



# REVIEW OF THE COUNCIL HOUSING FINANCE SYSTEM

## Narrative No 2 COSTS AND STANDARDS

May 2008

### 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 has four workstreams, as described in Narrative 1. This second narrative identifies and discusses some of the issues emerging from the workstream on Costs and Standards and its associated expert and practitioner workshop. Although some overlap is inevitable, this workstream will be seeking to determine the costs of running council housing by considering the standard of service and accommodation that it is appropriate for the landlord service to deliver, and how the finance system can help improve quality and cost effectiveness.

### Background

Under the Housing Revenue Account subsidy regime a local authority's (LA) spending power is primarily determined by the allowances it receives for management and maintenance (M&M), major repairs, and interest cover for borrowing for capital investment. The Major Repairs Allowance (MRA) was introduced in 2001 to increase resources available to local authorities and is based on the estimated long-term average amount of capital spending required to maintain a local authority's housing stock in its current condition.

The allowances for management and maintenance and major repairs are all determined by formulae which reflect factors such as the different costs associated with different building types, the differential costs associated with levels of deprivation, levels of crime and the geographic difference in building costs.

Before it can recommend new or revised mechanisms for delivering funding for council housing, the Review needs to establish a methodology which will enable Government to

identify the costs of running landlord services, including maintaining the quality of the stock. This in turn requires a view to be taken about the standard of services and accommodation that is appropriate for the future.

It is intended that OFTenant will regulate the whole social housing sector by 2010 and will have responsibility for setting standards subject to the direction of the Secretary of State on rents and physical standards. This workstream will help to scope the Secretary of State's directions to the Regulator.

### ***Costing the landlord's business***

The Review is set against the background of a significant body of evidence that present allowances are insufficient to sustain the condition of council housing and housing management services:

- In 2006-07 councils spent £605m more on M&M than allowances provided.
- The pilot project on self-financing also demonstrated that the current levels of allowances will not sustain the improvement made under the decent homes programme.
- Research by the Building Research Establishment in 2003 showed that management and maintenance allowances were some 40% below that indicated by empirical evidence.

LAs deliver a wide variety of services to tenants. The Audit Commission identifies the main service areas in the 'key lines of enquiry' (KLOEs) it follows during housing inspections. For the purposes of regulation in the future, the Cave review<sup>1</sup> divided services into core and non-core. In designing a system for delivering funding on a fair basis across widely varying authorities, it is necessary to consider what range of services it is appropriate for council landlords to deliver in future and also ensure that the system encourages and incentivises landlords to improve quality and efficiency in delivery.

In the current system, costs are directly influenced by the level of allowances: landlords spend the allowances they receive and most spend more if resources allow. In turn, the broad pattern of allowances and subsidy reflects variations in the amount of historic debt, over which LAs have no control, and the deprivation indices.

The expectation from tenants, councils, government and agencies is that standards will improve. There are differing views as to whether there is a direct link between resources and the quality of the service – some LAs have improved their star rating significantly without increasing resources, others may slip back if their resources reduce. Lessons from ALMOs suggest that incentives and providing rewards for good management lead to improvements. Changes in KLOEs seem to change landlord behaviour and spread good practice through the sector.

There is a wide variety of local practice that makes it difficult to compare costs and standards across LAs as they choose how to apportion the resources made available. The definition of housing management has also become more elastic. It used to be based on the core services of rent collection and repairs, but councils and ALMOs now

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<sup>1</sup> 'Every Tenant Matters' the Report of the independent review of social housing regulation led by Professor Martin Cave, Director of Management under Regulation at Warwick University.  
<http://www.communities.gov.uk/documents/housing/pdf/319302.pdf>

provide many additional services funded from the HRA – such as neighbourhood wardens, ASB work, family support, worklessness, neighbourhood management, community development and regeneration activities.

Rent policy is based on tenants paying a similar rent for a similar property irrespective of their landlord, but management and maintenance services may vary significantly depending on the landlord and the distribution of subsidies. The Government believes that tenants should be entitled to expect a similar minimum standard of service for their rent irrespective of landlord. The core argument in favour of a national redistributive system is that rents are not linked to the need to spend and so subsidy can be redirected from areas with fewer needs to areas with greater needs. For example, some areas have a far greater requirement for communal cleaning and caretaking or a neighbourhood warden service or intensive ASB work or maintenance than others.

Costs are also changing – nationally-set inflation allowances do not always reflect experience locally and in the real housing economy, where there are many variables to consider such as recruitment and retention, local job markets and staff costs.

### **Services**

Housing management services may need some clearer definition if the subsidy system is to better reflect the need to spend. But there are many difficulties in establishing what the standard and cost of services should be so that a fair system can be designed. Service levels vary between councils depending on the financial position of the local HRA, as determined by the subsidy system, and because councils vary in the needs they have to meet, local political considerations and local tenant priorities.

The current system is based on deprivation indices and areas vary greatly in deprivation terms. Working with national formulae makes it hard to be flexible or to accurately reflect local circumstances – for example pockets of deprivation within better-off areas.

Tenants clearly wish for extra social and community services as well as housing services – but they also feel that they shouldn't be paid for from rents. The expressed priority is normally to 'get the basics right'. Landlords are mindful of their contractual and legal obligations, but the pressure for example to put extra resources into tackling ASB might be at the expense of maintenance, building up problems for the future. Tenants are keenly aware that the HRA is sometimes used to enhance spending on services like refuse collection to ensure decent standards on estates. They also have a strong perception that more social and community services are being loaded onto housing, with mission creep from central government and a desire to keep costs out of the general fund locally. They feel that they are asked to pay twice for services through rent and council tax. (The workstream on HRA rules will look in more detail at the issues involved in the HRA ring fence.)

RSLs face less annual volatility and have more control over their finances than LAs and are able to cross-subsidise activities from sales, staircasing receipts and surpluses on other businesses like temporary housing. Their financial arrangements encourage long term asset management, and LSVT means there is more experience of 30 year plans. They have none of the complexity or uncertainty of HRA subsidy allowances.

## ***Physical standards***

The Government set the decent homes standard in 2000 and expected all social landlords to deliver. For LAs the Government provided delivery options that would bring in extra resources and over £40bn will have been spent by 2010 in achieving this outcome.

Preparation for the decent homes programme has substantially improved knowledge of the condition of the housing stock and has encouraged long term asset management. Long term plans (for example as developed by the self-financing project) help articulate the need to spend on stock maintenance in the future. The standard stock condition approach, based on the expected lifetime of standard components, does not paint the whole picture as costs are heavily affected by local factors. Maintenance costs can vary widely with the general culture of treatment of the property, intensity of use, vandalism, deprivation, child densities, lettings policy, etc, which fluctuate from area to area. For example, the same lift might need little repair in one location and constant repair in another.

Decent Homes has been a very encouraging programme, and many homes and estates have improved enormously. But it is a minimum standard and, for most, resources have not stretched far beyond the minimum. The strength of stock transfer business plans means that in some areas there is a stark difference in the quality of improvements between neighbouring retained council estates and stock transfer association estates, where much more comprehensive improvements, internally and externally, have been achieved.

The council stock will face major new challenges after 2010. The English House Condition survey shows that the progress made through decent homes could stall and that standards overall may decline again as homes fall back into non-decency (for example through aging of bathrooms and kitchens) and because LAs have deferred some high cost items that are not included in the standard, for example major capital works needed to communal areas. Recent modelling indicates that the MRA is not enough to support costs per property for future repairs<sup>2</sup> and some LAs may need to consider a new options appraisal soon.

The balance of spending in the programme may not have coincided fully with tenant priorities and it is often said that tenants, if given choice, would prefer resources to be spent on the environment outside their front door, including communal improvements such as fencing, paths, lighting, and secure entrances, rather than individual upgrades. The focus of attention generally is moving towards tackling environmental issues, especially climate change, improving communal areas and neighbourhood regeneration. Regulations are also requiring higher standards, for example for asbestos and managing fire risks in communal areas and higher recycling standards are also challenging in blocks of flats. It will be expensive to respond to these agendas across the whole council housing stock. Environment and neighbourhood works are not recognised in M&M and MRA and the system may need to be based on a better understanding of a wider range of costs.

LAs have growing experience of the creative use of assets, especially sales of high value blocks or pockets of land on estates, to bring in extra resources - but these could

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<sup>2</sup> <http://www.communities.gov.uk/documents/housing/pdf/selffinancinghousing.pdf>

also be used to support new affordable homes. Some councils (notably those retaining stock and management) rely on revenue contributions to capital and use has been made of prudential borrowing, but there is very little slack in the system and it is hard to cut costs elsewhere to create room to support capital spending. Some previous flexibility has also reduced, for example with tighter audit rules on capitalisation of revenue costs. Taking long term financial management decisions and planning for the future with any degree of confidence is problematic given the volatility in housing subsidy annual determinations.

### **Some Key Questions**

- 1. Should the council finance system be based on setting minimum standards or some more aspirational standard?*
- 2. To what extent should the standards be set nationally and how much local discretion should there be?*
- 3. If higher standards are set, how should they be defined, what would they cost; and how would those costs be met?*
- 4. Is it a reasonable approach to seek to define core services and determine the costs of provision, and then cost those extra services that contribute to wider social and community goals?*
- 5. Should these non-core items feature in the subsidy system or be dealt with through other subsidy streams?*
- 6. Should the approach of setting a minimum quality standard (decent homes) for the stock be repeated after 2010? Should it be narrowly focused on basic conditions or have a wider scope to include communal areas, the estate, and the impact on the environment?*

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May 2008

*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.*