



REVIEW OF THE COUNCIL HOUSING FINANCE SYSTEM

Narrative No 4

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MECHANISMS FOR DELIVERING COUNCIL HOUSING FINANCE

Introduction

Communities and Local Government and HM Treasury are undertaking a fundamental review of the council housing finance system, reporting jointly to the Minister for Housing and Planning, Caroline Flint MP, and the Chief Secretary to the Treasury, Yvette Cooper MP.

The Chartered Institute of Housing has been commissioned to support the Review by facilitating expert and practitioner workshops and producing a series of narratives for the sector to keep people informed of progress.

The Review is wide ranging, as described in Narrative 1. Although many of the issues are interlinked, the Review has been divided into four workstreams to make it manageable – Costs and Standards; Rents and Service Charges; Mechanisms for Delivering Finance; and HRA Rules. Narratives 2-5 identify and discuss issues emerging from each of the workstreams and the associated expert and practitioner workshop. Narrative 4 discusses some of the issues that will be addressed in the workstream on Mechanisms for Delivering Finance.

The overall objective of this workstream is to develop a sustainable mechanism for delivering council housing finance that is fair to both tenant and taxpayer and maximises the efficient and effective use of the assets within the Housing Revenue Account.

Background

The present vehicle for delivering finance to council housing is HRA subsidy. The Secretary of State makes an annual HRA subsidy determination for each of the 220 LAs with an HRA.

The determination sets out the amount of subsidy payable to the authority or to be paid by it to the Secretary of State. If an LA's assumed need to spend is greater than their assumed income, Government pays HRA subsidy to bridge the gap. If assumed income is greater than their assumed need to spend, the assumed surplus is captured and recycled within the system to meet deficits elsewhere.

In 2006-2007, 154 out of the 220 LAs with an HRA were in surplus and that number is expected to increase year-on-year on current projections. The policy of redistribution of assumed surpluses is not popular with local authorities – anecdotal evidence suggests that even deficit authorities do not favour the policy.

The main drivers for the Review have been the work on self-financing, which has demonstrated that system as it stands is unsustainable, together with the forecast of national surpluses and growing concerns over the complexity and lack of transparency in the system. The housing green paper 'Homes for the future: more affordable, more sustainable' highlighted that 'in the longer term, we (the Government) want to examine the case for more radical change to the redistributive subsidy system itself'.

In recent years, allowances for assumed need to spend have not kept pace with rises in assumed income, so that the system as a whole has moved into surplus (as has happened in the past). If the system nationally generates an overall surplus, resources are surrendered to the Consolidated Fund. The Treasury takes forecasts of deficits or surpluses in the HRA into account when agreeing the overall level of resources available for housing in CLG spending review settlements. These resources are therefore included within the settlement for housing, but this is not transparent. The council housing finance review is timed to deliver recommendations to the next Spending Review round, the outcome of which cannot be predicted at this stage, although it is reasonable to assume that public spending will remain tightly controlled. Use of current surpluses and possible additional surpluses is not determined beyond the current spending review period.

Implications of ending the HRA subsidy system

The work on self-financing has had a strong influence on the Review and further work to develop the model will continue in parallel with the Review.

In comparison with the current centralised system, a devolved system is seen to have a number of advantages. It might offer a better fit with the general direction of Government policy towards localisation and community empowerment. A greater degree of local control may offer opportunities for efficiency that are hard to achieve through the national system. It would improve councils' ability to manage assets and undertake long term business planning. It would improve accountability to tenants.

A key objective for any new system should be to improve long term planning for the stock, building on the generally successful experience of implementing decent homes programmes over several years. Planning for 30 years is not unusual for RSLs and is typical for new build projects. The need for future investment is not evenly spread and will continue beyond achievement of decent homes in 2010. The existing prudential borrowing framework could offer a route forward for LAs if they had the revenue income stream to support it.

LAs vary considerably in terms of how far they are from sustainability but this is largely due to large imbalances in the distribution of debt and other costs. Self-financing may offer the prospect of a way forward through controlled local freedom and by maintaining redistribution through debt reallocation. Self-financing agreements could include proposals for borrowing over the period and measures to control and limit new debt. Agreed 30 year business plans, with debt and borrowing built in, would rest on the

existing statutory powers for the prudential system with agreed prudential indicators and tolerances, giving the Treasury a solid basis to scrutinise, monitor and manage the total.

However there is still more work to be done to test the sustainability of the self-financing model. Modelling is undermined by the under-funding and volatility of the existing allowances – which make any system unsustainable. Self-financing would work for an individual LA if it could leave the system at a suitable level of opening debt. It will also have to work for those LAs left inside the system, who will not want to be left with fewer resources because others have opted out, and the Treasury, which will not want to face an unacceptable degree of fiscal risk. There are likely to be winners and losers and an element of rough justice would seem inevitable. LAs in negative subsidy can see the benefits of self-financing, but they may find the argument more balanced when they consider the amount of debt that will be reallocated to them. As with the current system, a formula-based reapportionment of debt might not be able to respond to local circumstances and variations.

The speed of movement towards a devolved system will also need to be carefully considered. There could be a danger of a lingering death as councils haemorrhage away from the system into self-financing or stock transfer, taking a share of the pot with them and leaving those that remain to struggle that bit harder - and with unpredictable results for central government. If devolution is the agreed outcome, a speedy end to the existing HRA subsidy system might be preferable - although there remains a possibility that it may prove impossible for some LAs to leave the system, exposing central Government to the risk of an unworkable hybrid.

A devolved system might result in local deficits and surpluses. As with RSLs, there will need to be a mechanism to decide what happens if a devolved HRA fails financially, and who picks up the tab. Surpluses could be restricted for use on HRA services, or used by LAs for general services, or used to support capital spending, or made available to central government for redistribution. There may be a role for the regulator in any control mechanism that is required for LAs, including supervising the use of surpluses.

Modification

Whether the current HRA system is brought to an end or modified, it is likely to apply for a few years more. Volatility must be better controlled. The system is unpredictable because the redistributive mechanism rests on such a wide range of factors, such as building cost inflation, changes in the formulae or the parameters, changes in local circumstances, and changing expectations of service delivery (eg ASB, family support) which impact differently in different places.

It is difficult to explain to councils and tenants why a slight change in methodology causes a massive swing in projections. As with the local government settlement, determinations covering longer term would help improve certainty and encourage planning. With some rough justice it may be possible to establish a core level distribution that is acceptable as a starting point – and becomes the basis for opting out.

If the subsidy system is retained it will be important to revisit the merits of having a 'notional' HRA as well as a real HRA as this is the cause of considerable confusion.

Debt

The treatment of debt within the HRA subsidy system is a critical issue for the Review. Historic debt is lumpy and gives rise to a significant proportion of the requirement to redistribute rental income within the system. Historic debt is a combination of debt associated with building the property in the first place and the borrowing for reinvestment for programmes of refurbishment like decent homes. LAs will need to take on new debt to continue to improve their stock and to build new homes.

Historic debt could be shared out among all LAs to create a more even distribution. Alternatively historic debt could be taken to the centre along with the subsidy stream that supports it. Neither approach would provide an overall financial benefit to LAs, but it might simplify the system and reduce confusion about the degree of subsidy redistribution.

A further option might be for government to take historic debt into the centre and receive a return on the investment through a cost of capital charge. This would reflect the national contribution to local provision.

The overall level of debt in the LA sector is about half that in the RSL sector. RSLs generate sufficient income to support this, raising the question of how this income is generated given that they are moving towards rents which are similar to LA levels. However, growth in housing debt to fund council housing would be at the expense of other housing programmes managed by CLG. CLG has to operate within overall investment plans agreed as part of its Spending Review settlement. The self-financing proposal recognised this by proposing appropriate control mechanisms.

Capital Receipts

The benefit of capital receipts is shared between central and local government. There is a lack of transparency and understanding about the pooling system and the uses to which pooled receipts are put. Although the general and local taxpayer will have contributed towards the construction and improvement of council housing, many LAs and tenants believe that all capital receipts should be retained locally and also be ring fenced to housing. However, at the national level, the Treasury predict capital receipts and take them into account when agreeing Spending Review housing settlements with CLG. If LAs kept a higher share of receipts, the Treasury would have to reduce the sum available to CLG to account for the loss. While there is no direct hypothecation between housing receipts and expenditure nationally a calculation of global receipts compared to global expenditure would show that more goes out from central government than comes back in for housing purposes.

It is a judgement as to whether the use of receipts to fund new affordable housing should be local or national. Some LAs have far less need to spend and national distribution means that resources can be channelled to the areas of greatest need rather than the areas that generate most receipts. Furthermore, the same level of public investment delivered through housing associations could deliver better outcomes through leveraging in additional private investment.

Some key questions

1. *Is it possible to modify the HRA subsidy system to make it fit for purpose? What changes would help enhance local decision making?*
2. *Should the principle of redistribution of HRA subsidy surpluses on a national basis be maintained?*
3. *Should the system continue to operate on basis of assumed levels of income and expenditure, rather than actuals?*
4. *How should historic debt be treated and should it be on a different basis from new debt?*
5. *Should the substantial historic contribution of taxpayers and central government in funding capital investment in council housing be formally recognised through the HRA paying a return?*
6. *What proportion, if any, of housing capital receipts should local authorities be able to retain?*
7. *If the HRA subsidy system cannot be improved satisfactorily should it be closed down and how quickly should this be done? What are the terms and conditions under which a council might leave the HRA subsidy system under a self financing arrangement?*
8. *Will there always be a need for some councils to operate within a national system?*

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This narrative is based on a range of views, including those expressed during the workshop, and is published to encourage wider debate. It does not necessarily reflect the view or imply the agreement of CLG, HMT, CIH, or any individual participant.