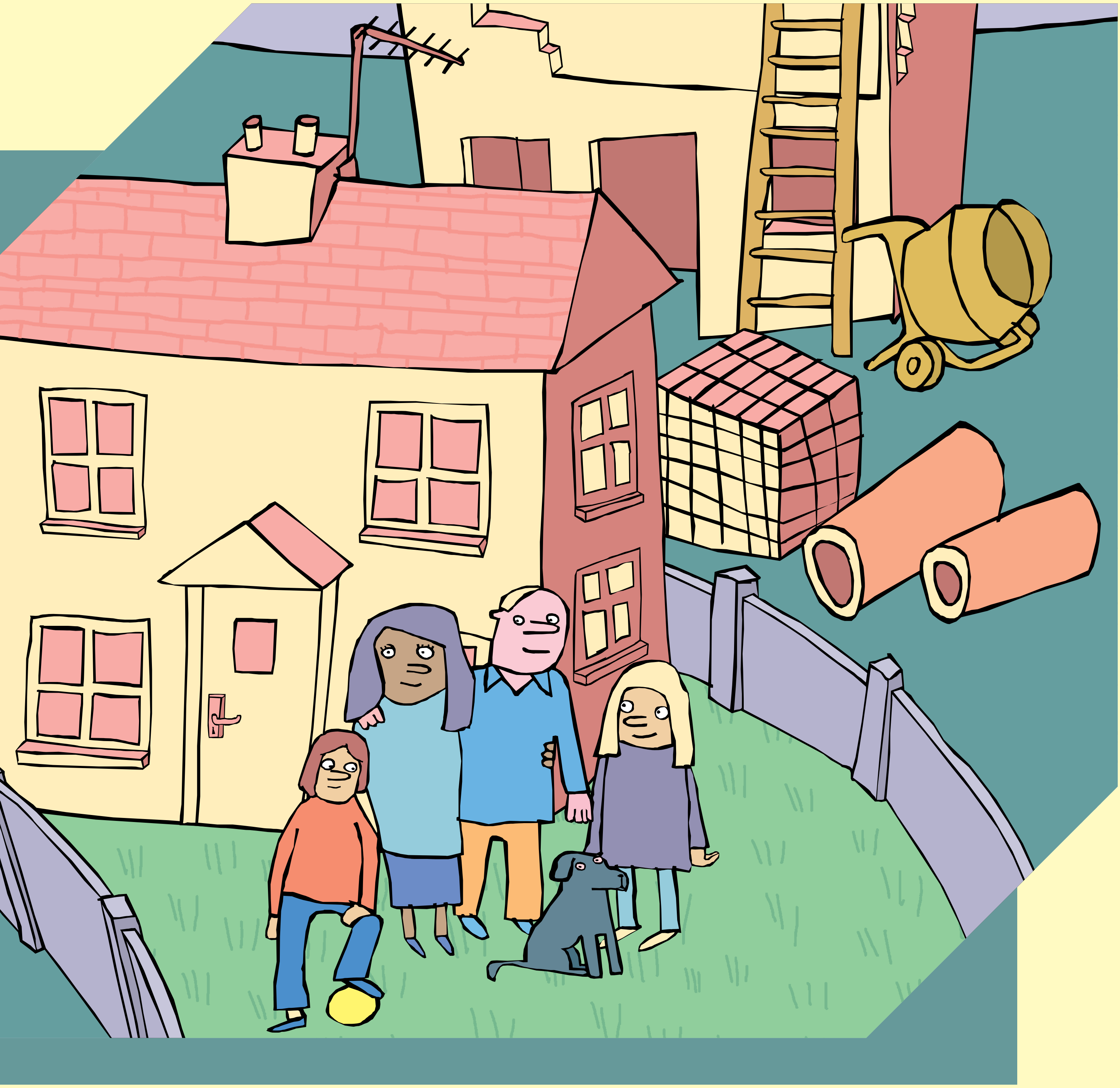


putting **people first**

local housing – local solutions

the case for self-determination

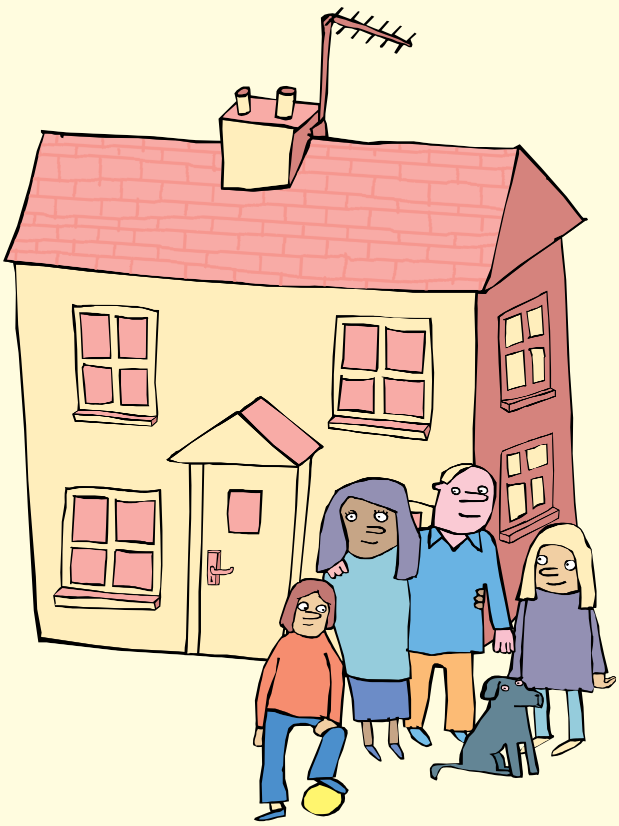
Local Government Association

executive summary

The Local Government Association (LGA) and its partners are united in calling for the Housing Revenue Account subsidy system to be scrapped and replaced with a fairer, more efficient localised system.

We are sure the government and politicians of all parties share a commitment to good housing conditions and the building of more desperately needed new homes. One thing stands in the way of these good intentions: an unjust, perverse, illogical and bureaucratic finance system.

This document sets out why change is desperately needed and strongly justified, and how it can bring about much needed additional investment in existing and new housing.



Its key propositions are:

- receipts and rents should be retained locally to be spent locally;
- council housing needs to be properly funded and placed on a sound financial footing to ensure long-term investment;
- councils should have financial self determination and be able to invest in their housing and contribute to the local economy;
- councils should be free from the constraints of historic 'notional debt', and there should be ongoing central investment for the small number of councils unable to achieve 100 per cent self-financing;
- councils should be able to borrow money to invest in their new homes in the same way and with similar conditions as their Registered Social Landlord (RSL) partners.

introduction

The LGA publication *My rent went to Whitehall* (July 2008) argued that reform of housing finance is essential to ensure that councils can deliver better services, better quality and additional housing for our residents. It set out the principles which the LGA and its partners proposed for the housing finance system to work effectively, namely that any change to the system should:

- enable councils to find the best ways of meeting local housing needs;
- provide fair rents for tenants;
- maintain a clear link between rents paid and services provided;
- be a clear, transparent system that tenants, members and officers can understand;
- ring-fence housing money both locally and nationally – tenants rents should not subsidise the Treasury;
- ensure that housing money is to be spent locally on housing and housing-related issues;
- allow councils to be certain of their financial position in the medium to long-term, and the short termism of the current system;
- ensure a link between local decisions and housing – through the local area agreement (LAA)/comprehensive area agreement (CAA) etc;
- acknowledge housing's role as a community asset in funding provision;
- mean that resource allocations decisions are locally and not nationally based;
- allow surpluses from the system to be spent on housing.

This report sets out practical proposals for reform of council housing finance. Our research shows that adoption of these proposals would allow:

- 80,000-90,000 additional affordable homes to be built by councils over the next five years. Thereby reducing poverty, ill health and improving our existing homes;
- over a ten-year period, by enabling councils to use the additional revenue stream from rental incomes would allow an extra 139,000 social houses to be provided. If councils were also released from the historic debt and allowed to borrow against their assets this figure could increase to 309,000. Providing an enormous boost, not only to the housing sector, but also to the wider economy.

This document has been developed under the oversight of a campaign group of elected local politicians, and on the basis of the professional expertise of a group of local government housing and finance professionals. The LGA is extremely grateful for their help and support.

Changing the way council housing is financed is central to the LGA housing campaign *places you want to live* which argues for unlocking councils' ability to provide more and better housing for local people.

It is not only councils that see the need for change. There is an emerging political consensus that the current subsidy system needs to be altered. Government and opposition ministers have said that they are prepared to consider any proposals that will allow for an increase in the provision of more housing.

"If local authorities can convince us that they can deliver quickly, and cost effectively, more of the housing that Britain needs . . . then **we will be prepared to give them our full backing and put aside anything that stands in their way**."

Gordon Brown, 29 January 2009

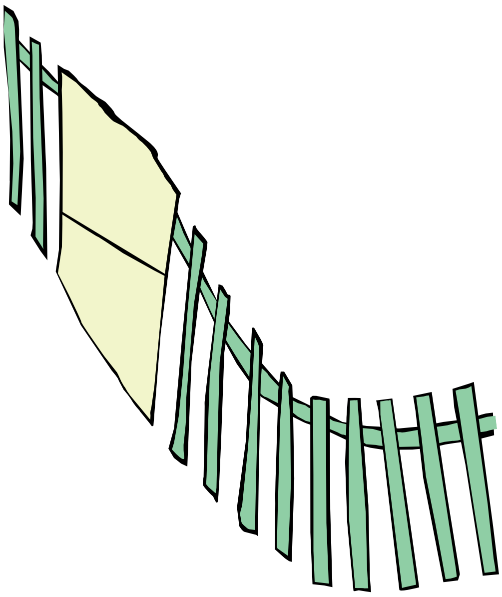
Stewart Jackson MP, Shadow Minister for Communities and Local Government,

"There is not a level playing field. The perversity and unfairness of the HRA is evident..."

Sarah Teather MP, Liberal Democrat Shadow Housing Minister,

"The clear conclusion is that we need to reform the Housing Revenue Account (HRA)...they will have to give councils the right to keep their right-to-buy receipts and rent in full, and we will need a system in which any required subsidy is provided centrally through general taxation. Only then will we have a system in which the finances are stable enough for councils to plan."

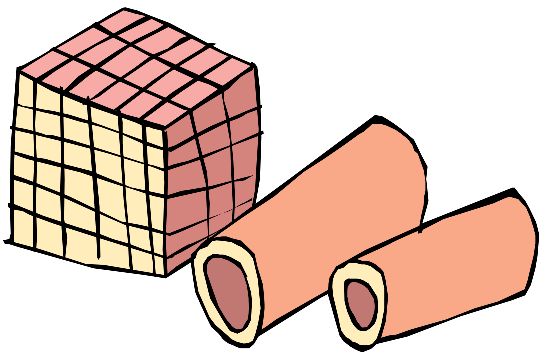
We believe that financial self determination for councils provides the answer that national politicians of all parties are looking for.



local authorities and housing

Housing is a key priority for councils. However, the current financial system makes providing ample, affordable, quality housing needlessly difficult.

There are many people who would like to rent from us, but the shortage of supply means that they are unable to. LGA research has noted that there are currently nearly two million people on councils' housing waiting lists, with this number expected to increase to five million by 2011, putting additional pressure on council housing. This at a time when the development industry is struggling and the number of houses being built is decreasing. The construction industry shrank by 53.7 per cent[1] last year.



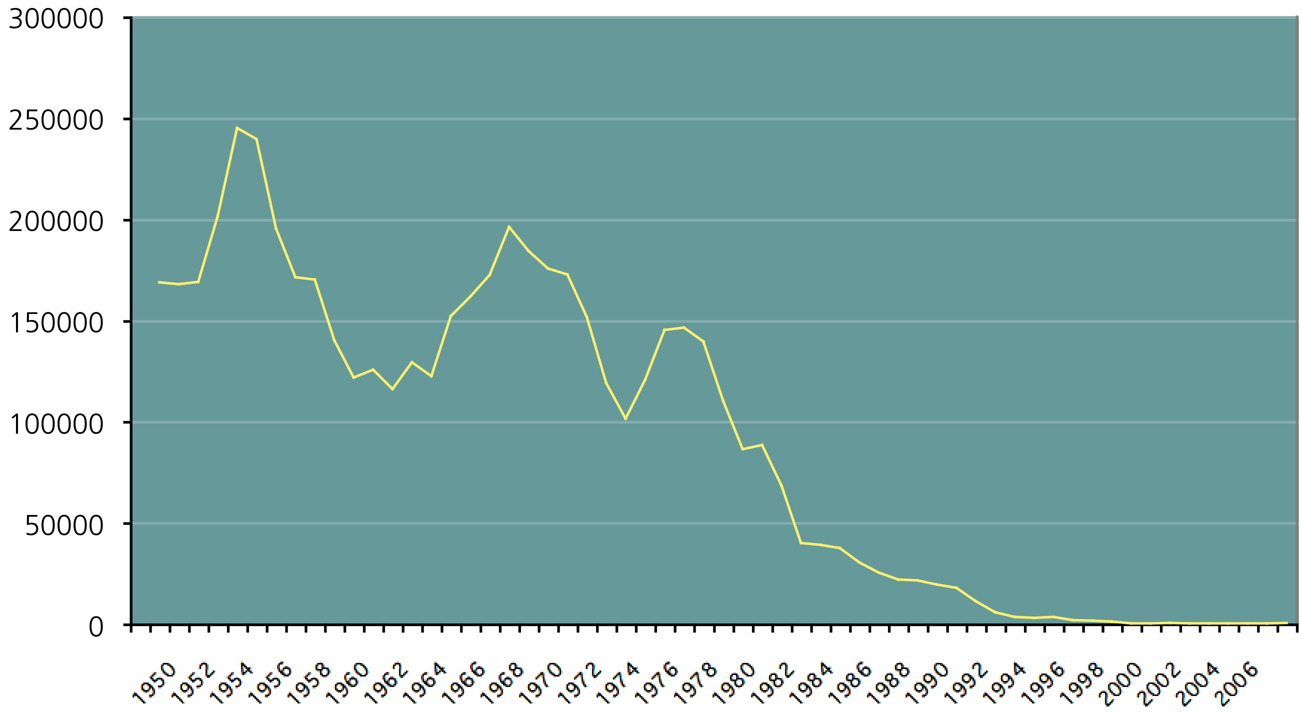
In the 1960s councils built tens of thousands of homes every year. However, as table 1 demonstrates, by 2007 they built fewer than 400 new houses, a tiny fraction of what is needed. Some councils are building new homes and many more would like to. However, the Housing Revenue Account (HRA) subsidy system remains the single largest barrier. In practice, when a council builds a new house, the assumed rental income for that property generally exceeds the assumed need to spend, and the difference is deemed to be a surplus – so government reduces an authority's subsidy. This means that councils lose revenue each year for each new house they build.

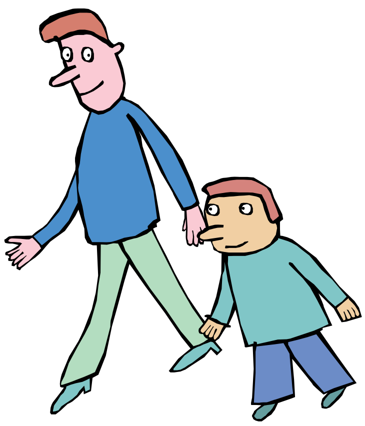
Recent government legislation has sought to ensure that councils have the freedom to exercise their responsibilities and build sustainable communities. Allowing councils to retain 100 per cent of their rental income would be the most effective way of achieving this in the council housing sector. The recent Communities and Local Government Department consultation on *Changes to revenue and capital rules for new council housing Capital and Revenue* has considered the options for excluding new council house building for the HRA subsidy system and allow councils to keep 100 per cent of rents and sales income. The government's proposals to exclude new council homes from the subsidy system will help a little, but will not provide the financial certainty and flexibility councils need to make a step-change in delivery of new council housing. We believe that **councils should be able to retain the income from all of their housing, not just recent new build.**

1 Nomis data

Table 1

Local authority housebuilding, 1949-2007





the HRA subsidy system

The current housing finance system is confusing but basically works like this:

- every council that owns and manages council homes is required to maintain a separate account of council housing income and expenditure (a HRA);
- the 'Housing Revenue Account Subsidy System' (HRASS) was designed in the 1980s to provide grant support for council housing. It is based on a 'notional' HRA containing calculations for management, maintenance, debt servicing costs and rents, none of which bear any relationship to actual income and expenditure for council housing in the real world. Indeed the calculations include four different 'rent' figures, all of them quite different to the actual rents paid by tenants. The calculations are set out in a Statutory Instrument and approved annually by parliament;
- if the 'notional' HRA shows a deficit then government pays that amount of 'positive' subsidy as grant to the housing authority. If, on the other hand, the notional account shows a credit then the housing authority must pay that amount as 'negative' subsidy to government;
- when the HRASS started, no council had to pay money to government. Now, out of 206 housing authorities, 156 pay 'negative' subsidy to the Treasury. In 2008/9 the Treasury took £194 million from council tenants. This is expected to increase to £214 million[1] in the current financial year. This situation is set to get worse. Even the councils that currently receive subsidy are receiving less each year and will in the next few years move into a negative subsidy situation until eventually all councils will be paying into the system;
- of the fifty councils currently receiving 'positive' subsidy nearly all of this money (98 per cent) is used to service the interest payments on historic debt.

1 Estimate prior to new rents setting formula in 2009

the problem with the current system

The housing finance system is unjust and inequitable with central government seeing their investment in local authority stock as debt, whilst funding of RSLs is viewed as investment.

This is fundamentally unfair and disadvantages councils and their tenants. There is no justification for this distinction and the LGA believes councils should be treated with parity with their RSL partners.

1989 Local Government and Housing Act which set up the HRA said that: **"The housing subsidy system should be fair, transparent and simple to understand and administer."** The current system is none of these things.

The housing subsidy system should be:	**Instead it is:**
Fair	**Deeply unfair:** how much subsidy you receive or pay to the government depends on the CLG's formula for assessing your 'need'
Transparent	**Confusing:** the formula for deciding money is complicated and is frequently changed by the CLG
Simple to understand and administer	**A bureaucratic nightmare:** requires councils to manage a complex process that they administer but do not control

The system as it stands is ineffective and inefficient. It is complex with a series of grants for refurbishment and major maintenance work which councils have to apply for and administer. The resource allocation within the system can change at very short notice, making it difficult for councils to plan effectively and the system does not reward positive management practice or allow innovative approaches to stock investment. The allocation formula creates perverse incentives, for example, if a council pays off its housing debt, reduces the level of crime on its housing estates or reduces the vandalism of its stock, it is liable to lose subsidy.

The system itself is under strain, whatever a councils' subsidy position, whether positive or negative, all councils suffer from the ineffective system that we have. Councils from all both ends of the subsidy spectrum have indicated that their HRAs are becoming increasing unviable to manage under the present system and that it urgently needs to change. The government in the HRA review has noted that the current system is underfunded. It is estimated that management and maintenance allowances are underfunded nationally by approximately 10 per cent[1], whilst Major Repairs Allowance which was set up to maintain the stock is underfunded by more than 40 per cent[2], meaning that the asset base is being eroded.

The current housing finance system runs counter to the ethos of community empowerment. The local government white paper places councils at the centre of local decisions, with the new LAAs giving them the power to co-ordinate the work of partner agencies to ensure consistent services for the public. Yet local authority housing finance as a major area of policy is centralised and is inconsistent with the new policy agenda. Local authority housing finance policy should be consistent with the ethos of councils' place shaping and community leadership roles.

The LGA and its partners believe that for all these reasons the housing finance system needs to change as a matter of urgency.

1 Report to HRA review by Hall, Partridge, Wilcox et al (2009)

2 Report to HRA review by Hall, Partridge, Wilcox et al (2009)

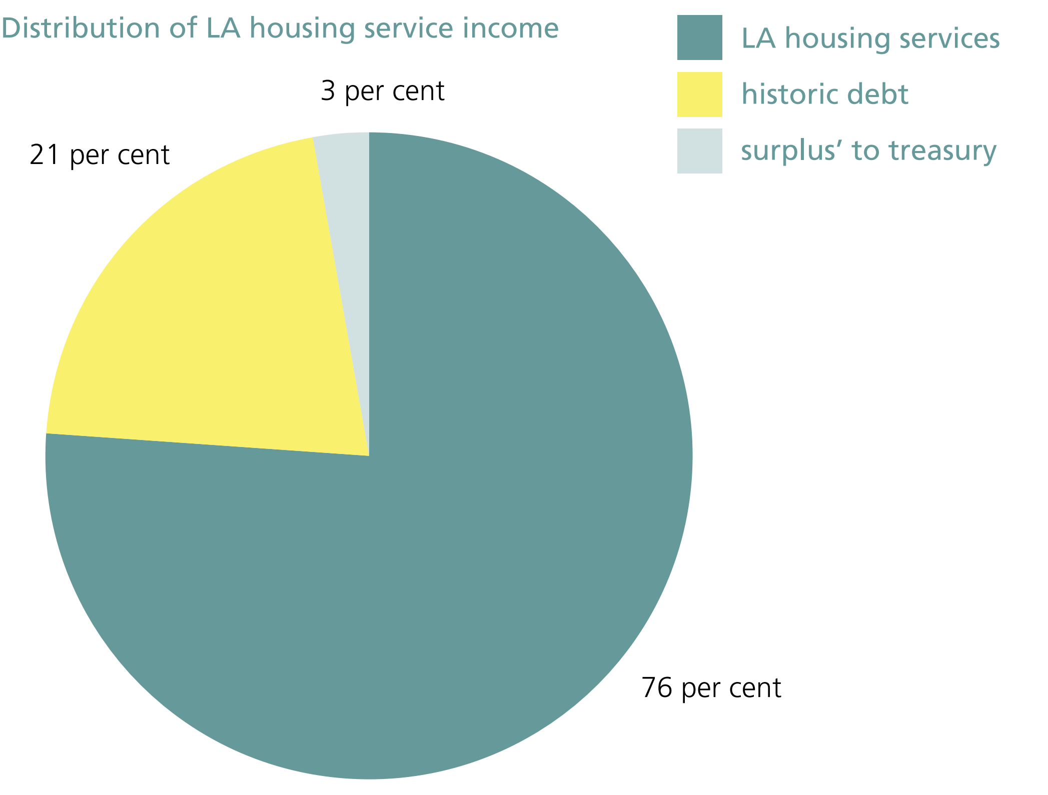
the solution - financial independence for council housing

The LGA with its partners have been developing a new system for housing finance. Our work and research has led us to conclude that to meet the fundamental principles we have set out, councils need independence and the ability to raise finance from the private sector.

We believe that there should be a transparency in the rental system, with council tenants being able to understand how their rent is spent. To deliver this to our tenants we need a level playing field with other social housing providers.

Currently RSL tenants know that all of their rent is used by their landlord to manage their current housing and provide new housing. Council tenants can not be clear about how much of their rent will be spent on housing in their area, as depending on the councils subsidy position a proportion of their rent goes directly to the Treasury to be used for national priorities. As the chart below demonstrates on average councils can only allocate 76 per cent of their income to managing and maintaining their stock. 24 per cent has to be spent of servicing debt or paying government surpluses.We believe that council tenants like their RSL neighbours should be able to know that their organisation is spending their money on the housing service.

Distribution of LA housing service income



the benefits of financial independence for councils

Allowing councils to retain 100 per cent of their rental income and capital receipts would lead to clear benefits for tenants, councils, the government and the wider community.

for tenants…

- creating a clear link between rents paid and services received
- supporting tenant choice and control by giving council tenants a real say over how their rents are used
- improving the quality of council houses by allowing council landlords to spend all of their rental income on local housing needs

for councils …

- providing certainty about future funding and allowing them to plan their housing investment over the life cycle of the properties they maintain
- encouraging efficient housing management and enabling them to manage assets more effectively
- allowing greater flexibility in their role as place-shapers

for the government…

- reducing risks for national finances by eliminating the uncertainty of the national surplus/deficit emerging from the subsidy calculations
- removing the complex, inefficient and unpopular subsidy system

for the wider community…

- allowing councils to improve the quality of people's homes and environment, thereby improving their health, education and life chances

Councils financial situations vary depending on their area, stock condition, authority type and debt history. It is our contention that a localised financial system will work for councils, as it allows for a developed business plan that provides a viable settlement based around current and future stock survey spending needs and would provide the headroom needed to fund this. It would ensure that councils are able to predict future resources, promote a proper asset management strategy and encourage 'a spend to save' model, with councils being able to plan their borrowing to make savings down the line.

The following cases highlight how a localised system would work in different councils.

Barking and Dagenham

This council in a deprived area of East London, manages 20,000 homes and is a negative subsidy authority.

Barking's Local Housing Company is starting on site in July for its first mixed tenure scheme which will create 470 new homes (two thirds of which will be affordable) and an enterprise centre. Beyond this, the company has a planned programme which could yield an additional 1,000 affordable homes in the next three years. However, if the housing finance system were to be localised Barking would be able to access additional revenue and could significantly increase this.

The council has sufficient land on cleared council owned sites (primarily infill sites) to make and immediate start, building up to 150 new Council homes in the next financial year (2009/10).

Simply based on the increased revenue stream, and without any additional borrowing, this would enable increased house-building in Barking over the next five years of over 500 new homes.

Sheffield City Council

This Northern Metropolitan council has a 3 star ALMO which manages the council's 42,000 properties and is currently in positive subsidy to £6.6 million. Projections done by the council show that post the 2012 allocation there is a big capital investment gap emerging and that there is no viable solution for non-traditional properties after this 'Decent Home' investment round.

The post 2012 revenue position for Sheffield looks unsustainable. Financial independence would allow Sheffield to address this issue. It would also enable them to develop a sustainable 30 year 'Decent Homes Plus' plan, improve service outcomes, provide better value for money and capture efficiency gains.

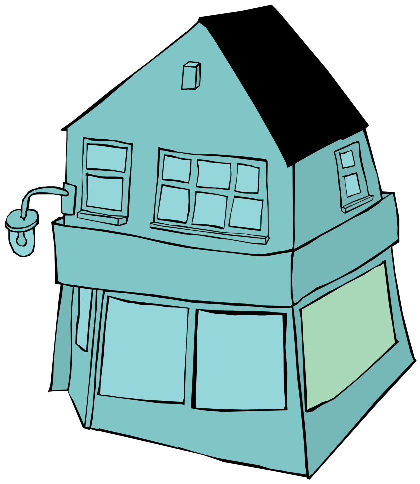
Waverley

This Surrey district council manages 5,000 homes and loses nearly £11 million a year (47p in every £1 of rental income) from the housing finance system.

Under a localised financial system the council would make a priority of investing an additional £5 million a year in repairs and renovations to bring all of its homes up to the government's Decent Homes Standard – which the current system prevents them from doing. This would also create a local economic benefit.

In addition Waverley is keen to meet local housing need through investment in new homes. They own a site, at East Street, Farnham, with planning permission for 235 new homes. In addition a Homes and Communities Agency site at Milford Hospital has capacity for 60 homes. There is capacity for an additional 100 homes on small sites 'locked in' to council (HRA) owned land. Waverley has established a local housing delivery company and would be ready to start work in the next financial year.

The council would therefore use revenue funding to build 50 new homes per year for the next five years, making a total of 250 new homes.



debt

There is currently an estimated debt of £15.5 billion[1] associated with the HRA subsidy system. This debt is a 'notional' debt and is based on a 'notional' Housing Revenue Account containing calculations for management, maintenance, debt servicing costs and rents; none of which bear any relationship to actual income and expenditure for council housing in the real world.

Indeed the calculations include four different 'rent' figures, all of them quite different to the actual rents paid by tenants. Many authorities that are under their own estimation debt-free, have because of the vagaries of the HRA had debt loaded on them from the government.

Estimated distribution of HRA subsidy 2009/10

1 CLG

The LGA and its partners believe that this is fundamentally wrong. Why should the financial calculations which determine council rents and expenditure bear no relation to the real financial situation in their council?

Since the introduction of the Right to Buy in 1980, approximately 1.8 million council properties have been sold. Councils are only able to keep 25 per cent of the sale receipt, 75 per cent goes to Treasury for general spending. Prior to 2004 councils could use sales receipts to pay off debt. Since 2004, the revenue from council house sales in England has been £6.2 billion[1] of which councils have only been able to retain £1.5 billion. If councils had been able to retain the additional £4.7 billion and use it to reduce their debt they could have reduced this to less than £9.3 billion.

Councils are currently spending more than £1.3 billion yearly servicing their historic debt. Councils have therefore repaid a large proportion of this 'historic' debt and will within eight years have spent more money servicing that debt than the debt itself.

As noted above we estimate that cancellation of councils 'debt' will allow them to provide 80,000-90,000 new affordable homes, which will in the next five years deliver approximately £35 billion additional investment to the English economy (an over 50 per cent return). 28,000 of these new homes could be released over the next year alone if councils had control over housing finance. Over a 10-year period, we believe that enabling councils to use the additional revenue stream from rental incomes would allow them to build an extra 139,000 social houses. This would provide an enormous boost, not only to the housing sector, but also to the wider economy, providing a minimum investment in the English economy of £50 billion. Cancelling councils historic debt and allowing them to borrow against their assets could increase build to 309,000 an investment of at least £72.5 billion. The additional housing and investment would have a lasting effect, reducing the call on the housing waiting list, improving housing standards and providing secure accommodation for families and residents.

The government has invested £1.3 trillion on funding the ailing economy. The cancellation of councils debt represents only 1.19 per cent of that sum. Debt cancellation would allow for local investment which would easily outweigh any short-term impacts on national finances. There are clear precedents for cancelling housing debt, most notably through the accepted practice of overhanging debt payments following stock transfers.

1 CLG Statistics Table 648

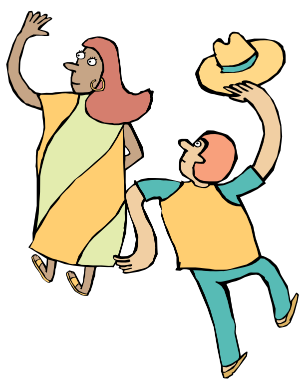
benefits of debt cancellation – economic stimulus

In addition to the direct investment into the economy, debt cancellation would help to reduce housing benefit bills and the public cost of homelessness.

Increasing the supply of council housing would reduce the current distortion in the social housing market that is forcing hundreds of thousands of people to live in more expensive private rented accommodation, when they could be eligible for council housing – council housing waiting lists currently stand at nearly 2 million people. Increasing the stock of council houses would shift the balance of low-income tenants towards lower-rent council housing, reducing the housing benefits payable to them without impacting negatively on their spending power. It would also allow councils to house homeless families more quickly, reducing the need to provide expensive temporary accommodation for extended periods.

Reduced pressure on central government finances

There is a clear and recognised funding gap in council housing nationally. This is currently met through significant national funding programmes, such as the Decent Homes Standard. Allowing councils to retain 100 per cent of their rental income and canceling historic housing debt would reduce councils' reliance on national funding initiatives. Meaning that this funding could be concentrated on those authorities, who because of their difficult financial circumstances will need additional help to manage their stock effectively.

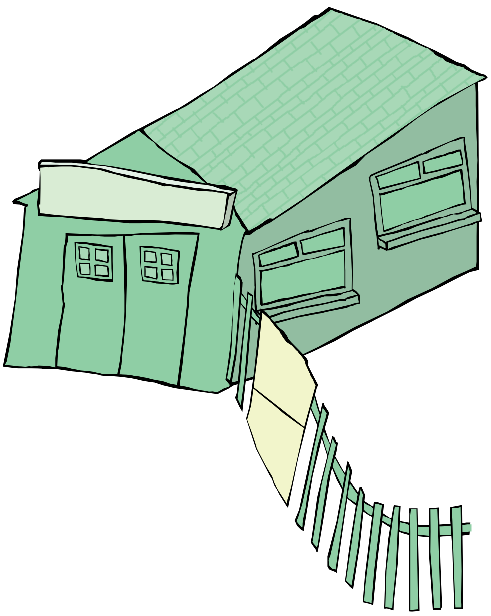


rents

We propose that under the self-financing model rents should be set locally to reflect the local market and to reflect the issues facing landlords and their tenants. The current rent-setting regime is extremely centralised with government imposing guideline rents on councils.

The process is inefficient and does not allow for proper forward planning, as councils do not know until December or January what their financial position will be in the financial year beginning April, which can disrupt services when not enough money is available in the provision for the following year.

We recognise that government will need to be confident that councils are setting sensible rents to allow for proper business planning and to ensure the quality of the services for tenants. The government has set up and invested in the new regulatory body for tenants, the Tenants Services Authority (TSA) whose role is to ensure tenants interests are protected. The LGA and its partners believe that rent regulation should form part of the role of the TSA and would propose that the TSA should be called in to intervene where there is a perceived problem with a council's rent setting policy. The TSA has the power to regulate and the Communities and Local Government (CLG) has the power to direct the TSA on policy. The LGA and its partners believe that this framework provides adequate protection and is comparible with the rent regulation of the RSL sector.



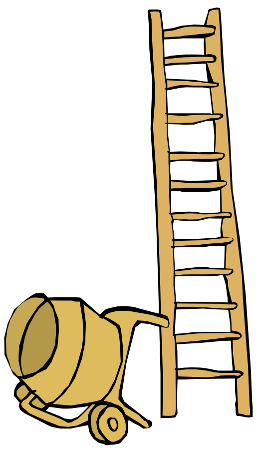
practicalities

We urge the government to ensure that transition arrangements to the new system are as simple and swift as possible, particularly given the current pressures on social housing waiting lists.

The existing system is complex and time-consuming; adding additional layers of bureaucracy would not be helpful. It could also increase the financial risk to the government if negative subsidy councils left the system early on, increasing the pressure on positive subsidy councils who remain in the system for a long time.

In our estimation once the issue of debt is sorted out, over 90 per cent of councils would be able to self-finance. Research shows that those authorities who can manage self-financing are able to fund 100 per cent of their current and post Decent Homes work. Councils should not be penalised if their local market and overall debt position makes it unviable for them to move to self-financing. For those in this position we would expect central government support to remain in place. These councils and their tenants should continue to be supported to ensure that they are able to maintain and improve standards. All councils should still be able to apply for Homes and Communities Agency grants and we would expect councils to have the same rights as other social housing partners to apply for capital improvement funding.

There is a need to ensure that authorities are not unfairly penalised when moving to a new system and that positive subsidy authorities are protected through transitional arrangements, to ensure that they are not left with unfeasible and unmanageable financial situations. The majority of councils would be able to move to self-financing swiftly and without any significant financial risk. For some, however, the removal of positive subsidy payments could create financial problems because of an historic housing debt servicing requirement, which will need to be addressed.



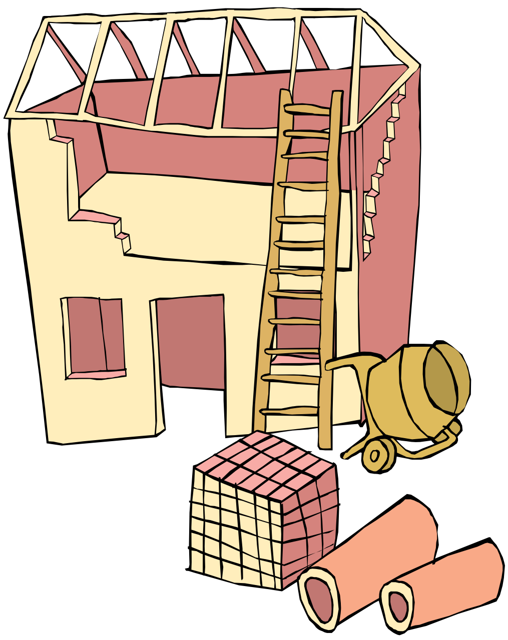
conclusion

The LGA believes that local financial determination will deliver on the fundamental principles that we set out in our publication *My rent went to Whitehall*. We believe that financial independence is the only way to provide a long-term sustainable future for council housing. Self financing will enable councils to provide good quality accommodation and build new stock, which will help to elevate locally the economic downturn and contribute to delivering on the government's three million new homes target.

We are asking the government to take three decisive steps for a fair and sustainable council housing finance system:

- abolition of the broken HRA subsidy system;
- financial independence for council landlords;
- cancellation of the historic housing debt.

Changing the current system of social housing finance can improve people's lives and prospects by enabling more homes to be built and improved with more efficient use of public resources. There is a consensus in favour of change. This document sets out how it can be done. We urge the government to act.



Local Government Association

The Local Government Association is the national voice for more than 400 local authorities in England and Wales. The LGA group comprises the LGA and five partner organisations which work together to support, promote and improve local government.

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