Paying its own way: a sustainable future for locally managed council housing

Submission to the Government's Review of Council Housing Finance

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Background

1. The government's review of council housing finance, which is now nearing conclusion, potentially heralds the most radical change in how councils run their housing for twenty years. The last major overhaul of council housing finance, in 1989, began a period of much tighter central control, underinvestment in both management and maintenance, and poor accountability by local authorities for the management of their stock and its finances. By contrast, the 2009 review offers the promise of devolving control firmly to local level, greater transparency of finances, stronger long-term planning and asset management, and enhanced accountability to tenants.

2. The opportunity presented through the current review has not come about by accident. The incremental changes which the government has made since 1997 have paved the way for a system which – if not yet sustainable – now has sustainability firmly 'in its sights'. The introduction of the major repairs allowance in 2001, the separation of rent rebates in 2004, reforms such as rent restructuring policy, resource accounting and prudential borrowing, and above all the setting of the Decent Homes Standard and making the investment needed to meet it, have transformed council housing into a sector which – probably for the first time in its history – is beginning to 'pay its way' at national level, with services also improving consistently at local level.

3. At the time when this government came to power, stock transfer was the only option for councils which wanted a sustainable future for their housing stock. The setting of the Decent Homes Standard and the creation of ALMOs in the April 2000 green paper radically altered that scenario. Since then, stock transfer has passed its peak, and in a short time ALMOs have grown to manage one million homes, or half of the remaining council housing. Other councils have, at present, found sufficient security from the changed financial climate to retain their stock 'in house' or have had to do so because their tenants have voted against alternatives. Councils as well as housing associations are on course to meet the decent homes target by 2010 or within a short time after it (for all those tenants who have agreed to the work being carried out).

4. However, while there is now a tremendous opportunity resulting from the policy changes and investment which this government has made, there is also a considerable risk. In effect the process of considering a devolved approach to council housing finance has already taken nearly seven years, beginning with the first consultation paper proposing self-financing in August 2002. Since then, there has been a succession of working groups – on the future of ALMOs, on the self-financing pilots and (now) on council housing finance overall. Understandably, at local level there is considerable frustration and concern about how long this has taken, with doubts about what may finally emerge. Three authorities with ALMOs are already considering stock transfer and many more are worried about their viability in the medium term. Stock retaining authorities are also increasingly concerned about the sustainability of their finances and two are known to be preparing ballots this year.

5. Recent announcements and turning points in housing finance have emphasised how much rides on the current review:

- Until a short time ago the national surplus on the HRA was little known or understood; now it is widely known about and the subject of protests by tenants and others, and claims that it is a ‘tenant tax’

- This was undoubtedly a factor in the recent reduction in this year’s guideline rent levels, but the decision (though understandable politically) emphasised just how centralised the system has become; announced at the last moment, it had a significant and unplanned impact on local HRAs, with the precise local consequences impossible to predict

- The Prime Minister has called on councils to build more homes and has promised to remove the barriers to their doing so. However, while councils continue to have so little flexibility in their finances (compared to housing associations) it is clear that they will find it difficult to respond on any scale, despite the advantage they currently have in being able to borrow more cheaply.

6. There is now an unparalleled opportunity to take advantage of lower building costs to make up for a lengthy period of underinvestment. Council housing debt is now (per unit) less than half that of housing associations. There appears to be sufficient capacity for future rents to meet revenue and capital needs at a national level. At a local level there are a number of authorities with very difficult stock and/or large post-decent homes backlogs. Mechanisms exist to target capital allocations to those authorities which have outstanding capital needs.

7. There is also now the opportunity to address the criticisms about the inefficiencies of the current system made by the Audit Commission in its 2005 report, and make full use of the building blocks of long-term asset planning and the prudential borrowing regime which the government has put in place. Other developments in government policy over the last few years, notably choice-based lettings, rents policy and the convergence of the regulatory and performance regimes for local authorities and housing associations, have strengthened their joint role in meeting the same housing needs. Under TSA domain regulation, tenants in both sectors will increasingly have the same expectations of their landlords. Social housing is now essentially provided to similar people in the same need off the same waiting lists and at similar rents, making it difficult to justify the continued retention of two completely different financial systems.

8. A further factor is that government has set a strong devolution agenda in which local government in general has more financial certainty and flexibility, and is expected to use all its resources to tackle strategic priorities set through LAAs. It has always been clear that the council housing service could only participate fully in this process with much more financial certainty and flexibility than it currently has, particularly if it is to involve tenants in management and in community ownership of assets, as envisaged in the Quirk review. Without such a radical change, council housing will continue to be limited in the contribution it can make to LAA goals.

9. Massive expectations therefore ride on the current review, and if options which offer long-term viability are not clearly available as an outcome of it, the plurality of providers could shift over a period of a few years to a position where a clear majority of social homes is run by only one type of organisation. This will lose the diversity and healthy competition between different types of provider – now roughly balanced between councils, ALMOs, LSVTs and traditional housing associations (with about one million units each). It will also jeopardise the achievements of the ALMO sector in delivering such high levels of performance (50 ALMOs with either two or three stars in Audit Commission inspections). It will drastically reduce choice for tenants. And – not least – it will put pressure on the government to use the available resources to finance one-off transfers of the remaining council stock. 'Doing nothing' is therefore neither a policy neutral nor a cost neutral option.

10. For this reason we have come together to write this short paper, as five individuals who have either contributed as experts to the work of the CLG and Treasury, or as advisors to the various trade bodies and the professional body in the sector, or both. We share considerable experience in housing finance and a conviction that it is vital that the review leads to radical reform. Our views are informed by our day to day contacts with local authorities and tenants, whom we are convinced want to see a viable council housing sector, which is properly accountable at local level and has the resources to be sustainable in the long term.

What are the essential outcomes from the Review?

11. The current Review has a range of objectives with which we broadly agree, but we would argue for both a clearer immediate focus and a stronger long term vision. If we look at the immediate priorities for the Review, we suggest that the crucial outcomes (say within the next three years) should be:

- To provide one or more options which will be seen as offering a viable and more stable future for council housing to tenants and local authorities, so that they can plan with confidence to retain their stock

- For ALMO authorities to offer a clear prospect of retaining the ALMO (possibly in modified form, if desired locally)

- To show how the prospective national surplus can be reinvested in the stock so that council housing remains attractive and lettable

- To provide councils with opportunities to raise finance to add to their stock and/or make it more appropriate for current needs

- After a short period of transition, to result in a financial system which provides as much local autonomy as possible within a regulatory framework that is common to council housing and to housing associations

- To create a system which is understandable and transparent to tenants and councillors - in which income is determined by rent levels (not decided by the current complex system), surpluses generated can be reinvested as part of long-term business plans, and assets can be managed locally (without receipts being largely paid back to government) – as has always been the case for housing associations

- Finally, to respond to tenants' complaints about HRA funds being used excessively to meet costs that should be funded from the General Fund. We do not believe tenants want to swap a system where they believe their rents 'go to Whitehall' for a system where their rents 'go to the Town Hall'. The HRA ring fence should be more consistently applied so that council rents do not pay for services that should properly be funded from council tax (which, of course, tenants also pay).

12. In addition, we believe from our discussions with councils and tenants that there is now a broad demand for government to set out a positive, long-term vision for a viable and stable council housing sector, with a clearly expressed policy that it should remain as a distinct sector that has different attributes to HAs. The ALMO model has delivered beyond expectations in terms of Decent Homes, housing management performance and tenant involvement, but few involved see it as a stable sub-sector going forward. Tenants in some areas have demonstrated a strong preference for direct management, and this should be respected within the context of a degree of separation between housing management and the parent council's strategic housing responsibilities.

13. The main aim of the Review is to create a long term sustainable financial system for council housing and to provide a vision for the 'shape' of the sector looking 10 to 20 years ahead which is consistent with this aim. It is therefore crucial that the financial system that emerges as a result of this Review acts as a stepping stone towards more sustainable organisational structures, not an obstacle to them. These may evolve as tenant-owned ALMOs, or municipally owned local housing companies, or some other long term model. But it is vital that it provides a platform for the creation of locally accountable and locally based structures which will remain distinct from housing associations but will have similar financial autonomy, within a shared regulatory framework (through the TSA).

14. The main features of such a framework, based on the research undertaken for the Review (to which we have contributed extensively) are:

    - Recognition that the system can from now on be sustainable in revenue terms at national level because required levels of management and maintenance and major repairs allowances can be met (at least, for all but a few authorities) from formula rents

    - Surpluses to be to be reinvested in existing or new stock or services to that stock

    - In day to day terms, the system to be self financing, both overall and at the level of individual authorities

- Councils with and without ALMOs to be treated in future as far as possible on the same basis as housing associations in access to capital grant, ability to borrow, accounting rules, initiatives about improving standards, etc,

- Options for change should focus on putting in place these elements across the sector within a short (three year) transition period.

The remainder of this paper is a summary of the main components of such a framework.

Rents

15. The current surplus in the national HRA is to a significant extent the result of rent restructuring, which has increased rents in real terms and produced a situation in which rents meet costs and increasingly generate a surplus. (The gap between LA and HA rents has reduced considerably over the last decade). In addition, LA debt has fallen through the earlier setting aside of right to buy receipts.) We therefore support a trajectory for rents in which they continue to converge on formula rent levels, so as to sustain income levels and provide a margin to generate future surpluses which can be reinvested in housing. For this reason (and because of its benefits for more realistic business planning) we support the retention of the ring-fenced HRA.

16. Within this broad approach, we also believe that:

- The TSA should develop a policy framework for affordable rents and service charges which applies (with provision for convergence over time) across the social rented sector. This, and the agreed business plans on which local authorities are allowed to become self financing, should be the only policy framework for rents (as would be the case if authorities in future opted for stock transfer)

- The framework would continue to protect public finances overall (ie, the costs of housing benefit)

- Assuming that long term income growth outpaces price increases, general rent rises should be pitched so they increase broadly in line with earnings at least until convergence is achieved, thereby bringing more funding into the sector while remaining at affordable levels. Formula rent increases would be affordable if kept at or below the rate of increase in earnings, would not have a significant impact on HB costs and would provide some landlord surpluses for reinvestment

- The framework should provide more flexibility for variations in rent within a landlord’s stock to reflect local market conditions and landlord priorities – especially so as to have greater differentials between smaller and larger properties. This would enable rents to be used more positively as a tool in asset management (as would be the case in the private sector)

- Artificial limits on rent such as the current rent rebate subsidy limitation, which apply only to the council sector, should be ended as unnecessary complexity against the background of the new TSA framework which we envisage.

Drivers for efficiency

17. A key defect in the current system is that there are only limited drivers for efficiency, except in the case of ALMOs who have to achieve a 2* or 3* rating from the Audit Commission to gain Decent Homes funding.

18. Under self financing, the main driver for efficiency will be the ability to create surpluses to reinvest in new or existing stock. Local authorities will have a similar incentive to do this as associations, within the TSA's performance regime, monitored against their business plans. Furthermore, access to Social Housing Grant will be subject to comparable criteria to those that apply to associations.

19. While concerns about whether there are sufficient drivers for efficiency under self financing are understandable, it needs to be borne in mind that:

    - Councils only have very limited drivers at present: effectively, through the national HRA system, instead of the freedoms and efficiency drivers that apply to associations, non ALMO authorities operate in a totally constrained environment which safeguards them from financial failure but does not reward greater efficiency/effectiveness except at the margins

    - Volatility and the inability to plan resources more than a short period ahead are a major barrier to making genuine efficiency gains, rather than unplanned cuts, in the current system

    - ALMOs have made an impressive response to performance incentives, with 20 ALMOs gaining the 3* level

    - The current system does not take advantage of the positive role that tenants can play in driving efficiency because the benefits are not seen locally.

Policy on surpluses and receipts

20. Ideally, future surpluses should be retained locally not captured or partially captured centrally. This is in part because they are then fully available for local reinvestment, in part because it avoids maintaining a centralised system, and finally because it provides a strong incentive to authorities to opt for self-financing and helps provide a powerful case to councillors and tenants. Use of surpluses would form part of more effective business planning and (as with HAs) would mean that such planning would become a much more significant and realistic exercise. However, thought needs to be given as to whether some capturing of surpluses centrally may be needed for a period to deal with backlogs that are not evenly spread, but these should be reused as capital grants not (as at present) recycled through revenue subsidy.

21. We also believe in principle that receipts should be retained locally. There are various persuasive arguments for this:

- At national level, receipts are now much lower than they have been providing an opportunity for change without any dramatic effect on national resource levels

- Housing associations are generally able to retain receipts as cash for investment and LSVT associations also do not have to pay back into a national pot

- Scottish LAs fully retain their receipts

- Government has already opted to allow LAs to retain receipts from new build properties.

However, we are not aware of a study showing the impact of receipts being fully retained locally and, as with the issue of surpluses, we believe that this should be done before a final decision is made. It may be that a transition period will be needed during which there is still some repayment of receipts. In any event, there is a strong case for use of receipts to be ring-fenced to housing and regeneration activities (accepting that the latter will allow some scope for flexibility at local level).

Achieving and maintaining decent homes

22. One of the main disadvantages of the current system is that – despite the addition of Decent Homes funding – it has under-resourced council housing by setting expenditure on management and maintenance and on major repairs at levels which have been too low to sustain the stock and the housing service. Since the funding shortfall was first identified by BRE, the government has partially closed this gap. The existence of the forecast surplus now provides the opportunity to raise spending to required levels and perhaps close the gap completely. In our view, there is a need to raise M&M allowances by a minimum of 10% and the MRA by, at the very minimum, 43%. Successive stock surveys and further BRE evidence show that an increase of at least 60% would provide a more sustainable longer term platform for capital investment to meet the needs of the stock. Providing there is a sustainable self financing settlement, this could leave many councils in a position where they can maintain their stock without recourse to further significant borrowing. Some will not be able to do so at this level and will need to borrow at a higher level and/or access grant in some form (which would be reflected in their business plans).

23. Treatment of debt

24. Clearly, a self financing solution requires a solution to the problem of accumulated debt. The options are redistribution between authorities, centralisation of debt or a combined, two stage approach (ie, centralisation followed by redistribution as authorities leave the system). All have merits, but a centralised debt option or two stage approach may be easier to implement and more readily pave the way for a centrally negotiated self financing scenario. We therefore favour these but acknowledge that detailed implementation will require further work. Redistribution should be on the basis of projected future surpluses (ability to take on debt) not any form of capital charge, which would have unpredictable distributional consequences.

25. A framework for future investment

26. It is essential if council housing is to have a sustainable future that it has access to capital finance, generated from revenue, capital receipts and/or prudential borrowing. The projected future surpluses throughout the system create the headroom to support this essential capital expenditure. This is important if local authorities are to deliver the government's own objectives of increasing council new build, regenerating estates as part of the effort to close the gap between the poorest neighbourhoods and the average, and reducing carbon emissions by investing in their stock to improve energy efficiency.

27. We understand that the Treasury is concerned about the growth of prudential borrowing. However, if a self financing approach were developed in parallel to reforms in the national system, there would be a number of safeguards which apply or special characteristics of LA borrowing that should provide comfort to the Treasury on this issue:

- Councils have to abide by the Prudential Code, monitored by a legally designated Finance Officer, and are subject to external audit

- Councils could undertake capital investment by exploiting the opportunities of funding it from revenue or capital receipts before turning to prudential borrowing (as has happened to an extent in Scotland)

- Councils exiting the national HRA system will need to apply to do so. Agreed levels of borrowing can be included in the self financing business plan on which the government's approval is based. (Some may not need to borrow to sustain their stock)

- Councils and ALMOs will tend to limit new investment to a relatively small geographic area, unlike LSVT housing associations which in some cases have greatly expanded their area of operations and hence their business

- Prudential borrowing by Scottish councils does not count against Departmental Expenditure Limits as it does in England and Wales, yet excessive borrowing by them has not yet been an issue (despite similar pressures in terms of stock standards and new housing demand in many areas)

- Once council housing becomes subject to regulation by the TSA, it can be subject to the same financial monitoring arrangements as housing associations, to ensure compliance with agreed borrowing levels. Income to service potential borrowing will also be limited by rents policy (see above)

- Finally, the Treasury retains a default power to limit borrowing levels. Although it will be reluctant to use this, it remains a safeguard which is available as a last resort, and TSA monitoring will provide the data on which any decision to use the power can be based.

28. In any case, there is a powerful case for investment in council housing, as a business whose costs are covered by income, to be treated differently from other public borrowing – as it would be in many other European countries. This would of course be the case if government adopted the General Government Financial Deficit as its main measure of debt – as the GGFD excludes public sector trading activities such as council housing (and, indeed, the recently nationalised banks). On this measure, government borrowing is below average at EU level and is forecast to remain so. Recent events have undermined the argument that private and public sector bodies need to be accounted for differently in terms of the risk posed for the public sector, as the government has not only rescued private sector banks but is also considering intervention to save PFI schemes, including housing projects.

29. Transition to self-financing

30. Whilst the option of voluntary applications to exit the system retains the element of choice, we believe that it would be worth exploring, through consultation, a one-off settlement phased over a limited transition period (say three years). We recognise that there may be issues around persuading some authorities to take on more debt as a price of leaving the system, but think this would offer a cleaner change than a hybrid arrangement where, for many years to come, some remain as part of the current revenue system while others have left it.

31. CLG has discussed, and we would support, a process for negotiating a national settlement which is similar to that employed in (for instance) the regulation of utilities: a draft settlement is announced with a consultation period, revisions are made in response to submissions, a second draft is issued with more limited scope for discussion and this (after possible final adjustment) leads to a final settlement which is then binding on all parties for a determined period.

32. Finally, we believe that there are sufficient powers using a combination of established legislation underpinning the subsidy system, and the new power in section 313 of the Housing and Regeneration Act, to implement such a settlement.

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