HOUSE OF COMMONS
COUNCIL HOUSING GROUP

Council Housing: Time to Invest

Fair funding, investment and building council housing

Our report to the Government's Review of Council Housing Finance

Paper 5 INTERIM VERSION

Housing finance: National HRA or Self-financing

REVIEW OF COUNCIL HOUSING FINANCE

"The purpose of the review is to ensure that we have a sustainable, long term system for financing council housing... [it will] consider evidence about the need to spend on management, maintenance and repairs." Yvette Cooper, 12 December 2007

"Housing Minister Margaret Beckett said she wanted local authorities to play a bigger role in the delivery of council housing." (DCLG, *New freedoms to increase council house building*, 21 January 2009)

Preface

by Austin Mitchell MP, chair of the House of Commons 'Council Housing' group

Ministers launched a 'Review of Council Housing Finance' in 2007 with the promise to "ensure that we have a sustainable, long term system for financing council housing" and "consider evidence about the need to spend on management, maintenance and repairs". The Housing Minister is now also consulting on new rules that will enable local authorities to start building new council housing again.

This Review is due to report this spring. It will, we hope, provide for the 'Fourth Option' so long campaigned for. It must create a level playing field freeing councils to invest in existing and new homes, on equal terms with Housing Associations.

To influence the outcome of these consultations our group issued a call for evidence to identify the level of funding required to manage, maintain, repair and improve exiting council housing and to start building a third generation of first class council homes.

We have received written evidence from a wide range of organisations. On 25 February 200 tenants, elected councillors, council officers, trade unionists and academics took part in our inquiry session at Westminster. We heard verbal evidence from 26 delegations during the day.

To take the debate forward we are publishing a series of interim papers with the aim of printing a full report. We welcome comments and call for additional evidence to strengthen the arguments. We hope to maintain the dialogue we have started with Margaret Beckett and have also asked to meet the Prime Minister to put the case.

If you would like to contribute to this 'work in progress' please send submission to my office.

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Papers

This report is dedicated to Alan Walter, chair of Defend Council Housing. Alan proposed and organised our Inquiry, worked tirelessly to make it the success it became, and died working on this Report. We trust this Report is the final 'heave' to win a secure future for council housing. Without Alan it would not have been possible – we are committed to winning in his name.

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5.1 Introduction

Alongside the burning question of the financial resources council housing needs, is the question of whether that system should be retained as a national entity or broken up.

In recent years a strong lobby (within government, some local authorities and housing professionals) has argued for breaking up the national Housing Revenue Account with councils 'opting out' or becoming 'self-financing'.

In 2007 the government set up an 'opt out' pilot model. This provided useful evidence on the underfunding of council housing (see paper 2). Here we consider its self-financing proposals.

The pilot report describes the problems facing council housing as not simply of resources but of 'robbing peter to pay paul', of authorities in negative subsidy losing money which goes to a few authorities in positive subsidy. The report did identify some of the financial risks of opting out of the current system, but these have been largely ignored in the debate so far.

Building on this report, the Local Government Association (LGA) in July 2008 issued a policy paper, *My rent went to Whitehall,* which states:

"We want self-determination for authorities, with sufficient resources raised from grants, borrowing, rents and pro-active asset management to enable them to manage their properties and their areas efficiently and effectively in perpetuity. We believe that councils should have a level playing field with our housing association partners and be able to manage their housing service as a sustainable business. There should be an end to the redistribution system with authorities being allowed to spend the money raised locally on local housing services… Future rent policy, and its supervision by the regulator, should allow genuine local rent freedoms within the broad principle of parities across properties and social housing providers."

The paper claims that breaking up the system in this way will result in more local accountability and stability, enabling councils to plan over the long-term and provide more new housing. More local accountability and stability would be a good thing, but this is only part of the picture.

The driver for the self-financing lobby is lack of resources. We believe it is important to separate the debate on the benefits and risks of self-financing from the question of adequate funding.

If we get allowances funded to meet actual needs and financial changes which allow councils to plan long term we believe this would make the risks of self-financing avoidable. When councils tell their tenants that the problem is urban versus rural councils or north versus south this creates false divisions – the reality is that all council housing is underfunded and all tenants are being robbed.

"The debate concerning the reform of the housing revenue account seems to have deteriorated to the point where councils seem to be claiming that 'my tenants are poorer than your tenants'… In the future, unless there is a significant change to the system, we will see paid subsidies increasing and received subsidies reducing, while the government pockets an increasing amount…. reform is in all our interest". Richard Gates, leader and portfolio holder for housing, Waverley Borough Council (*Inside Housing,* 12 September 2008)

In this paper we assess the benefits and risks of self-financing versus a national council housing sector. The question of resources is addressed in papers 2 (*fully funding allowances*) and 3 (*debt write-off*).

Section 5.2 contributes to the debate by assessing the financial risks involved. In sections 5.3 and 5.4 we examine the issues of accountability, localism and long-term stability raised by self-financing and the break-up of the national council housing sector. Finally, in 5.5 we look at the bigger issue – the underlying disinvestments at work, which current debate obscures.

> "Unless there is a significant change to the system, we will see paid subsidies increasing and received subsidies reducing, while the government pockets an increasing amount…. reform is in all our interest". **Richard Gates, leader and portfolio holder for housing, Waverley Borough Council**

5.2 The Financial Risks of Self-Financing

Breaking up the national housing system involves serious risks for local authorities and their tenants.

The present national subsidy system protects council tenants from 'macro-economic' risks, as the self-financing pilot explains. The impact of changes to interest rates or inflation is borne by government not by local authorities. If councils opt-out of the national system they could end up with a huge debt, leaving them dependent on private lenders if things go wrong. A self-financing settlement involves assumptions – guesses – about 30 years of inflation, interest rates, costs, and right-to-buy sales. These can fluctuate massively as the recent economic downturn demonstrates. A local authority business plan depending on building homes for outright sale to bring in extra money (as those in the self-financing pilot do) is at risk of building costs rising, or house ➜

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➜ prices collapsing. The pilot identifies the further risk of government introducing new policies obliging councils to provide more services or meet higher standards – leading to higher costs.

To understand the risks involved, there are two analogies whose track-record can be examined and for which evidence is available: large-scale voluntary transfer to a Registered Social Landlord (RSL); and small-scale transfer in a regeneration programme.

The Tenants Participation Advisory Service, in a financial analysis for North Lincolnshire Council, details some of the risks of transfer, of which the following are relevant to any stand-alone organisation:

"What happens if there is an error in the business plan? …The Willow Park (South Manchester) transfer had a reported "gap" in its business plan of £22m…Danger of inadequate treasury management (borrowing money at too expensive an interest rate)… rash decisions…Theoretical risk of bankruptcy…one in five transfer landlords require some form of intervention by the Housing Corporation" (Options Appraisal, North Lincolnshire Council, October 2004)

Tenants in Edinburgh had the benefit of a detailed and independent commentary on their council's financial plans for transfer, from the Scottish Tenants Information Service (TIS). TIS' analysis shows some of the issues that can affect a business plan over 30 years, and much of it is relevant to self-financing:

"The business plan is worked out using a forward projection of income and spending over 30 years. … Sound estimates of future income and costs have to be made. Once a price is paid, [the landlord] would have to operate within the income from rents and the borrowing that the rents can support over the long term. It would need to satisfy lending banks that the loans are low risk and can be repaid." (*Financial Assessment of the City of Edinburgh Housing Association's Business Plan*, Tenants Information Service, September 2005)

The report reveals a long list of potential areas where business planning can go wrong, from assumptions on rent loss due to bad debts and homes left empty; levels of building cost inflation; the effect of major improvements on day-to-day repair costs; the costs of housing management; different opinions on major repairs needed; and right-to-buy levels. TIS explain, for example, the effect of guessing right to buy levels wrongly:

"We are opposed to proposals that expose council tenants to changes in interest rates, inflation and property values. We do not want the council to 'opt out' of the national council housing system exposing tenants to new risks."
Dave Morris, Secretary, Haringey Federation of Residents Associations

"[the council] must make estimates of likely sales, because it reduces total rent income as well as reducing spending needs… If costs exceed forecasts, a choice exists to increase rents beyond the rate of inflation, or slow the pace of progress on investment in tenants' homes or make reductions in other operating costs."

Tenants are very concerned about financial risks of self-financing, as we heard in our inquiry:

"We are opposed to proposals that expose council tenants to changes in interest rates, inflation and property values. We do not want the council to 'opt out' of the national council housing system exposing tenants to new risks." (Dave Morris, Secretary, Haringey Federation of Residents Associations, written evidence)

The risks faced by regeneration programmes has been starkly exposed in a recent report of the effect of the credit crunch (*The Credit Crunch and Regeneration: Impact and Implications*, CLG, January 2009), which makes it very clear what could happen to any schemes which rely on building homes for private sale to cross-subsidise improvements to and/or the provision of new 'social' housing.

Regeneration programmes involving housing are the biggest victims. In the CLG survey over half (57%) had already experienced a 50% or more reduction in regeneration activity; with only 2% unaffected. 64% said they expected to experience a 50% or more reduction over the next two years. The results of this fall in private sector sales identified by the report are: a reduction in costs affecting quality, sustainability and environmental standards; refurbishment programmes delayed or abandoned; promised numbers of new 'affordable' homes being scaled back; demands for more public sector subsidy; and community projects promised in addition to housing being dropped.

A particular type of regeneration programme frequently used to regenerate council estates is the 'New Deal for Communities'. These regeneration schemes have been hit hard as the case studies in this report show:

"The housing-led project with national companies would lead to the demolition of 2,000 homes and the new provision of 3,500.. the LSVT and City Council were putting in land free… But the private sector partners had become concerned about the viability of the scheme based upon sales volumes and values, cash availability, the mortgage market and redundancies… The prospect was that the original ➜

➜ arrangement might not work and the scheme would require extra public money."

"Tenants will have to live in derelict properties until the money is found…Residents will have paid a very high price since they may have lost their existing homes in the demolition phase but will not have replacements… other regeneration projects like community health, safety and employment projects had to be shelved." (*The Credit Crunch and Regeneration: Impact and Implications*, CLG, January 2009)

5.3 Local Accountability and Collective Power

Everyone agrees that there should be more local accountability and control for council housing. However, our Inquiry identified a number of problems if localism is allowed to jeopardise collective security and accountability. These include:
• pooling resources to help those in most need is a key welfare state principle; abandoning it could lead to a two-tier system
• breaking up the sector may impact on the ability of councils and tenants to collectively defend

RISKS OF SELF-FINANCING (The first 7 entries are relevant to all self-financing proposals and the last one is also relevant to all those which involve an element of new-build for private sale on the open or intermediate market)

Risk	Impact	Effect on Tenants
Interest rates higher than expected and/or lack of credit availability	Additional borrowing becomes more expensive	Likely to mean reduced borrowing levels and promised programmes scaled back
Increase in interest rates demanded by lender during period of borrowing	Viability of landlord could be threatened	Range of possible effects from reduced programmes to forced transfer to new landlord
General inflation lower than expected	Burden of opening debt higher than expected	Likely to mean above inflation rent rises, service cuts or efficiency savings
Cost inflation higher than expected	Adverse effect on business plan viability	Likely to mean above inflation rent rises, service cuts or efficiency savings
Receipts from RTB sales higher or lower than expected	Lower sales reduces capital available; higher sales creates revenue problems due to loss of scale	Less capital will mean promises broken; less revenue will lead to service cuts
New policies / standards demanded by government without additional funding	Reduced collective lobby power against such proposals	Could lead to rent rises or cuts elsewhere
Unforeseen contingencies not planned for in business plan - such as flooding, subsidence, asbestos etc	Major works cost more than anticipated	Promised programmes may be scaled back or delayed
Mistaken assumptions on income or costs – efficiency savings; management and repairs costs; void levels and rent arrears etc	Revenue affected	Likely to mean above-inflation rent rises, service cuts or efficiency savings
House prices fall lower than expected or lower volume of sales than planned	Where business plans rely on private or shared-ownership sales there will be an adverse effect on business plan viability	Major works scaled back or not carried out; could mean tenants left in derelict property, homes demolished and not replaced; promised community projects or new housing could be dropped

This table has been compiled based on information from: 'Self-financing of council housing services: Summary of findings of a modelling exercise' (Department of Communities and Local Government, March 2008; 'The Credit Crunch and Regeneration: Impact and Implications' (Department of Communities and Local Government, Jan 2009); The risks of transfer to RSLs as detailed by financial consultants in options appraisals
Press reports on the effect of credit crunch on financial viability of RSLs

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➜ the principles of secure and affordable housing
• local rent-setting with no safeguards could lead to unaffordable rent rises for tenants
• there is a danger of an increase in the leakage of tenants' rent money to the general fund (see Paper 4, *Ring-fencing the money that belongs to council housing*)

Pooling: a key principle

When the Council rent 'negative subsidy' system replaced the 'daylight robbery' of rent rebates, the idea of a national pooling system was regarded positively:

"Responses to the consultation exercise indicated 'general support for the principle involved'. The majority of respondents agreed that it was right to regard local authority housing as a national programme and that assumed surpluses in authorities' housing accounts should be retained within housing and redistributed through a pooling mechanism." (House of Commons Debate 23 May 2000 c 437W)

The trade union UNISON believes that:

"Within a national framework the concepts of pooling and redistribution are sensible provided they are able to command broad support from individual local authorities, tenants and representative trade unions. UNISON believes that such support can be broadly secured provided resource distribution is demonstrably based on relative housing need and affordability." (*Submission – Review of the Housing Revenue Account*, UNISON)

And we heard in evidence to our inquiry:

"The current redistribution between areas through the HRA means that any reforms need to be handled carefully so that tenants in areas with negative subsidy and very poor stock do not lose out. We do not support the disaggregation that the Tories want, which will allow each local authority to keep its own HRA – there lies the danger of a future degradation of opportunity and the threat of sell-off… Government has to accept that management and maintenance and major repairs allowances must be funded at level of need and council housing put on a 'level playing field'." (Stroud DC Labour Group, written evidence)

Breaking up the sector may impact on councils' and tenants' collective power

Tenants are also concerned about the break-up of the national council housing sector in terms of losing their strong collective lobbying ability, as we heard in evidence to our Inquiry:

"It is not the principle of a national pooling system that is the problem. Council tenants are angry that government profits from council housing but can also see how the old tactic of 'divide and rule' can be used to try and break up a national council (public) housing sector. We are suspicious that proposals for councils to 'opt out' of the national HRA would leave council housing in a more precarious situation and is a stalking horse for privatisation…" (Dave Morris, Secretary, Haringey Federation of Residents Associations, written evidence)

"We are opposed to breaking up the national HRA. We believe this would create disunity among Councils and tenants, expose tenants to more financial risk, and make it easier to isolate tenants from different authorities in order to pick us off for privatisation". (Camden Federation of Tenants and Residents Associations, written evidence)

Local rent-setting could lead to unaffordable rent rises for tenants

Self-financing as envisaged by those calling for break-up of the system could punish tenants. The LGA submission to the Review wants local rent setting:

"Future rent policy, and its supervision by the regulator, should allow genuine local rent freedoms within the broad principle of parities across properties and social housing providers. Acceptable variances should additionally recognise differences in the physical condition of stock of the same type, and also in the local estate environment that might include communal improvements to external areas or direct spend to blocks, such as external cladding and roofs to refurbish ageing concrete towers." (*My Rent Went to Whitehall*, June 2008)

The Chartered Institute of Housing' submission to the Review envisages rent rises above the already-punishing levels forced on tenants in the name of rent convergence:

"The finance system must allow a degree of flexibility for local authorities together with tenants to set actual rents and agree service priorities… If the council housing finance review results in a settlement which allows authorities to raise rent levels, it may well have some impact on HB costs… Rent increases in the future will be an important part of meeting the invest- ➜

"Within a national framework the concepts of pooling and redistribution are sensible provided they are able to command broad support from individual local authorities, tenants and representative trade unions. UNISON believes that such support can be broadly secured provided resource distribution is demonstrably based on relative housing need and affordability."
***Submission – Review of the Housing Revenue Account,* UNISON**

➜ ment needs of the stock and the level of services required by tenants, and addressing the current underfunding." (CIH Submission to the review, September 2008)

Big discrepancies in council rents across the country or within authorities would create a divisive 'post code lottery.' An HRA system based on pooling provides important protection for tenants who happen to live in properties with higher costs. Tenants who live in estates needing higher levels of maintenance or refurbishment shouldn't be forced to choose between decent conditions and rents they can afford.

5.4 Long-term Stability

The pilot study on opt-out highlights the benefits to council housing of being allowed, like other landlords, to develop a 30 year business plan based on long term funding assumptions. Local authorities cannot plan maintenance programmes with any certainty currently due to constantly-changing formula for spending allowances. The pilot study identifies benefits of long term stability including provision of new homes, better planning and more local accountability.

However, Defend Council Housing have pointed out that

"These benefits are related to increased resources and/or more stability, to knowing what your income and expenditure are going to be over 30 years rather than changing annually. It is not necessary to 'opt out' of the HRA to achieve these benefits; increased resources and more stability could easily be delivered within the existing pooled regime."

The stable financial regime local authorities require could be achieved by increasing allowances to an independently assessed 'level of need', and reinforcing that in law to ensure allowances in future cannot drop below this agreed level. It would mean bringing into line the methodology for carrying out stock condition surveys with the methodology for calculating the Major Repairs Allowance (see paper 2). It would also mean a one-off settlement to deal with the backlog and enable catch-up.

The Secretary of State would then only have discretion every year to reflect changes in interest rates and inflation, so that the risks associated with changing economic conditions were borne by government. The formula could give government the power to increase allowances (and a duty to do so if they introduced new standards) but prevent them from decreasing allowances. This would allow for long-term planning by local authorities with confidence that minimum allowances would meet level of need.

5.5 Underfunding: the root of the problems

Those who argue that today's tenants in negative subsidy authorities are subsidising tenants in other parts of the country are in danger of obscuring the real injustice. Local authorities need to disentangle self-financing arguments from the over-arching case for fair funding.

The last discredited 'Daylight Robbery' system of redistributing council rent revenue used housing benefit (HB) subsidy as the mechanism for shifting – and siphoning off – subsidy between government and councils. Some focused their opposition on this HB subsidy mechanism; the anger forced government to drop it and introduce the Major Repair Allowance. Changing the mechanism did not end the Robbery however.

Those who focus on the mechanism of the current negative subsidy system need to be clear – the current system robs all tenants and underfunds all council housing. To illustrate this three examples of hypothetical councils show the range of current financial situations councils are in.

HOW THE NEGATIVE SUBSIDY SYSTEM ROBS ALL COUNCILS

A Council A is debt-free. It takes £100m in rent; gets to keep £75m in allowances; and has to hand over £25m in negative subsidy.

B Council B has a lot of debt – it costs £65m a year to support.
It takes £100m in rent; gets to keep £75m in allowances;
spends the other £25m on debt and receives a positive subsidy of £40m to also spend on debt.

C Council C has some debt – it costs £10m a year to support.
It takes £100m in rent; gets to keep £75m in allowances;
spends £10m on debt; and has to hand over £15m in negative subsidy.

ALL THREE COUNCILS ARE BEING 'ROBBED' OF £25million A YEAR.
ONLY TWO OF THEM ARE IN 'NEGATIVE SUBSIDY'.

As Waverley Council pointed out in a presentation to the LGA conference on 24 February 2009:

"Those paying subsidy are paying more each year. Those receiving subsidy are receiving less each year"

Instead of focusing on whether a council is in positive or negative subsidy it is more useful ➜

➜ to look instead at the robbery – the difference between rents and allowances. Equitable shares of not enough should not be our aim. Focusing on the negative subsidy leads to demanding only an extra £200m a year, the 'outright robbery' or surplus the government makes from council housing. If debt was written off or taken over by government, and all our rents were ring-fenced for council housing there would be an extra £1.7 billion a year to increase allowances to a sustainable level.

5.6 Conclusion

The determined campaign to defend council housing, and the private housing market crisis, has forced fair funding for council housing to the top of the political agenda. We need to unite all those who support council housing, by calling for measures of maximum benefit to the greatest number, addressing short and long term funding problems and injustices.

We must expose and address the root injustices of the current system. Any system, whether based on national allowances or self-financing, must give adequate funding for the management, maintenance and repair of council homes. The scandal of Rent Robbery must end: tenants' rent revenue must be ring fenced for the management, maintenance and repair of homes. And we need a level playing field: the benefits of debt write-off and gap funding should be made available to councils on the same level as have been provided to RSLs through stock transfer.

Tinkering around the edges will not resolve the root of the underfunding and disinvestment crisis. We cannot accept this inbuilt injustice; unless it is addressed now the injustice and underfunding will persist, and the threat of privatisation will remain.

The alternative is to achieve sustainable long-term financial stability combined with funding addressing local levels of need, allowing maximum local flexibility with safeguards and protections for tenants.

No local authority should be allowed to raise rents above fair levels or siphon off revenue and receipts to benefit the general fund. In any system, based on national allowances or self-financing, there must be stronger protections and safeguards for tenants to protect publicly-owned assets, keep rent levels affordable and to ring-fence all rents and right-to-buy receipts solely to be spent on council housing.

We must expose and address the root injustices of the current system. Any system, whether based on national allowances or self-financing, must give adequate funding for the management, maintenance and repair of council homes. And we need a level playing field: the benefits of debt write-off and gap funding should be made available to councils on the same level as have been provided to RSLs through stock transfer.

In addition, if a new system is based on self-financing, then the government must protect against business risks to tenants' homes and rent by providing a public-sector safety net as part of the self-financing agreement.