



**Association of Retained Council Housing**  
**Council housing: a real future**  
**Joint response to the Consultation Prospectus**

**Introduction**

The Association of Retained Council Housing (ARCH) represents the views and interests of councils which have retained management and ownership of their housing stock. Our members manage nearly 600,000 council homes across England in areas as diverse as large metropolitan boroughs, inner London Boroughs and rural districts. These local authorities are represented by all political parties.

We believe that a strong and vibrant council housing sector can bring community, investment and economic benefits as well as delivering improved lives for millions of council tenants. We also believe not only that the current financial system for council housing *discourages* us from investing, but that it has *actively prevented* bringing forward the investment our tenants and residents deserve.

In our response to the consultation of July 2009 following the Review of Council Housing Finance, we set out our strong support for the government's proposals to dismantle the outdated and unfit-for-purpose Housing Revenue Account (HRA) subsidy system. ARCH was amongst those representative bodies which were at the forefront of the initial response to government at that time pressing for a voluntary settlement utilising the powers the Secretary of State has under the Housing and Regeneration Act 2008. We therefore welcome the government's prospectus issued on 25<sup>th</sup> March and have been actively considering our response in conjunction with the response of our members since it was issued.

We therefore also strongly welcome the commitment made by the new government to continue with the HRA reform proposals and especially the announcement made by Housing Minister Grant Shapps on 8<sup>th</sup> June that the consultation process would proceed as previously planned. We also welcome his comments about the nature and challenges posed by the current subsidy system within recent speeches and publications. We have no doubt that the new

administration is as committed as ARCH is to seeking a long term solution for council housing finance and, like them, see this as a key plank of a refreshed commitment to localism.

Our response comprises a series of general comments on the overall proposals and responses to the specific questions posed. Our responses are made as a representative body and therefore our views on some of the questions are on that basis; we have encouraged our members to respond to the prospectus and no doubt all of them will have done so.

As before, we have conducted a wide ranging process to consult our members and an exercise to model the implications of the prospectus for a series of representative member authorities. We held a member event (in early May) with a total attendance of over 120 delegates in which the principles of the proposals were debated and discussed. Work was carried out for six case studies in order to set out for members the main issues and factors likely to be significant in the full range of local circumstances. We also ran a Tenants' Sub Group meeting in mid-May to enable debate of the detailed proposals by the group and to gather feedback on tenants' views. The key points from all of these events and the modelling work that has been undertaken are incorporated into this response.

### **General comments**

ARCH members are net payers in to the national subsidy system. Our 54 members are likely to contribute an estimated £255m in net negative subsidy payments in 2010/11. Our members recognise that the system will only get worse, as rental surpluses rise and allowances are controlled by central government; in 2011/12, our estimate of the contribution ARCH members would make in an unreformed system is nearly £300m. Member authorities can see the sense in replacing such a system with one in which future income is retained locally rather than paid over centrally in increasing annual amounts.

We recognise that the government is consulting on a 'deal' between itself and local government. We recognise that the government has to balance the overwhelming case for self financing with a new approach that is consistent with the economic and public expenditure pressures of the next few years. The components of that deal are numerous and varied but essentially involve local authorities receiving an increase in funding assumed for management, maintenance and major repairs, the ability to retain all future rents and Right to Buy receipts and to undertake to move to self financing voluntarily on 1<sup>st</sup> April 2011. In return, local authorities will be required to accept retention of central control over future rent policy through the regulator, the allocation of more debt than is currently supported by the subsidy system, the close control of capital

funding for outstanding backlogs and the capping of borrowing at the opening debt level, driven by the difficult public expenditure climate.

ARCH supports the proposed abolition of the Housing Revenue Account Subsidy System and the implementation of self financing. Our members strongly support the principles of localism and local financial autonomy which are inherent within the proposals.

We recognise that the prospectus has been issued at a time of public finance pressure. We acknowledge and support the intention to implement an assumption of increased expenditure allowances within the debt allocations and welcome the fact that the long standing case put by the council housing sector setting out why and how they are under-funded has been partially accepted.

However, the full recommendations from the government's own detailed research, carried out over extensive periods have not been implemented and we regret that this is reflected in the prospectus through the allocation of more debt than is currently supported by the subsidy system. We acknowledge that the proposed £3.6bn debt excess is in some ways a 'price of freedom' and many members will be better off in the longer term. However, ARCH's position, and the position of our tenants, remains that as a matter of principle, local rents should be retained locally and that the national debt allocation should be no greater than the current level of debt so that tenants get 100% of the benefit of all future rental increases.

In addition, we recognise that the government maybe felt it had no choice but to restrict investment in capital funding to the completion of ALMO decent homes programmes and to constrain future investment through capping borrowing. The former is a matter of further regret for ARCH where the delivery of decent homes standards by our members has been managed without the injection of additional central government resources. It might appear, *prime facie*, that the excess debt allocation is intended to be utilised to support one part of the council housing sector only.

We strongly believe that all councils should have the opportunity to bid for capital grants in the future. We strongly believe that the new self financing system should begin on the basis that authorities are clear about how future capital needs will be met. Those areas of backlog need and investment which were identified in the research totalling £6billion (for backlog), £5billion (for adaptations, health and safety and asbestos related work), coupled with the rising costs to address fire safety in flats, should be recognised from the outset.

The cap on borrowing is of concern on two levels:

- Firstly that it cuts across the principles of the Prudential Code, which has been used successfully for 6 years to facilitate much needed and sustainable investment in local authority assets
- Secondly that it is counter-productive in that it prevents investment that is actually more efficient and effective in the long run, allowing development, regeneration and redevelopment schemes to come forward to improve supply, improve conditions and reduce costs down the line, and to allow the release of capacity in public assets which is a key plank of government's plans to achieve better value.

The limitation on borrowing must be seen in the context of there being no similar process in place for Housing Associations (other than their own assessment of their ability to repay and/or service their borrowing), despite the fact that the asset base and income streams are similar. ARCH continues to support the case for a suite of pre-determined borrowing ratios and covenants (similar to those applied by lenders to Housing Associations) that would have to be met (and reported on as part of the council's annual report), allowing sensible and sustainable additional borrowing.

The prospectus sets out medium term opportunities for local authorities to participate more actively in the direct provision and re-provision of new housing. ARCH welcomes the delivery of capacity for new build, be that through the allocation of a 'lower' debt settlement, or through the ability to use future headroom that builds up in local plans. Our members are keen to make a very positive contribution, evidenced by the number of retained-management authorities which had bids accepted under the recent round 1 and 2 new build programmes.

However, the restrictions on capital investment set out above are likely to cause particular difficulties if they are implemented at the same time as reductions in the ability of the Homes and Communities Agency to deliver grants for refurbishment, regeneration and new build.

We would like to work closely with government to further exemplify the issues around the restrictions on capital investment. For the reasons above, we believe that there is a therefore strong case to continue to support housing investment in the short term. We understand that member authorities will be able to generate additional resources in the future as rents are retained locally but many of the pressures exist now. ARCH would like to have a constructive dialogue with government about how our members can bring forward investment through a sensible and sustainable combination of prudential borrowing and centrally provided resources to maximise the future value to the public purse.

ARCH is realistic in responding to the prospectus. Our members and their tenants can see the long term benefits of self financing and that these are significant, even when compared to the short term difficulties in capital finance. The total net debt take-on for ARCH members is c£4.5billion and this should give many members the opportunity to develop more robust management and maintenance plans from a very early stage.

ARCH understands that the current system would be further under-funded and even more debilitating in bringing forward long term plans. On balance, our view is that the proposals in the prospectus can be made to work, despite the short term challenges and we therefore look forward to working with government to facilitate an early and comprehensive introduction of self financing for April 2011.

In order to gain the benefits of longer term and more effective planning and asset management, it is absolutely critical however that the government accepts that the settlement is 'once and for all'. We recognise that for as long as council housing sits on the national balance sheet, the government has a legitimate interest in what happens to it. Ideally, the opening of self financing agreements should not take place in the future at all but, if there is to be scope to do so, the circumstances must be limited and set out definitively from the start.

In summary, the prospectus provides ARCH members and all local authorities with a long awaited (and overdue) chance to be able to take full control of decision making locally, to use the increased flexibility to better reflect tenants' aspirations and to have the financial resources and the opportunity to plan effectively for the long term. We urge the government to implement the proposals as soon as possible and further urge the government to ensure that capital resources are not artificially restricted and that settlements reflect the transfer of short term risk to local authorities.

Specific responses to the consultation questions are set out below.

***1. What are your views on the proposed methodology for assessing income and spending needs under self-financing and for valuing each council's business?***

General

ARCH supports the allocation of debt based on individual valuations of the net income stream arising from council housing. We would prefer the calculation to be undertaken on the basis of actual income and expenditure but accept that a methodology based on subsidy income and allowances is neutral at the national level and therefore has its attractions from an administrative perspective.

We support the valuation approach as it allows authorities to judge the implications of leaving the HRA subsidy system against staying in the system, such that if there is no unanimity between authorities (and we hope that there can be), self financing can still proceed for those who wish to at the earliest opportunity.

## Properties

Our members note the importance of ensuring that property numbers are accurate within the debt settlement and wish to avoid a situation in which debt is taken on for properties which have been cleared (or otherwise removed from debit). Our case study modelling showed one authority where proposed clearance was likely to be significant in 2010/11 and we would urge the government to find an equitable way of ensuring that authorities in this kind of position taking sensible asset management decisions are not penalised.

## Income

We note that the modelling has been developed on the basis that rents will converge under the current rent restructuring arrangements in 2015/16. Whilst we appreciate that some assumption had to be made and this is a national average, many authorities will not achieve practical convergence until after that date, in some cases this is many years into the future. We urge the government to reflect in the income assumptions the local position on caps and limits for all authorities, given that it is government policy both to meet rent convergence targets and to limit real term rent increases to £2 annually.

We welcome the retention of rent income locally but believe the government needs to go further to allow rents to be set locally. A greater degree of local determination of rents, and therefore service levels, would be more likely to foster effective local involvement, accountability and efficiency. We believe that giving local authorities the power to set rents locally, but under regulatory control, would protect the long term viability of self-financing and be in the best interest of tenants.

## Expenditure

ARCH welcomes the commitment to allow for uplifted allowances in the debt settlement calculations. We are unable to comment on the distribution of the uplifts between authorities but are generally in agreement with the principle of adopting a consolidated minimum uplift for all. Although we feel that this will leave some areas of essential service unfunded (notably the provision of adaptations for the disabled) on balance the methodology is acceptable. ARCH remains convinced of the case for further increases in allowances to meet practical day to

day spending needs and to ensure that the investment made in council housing in the recent past is protected for the future.

As set out above, we are concerned about the mechanism and quantum of the 'backlog' funding that has been highlighted as still a necessary part of the overall funding package for local authority housing. In addition to our comments above, we would support an approach in which the 'revenue' and 'capital' parts of the self financing settlement are integrated; we would therefore urge the government to explore the implications of an approach in which there is a reduction in debt settlements offset against immediate and future capital spending needs.

#### Other factors

ARCH has campaigned vigorously for a leveling of the playing field between stock transfer and stock retention and in this context we welcome the use of a discount rate of 6.5% in the debt settlement which is line with valuations for recent stock transfers. We further welcome the further concession to allow an increased rate for authorities on the basis that plans for new supply are brought forward. We trust that the government will resist the option to reduce the discount factor in the forthcoming Spending Review on the basis that authorities have carried out their modelling at 7%, have therefore assessed the implications on this basis and have responded on the basis that the debt allocations will be confirmed in the autumn, subject only to changes in property numbers. Amendment of factors such as the discount rate and uplift allocations for allowances would be a retrograde step and would threaten the basis for a voluntary process commencing on 1/4/2011.

The case study modelling undertaken for ARCH highlights that all of our members are likely to benefit in the longer term as rental surpluses are retained locally rather than pooled nationally. The proposed methodology and proposals for the actual debt allocations would appear to support a long term sustainable business plan for all of our case studies. Nevertheless, one of the six authorities was worse off in revenue terms in the short term and one authority was particularly affected by the proposal to wrap its PFI subsidy into the opening debt settlement.

Therefore, in accepting the general methodology and approach (including the proposed allocations), we also urge the government to review its approach to authorities in which debt is reducing but where interest rates are higher than the discount factor in the settlement, and the approach to existing PFI schemes which is counter-intuitive in that there is discounting of a revenue stream that is already discounted, and in any case runs counter to PFI policy elsewhere in the public sector.

## **2. What are your views on the proposals for the financial, regulatory and accounting framework for self-financing?**

### HRA balance sheet

ARCH welcomes the increased transparency that an HRA balance sheet would bring both to tenants within local authorities and to national agencies, regulators and government. We feel sure that authorities individually and the council housing sector as a whole will benefit in the long term from greater transparency which will highlight the obvious opportunities for greater investment which are prevalent in most authority areas.

We note from our members that there needs to be clarity on stock valuation policies and look forward to appropriate guidance from government and accountancy bodies in due course.

### Depreciation

ARCH recognises that one of the imperatives going forward is the establishment of an appropriate depreciation policy, backed by a developing major repairs (or appropriate cash-backed capital) reserve to make long term financial provision for future need. We ask simply that any such policy developed centrally be clear and simple to apply as well as compliant with accounting standards (including IFRS) and that it is shaped to align with the long term viability of the business plans developed by authorities. We must avoid a situation where depreciation policies inhibit the investment required in council housing in the short term and again look forward to appropriate guidance from government and CIPFA in due course.

### Debt separation

In supporting the move to an HRA balance sheet, ARCH would also support a more detailed debate about how the greater separation of General Fund and HRA borrowing as hinted at in the prospectus can be achieved. Authorities currently pool all debt and our members report that they would wish to retain flexibility locally as to how the separation was achieved. Ideally, our members report that they would want the option to either pool or de-pool depending upon the prevailing conditions at the time of the settlement as well as to manage any unintended consequences for the General Fund.

ARCH considers that treasury teams locally must be left with sufficient flexibility to manage the move to this position in the most effective way locally.

### Impact on General Fund

We note that, due to technical issues sometimes buried deep in the past, some members may experience adverse impacts on the General Fund as a result of the HRA proposals. We urge the government to explore all options, including amendment of technical guidance and documentation in order to avoid a situation arising where this settlement hits council tax payers, especially given the likely financial climate for local government in the future.

#### Ring fence guidance

In general, ARCH also supports the re-issue of the draft ring-fence guidance contained within the prospectus, especially in the context of encouraging greater transparency in the treatment of costs. Member authorities may differ in their responses on this issue and this will no doubt be based on their local circumstances. ARCH would reserve its position subject to those responses but we would want to see guidance issued which is for local stakeholders to interpret in the context of local circumstances, and that it should be used to inform local decisions and consultations with residents, who may wish to interpret the guidance more widely in some areas than others. We are not therefore convinced of the need for a 'schedule' of services which, while aiding transparency, could limit future flexibility to the detriment of tenants and council tax payers alike. In fact, such a list could encourage just the kind of contentiousness that the guidance is presumably seeking to avoid.

### ***3. How much new supply could this settlement enable you to deliver, if combined with social housing grant?***

As a representative body of local authorities, we are unable to offer direct evidence and leave it to our members to make their responses directly.

However, we welcome the commitment to find ways to facilitate the delivery of new council housing and would strongly encourage the government not to abandon the proposals to allow greater headroom for development as part of the self financing settlement.

The operation of the debt cap is of particular concern in that it might prevent investment in new housing which was sensible, sustainable and offered better value over the longer term. Similarly, authorities will require clarity from the HCA going forward about the level of grants rate that might be expected in the future to ensure that modelling is undertaken on appropriate bases.

### ***4. Do you favour a self-financing system for council housing or the continuation of a nationally redistributive subsidy system?***

ARCH believes that the existing national redistributive system is not fit for purpose and believes that a move to a locally managed self-financing system (with the appropriate building blocks in place to make it viable) is the best solution to continue to improve the lives and living environment of council tenants.

**5. Would you wish to proceed to early voluntary implementation of self-financing on the basis of the methodology and principles proposed in this document? Would you be ready to implement self-financing in 2011-12? If not, how much time do you think is required to prepare for implementation?**

ARCH recommends that, subject to local and technical considerations which might impact on some authorities, its members proceed to early implementation of self financing on the basis set out in the prospectus. ARCH would also want to opportunity to comment on the final assumptions and debt allocations (following the Spending Review) before taking a final position. We would urge the government not to amend the proposals prior to any 'final offer' (other than for property changes) as this could result in many authorities reconsidering their positions.

The practical arrangements for implementing self-financing would appear to be relatively straightforward provided the procedures around the handling of the changes in debt are clearly resolved. Provided that this is the case, ARCH can see no reason why all authorities and members could not be ready for full implementation in April 2011.

However, we recognise that substantial elements of guidance relating to the financial and accounting framework are yet to be put in place and we strongly urge the government, together with the relevant bodies (CIPFA and the Audit Commission) to bring forward proposals for consultation as soon as possible and in any case prior to any final offer. Authorities must have the opportunity to consider the implications of debt, depreciation and other policies prior to making a final commitment.

**6. If you favour self-financing but do not wish to proceed on the basis of the proposals in this document, what are the reasons?**

No response required