to enforce self-financing. This implies that self financing is likely to disadvantage some local authorities. If primary legislation is required this will need to be enacted during the 2009/10 session of parliament during which a general election is anticipated. This raises the possibility of the legislation not being passed before the election. It is not clear whether a new government would wish to continue with self-financing or whether they would wish to take an initiative of their own.

In the Local Government Chronicle in July 2009, David Curry MP (Conservative) stated that:

“The end of redistribution almost certainly foreshadows Tory policy, even if the rest of the package may be less congenial.”

Chair of the 'Communities & Local Government' select committee, Dr. Phyllis Starkey MP, stated that:

"If local authorities were able to come to an agreement among themselves – maybe brokered by the Local Government Association – then the system would be introduced more quickly."

But, Councillor Philippa Roe, Cabinet member for Housing at Westminster City Council, was quoted in the 'Local Government Chronicle' as saying:

"Some councils are massive beneficiaries and some massive donors in the current system, so interests are completely unaligned."

Cynics would say that the present government has been in power since 1997 and has been talking about self financing for some years. In 2001 the Local Government White Paper said that:

"Our current housing finance systems are extremely complicated and poorly understood. We need simpler and more transparent arrangements that are more sharply focused on addressing the pressing housing problems we face."

In 2005 the Audit Commission proposed self-financing. Since then it has been discussed and studied by ministers, civil servants, local authorities, management consultants and others but it has taken four years to reach the point where the government can issue a consultation paper. It could be argued that progress has been so slow that the government is now running out of time to do anything.

Reaction to the Announcement

Stephen Hilditch, the Independent Chair of the housing revenue account review sessions was quoted in 'Inside Housing' as saying:

"For the first time in thirty years council housing has got a sustainable future and what's needed is for people to grab that opportunity... The worst thing that could happen to this now is for it to be ripped up in the pursuit of the general election."

Grant Shapps MP, Shadow Housing Minister (Conservative) was quoted in 'Inside Housing' as expressing:

"Grave concerns over the suggestion that responsible councils should be punished for being prudent and will be burdened with other people's debt... I fear that this is an excuse for partisan Labour ministers to transfer funds from efficient Conservative councils to badly run Labour councils."

Margaret Eaton, Chair of the Local Government Association, was quoted in 'Public Finance' as saying:

"We have campaigned long and hard for councils to be able to keep all the proceeds from their own council house sales and council rents. We continue to call for councils to have the financial independence to invest in their housing stock."

Paul Bettison, Chair of the Local Government Association's Environment Board, was quoted in 'Inside Housing' as saying:

"It is good news that the government will consult on major reform of council house finance. We have campaigned hard for town halls to keep control of proceeds from council house rents and sales that could deliver 300,000 new homes in the next decade."

Councillor Richard Gates, Conservative Leader of Waverley District Council which gives up a larger proportion of its rent to negative subsidy than any other authority, was quoted in 'Inside Housing' as saying:

"We still think there are debates to be had about how the debt is treated."

Brian Reilly, Deputy Director of Housing at Wandsworth Borough Council, speaking on behalf of the Association of Retained Council Housing was quoted in 'Inside Housing' as saying:

"What is missing from the announcement is any reference to under funding of (management and maintenance allowances) and the (major repairs allowance) recognised during the review. We would need to see the detail."

Eileen Short, Chair of Defend Council Housing was quoted in 'Inside Housing' as saying that the announcement appears to:

"Commit to an end the privatisation blackmail and to funding for self financing councils on the same basis as would be offered by stock transfer... We will continue to campaign until the legislation is passed, the money is delivered and there is work going on in the estates."

Conclusions

The announcement offers local authorities self financing and also appears to offer them significantly increased resources in terms of:

- A redistribution of debt based on need to spend
- Increased Major Repairs Allowances
- Increased funding to support the Decent Homes Standard
- Increased funding for new build

Behind these proposals there appears to be a significant shift in government policy towards local authority housing with less enthusiasm for stock transfer, a commitment to a 'level playing field' and additional resources for retention authorities.

However, it is difficult to see how 'Communities & Local Government' could fund this within the constraints that have been set by the Treasury. The consultation paper will presumably provide the detail and will be keenly awaited.

However, it is possible that the government will not be able to pass its legislation before the next election and self-financing would then, presumably, become a manifesto commitment for the election.

Adrian Waite
July 2009.

Appendix - The Ministerial Announcement

The text of the announcement is reproduced below:

"I intend to publish a consultation document before the summer recess on reform of council housing finance. My intention is to dismantle the housing revenue account subsidy system and replace it with a devolved system of responsibility and funding. However, I can confirm to the House today the principles on which this will be based. I want to provide more flexibility in finances and more transparency in the operation of the system. I want to devolve control from central to local government. And, in return, I want to increase local responsibility and accountability for long-term planning, asset management, and for meeting the housing needs of local people. The current system makes this difficult to achieve.

"On 12 December 2007, my predecessor as Housing Minister announced to the House a review of council housing finance to be led jointly by my Department and the Treasury. Its purpose was to identify options for a sustainable, long-term system for financing council housing that would be fair to both tenants and taxpayers.

"The review has been conducted with a wide range of interested and expert organisations through meetings and workshops, calls for evidence, focus groups and questionnaires. Research and analysis were commissioned internally and from external experts.

"There is a clear rationale for the current redistributive housing revenue account subsidy system. Councils have different spending needs and different capacities to raise income. Without redistribution, some councils would have to charge higher rents or deliver lower quality services. By redistributing money, all councils should be able to deliver a similar level of service while charging a similar level of rent.

"However, there are significant drawbacks in a national system for financing council housing and in the relationship it creates between central and local government.

"Our consultation following this review will propose a devolved self-financing alternative to the current system. This would remove the need to redistribute revenue nationally, while continuing to ensure that all councils had sufficient resources. With these reforms, councils would finance their own businesses from their own rents, in exchange for a one-off redistribution of housing debt. By freeing councils from the annual funding decisions in the current system, this will enable councils to plan long-term and to improve the management of their homes, secure greater efficiencies and improve the quality of service to their tenants.

"This would provide councils with a financial framework in which they could plan and manage for the long-term in the same way we expect of other social housing providers. It would give councils a greater capacity and more freedom to respond to local needs and, in doing so, increase their responsibility and accountability to local tenants and residents.

"Change on this scale is complex and will require primary legislation. The consultation will set out how moving to a self-financing system will require an adjustment of debt levels for most authorities. At present around £17 billion of housing debt with annual servicing costs of around £1.1 billion is spread across the 202 councils in the system. The self-financing model would enable each council to manage directly and fund their own debt.

“In addition to revenue redistribution, councils are currently required to pay Government different proportions of the receipts from right to buy sales and sales of other HRA assets. There is a strong case for allowing councils to retain all of their capital receipts which could give councils the ability to develop a comprehensive strategy to maintain, improve and develop their housing. The consultation document will therefore set out proposals to end the pooling of all housing capital receipts.

“I want to see councils building and commissioning more of the new homes that people need in their area. We are therefore taking immediate steps to support this role for local authorities, based on the same principles I am setting out for our long-term reforms.

“For the first time, councils can now access the same capital subsidy through the social housing grant that is provided to housing associations for new affordable homes. Decisions on the first council schemes to be funded in this way will be confirmed in September.

“At the Budget, we announced £100 million to fund some 900 new council homes. Yesterday, in his Housing Pledge, the Prime Minister announced a further £1.5 billion to build an extra 20,000 affordable and energy efficient homes, increasing the scale of the programme for the next two years to a £2.1 billion investment for 110,000 new affordable homes. This includes a four-fold increase in our plans for new council homes. Together, these changes will enable councils to become once again significant providers of new housing, with further flexibility to do more, where councils can act rapidly and offer good value for money.

“We want to maximise our efforts behind building of new affordable homes. So I can also confirm that we are closing the open market homebuy scheme to new applicants and in future our low cost home ownership programme will be directed to schemes which support new build homes.

“Tenants and council tax payers expect to see their services delivered with the very best value for money. I want to ensure that our reforms to the council housing finance system have strong incentives for improving efficiency, which will benefit councils and their tenants

“We remain committed to completing our comprehensive decent homes programme and to maintaining this standard. The reforms I propose will safeguard this commitment. Capital funding will be provided to support this. We also intend to complete improvements required to common areas of estates and will ensure that there is sufficient funding in the system to maintain them in the future.

“Our aim in setting up the self-financing system is to ensure that it delivers the investment needed to sustain and maintain the existing stock of council homes.

“In the future within this self-financing system, local authorities may also wish to borrow to fund investment. Government are currently considering whether and how any local flexibilities for new investment could be reconciled with the need to ensure that the overall fiscal position for Government is not undermined.

“The benefits delivered by arm’s length management organisations that manage council housing services should not be affected by a change in the system for financing council housing. We see a strong future role for ALMOs which are valued by their tenants. We would expect ALMOs to continue to develop their housing management capacity and to look for opportunities to extend the range of services they offer, including to other landlords, where this would improve efficiency and effectiveness.”

“Transferring to a housing association should also remain an option that council tenants can choose. There are potential benefits from bringing in a not-for-profit body with access to private finance to own and manage the homes. However, there should be equity in the terms of public funding whether they are transferred or retained in the future under self-financing. The value placed on the stock in a self-financing agreement and a transfer deal will be based on delivering the same standards of service at a comparable cost.”

“We will continue to work with councils whose tenants have voted for transfer and councils who are currently developing transfer proposals to bring these to completion. Future transfer proposals will not gain any financial support beyond what would be provided under self-financing.”

“A number of councils have been developing proposals to establish Local Housing Companies (LHCs) that combine public land and private finance to deliver new mixed tenure housing. Current market conditions create difficulties in taking the next steps, and the consultation document will confirm how we will assist the establishment of viable LHCs as quickly as possible. In future, self-financing will provide another option for councils who want to put their land and income into schemes to deliver new housing.”

“Responses to the review showed strong support for a more devolved approach to financing council housing.”

“A fully self-financing locally devolved system cannot be implemented in a single step but I want to move as rapidly as possible to put these reforms in place and the consultation document will set out my proposed timetable.”

“However, there are steps we can take without delay. So I am announcing that from today we will exclude all new build council housing from the HRA subsidy system which means that councils will retain in full the rent and capital receipts from these homes.”

“I will work with all those with an interest in improving the system to make sure that these plans for reform are robust and deliverable.”