



ASSOCIATION OF RETAINED COUNCIL HOUSING SUBMISSION

Reform of council housing finance: consultation

October 2009

1. Introduction

- 1.1. 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. Further, these local authorities are represented by all political parties.
- 1.2. 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.
- 1.3. We therefore support the government's commitment to radically overhaul the financial system for council housing and strongly support the move to dismantle the invidious and outdated Housing Revenue Account (HRA) subsidy system. We support a move to self financing in which the resources generated from housing locally are invested locally and look forward to working closely with the government to bring forward a meaningful series of proposals to enable our members to implement sustainable self financing HRAs now that it has accepted the case for them.
- 1.4. Our response, set out below, summarises the key principles our members wish to see adopted within the new system and during the process of transition. We have also addressed each of the questions in detail as requested within the consultation paper.
- 1.5. In shaping the response ARCH has conducted a detailed exercise to consult its members, including an analysis of the possible financial implications for our members in summary and for a series of detailed case studies. We held two events (in late September and early October) with a total attendance of over 130 delegates in which the principles of our response were debated and agreed.
- 1.6. In addition ARCH held a meeting of its Tenants' Sub Group in September to outline the proposed changes to the group and gather feedback on the views of its tenants. The key points from this discussion have been incorporated into this response.

2. Summary: the key principles of our response

- 2.1. ARCH believes that there is a strong case for releasing local authorities from some or all of the historic debt sitting within the current system, in order to free up revenue streams for investment in new and existing stock. We note that over £3billion of housing debt has been written off since 2003 to secure stock transfers. Our preferred position would therefore recognise the potential that debt write off has to release capacity for investment and to match the government's commitment to 'level the playing field' between self financing and stock transfer.
- 2.2. However, ARCH members recognise that all indications from the Government are that it is unlikely to accept this argument and will not therefore agree to any write off of debt for stock retained authorities, particularly given the political imperative (from all parties) to manage the future level of public sector debt. Our members therefore believe that a more pragmatic approach is required in discussions with government about debt allocation.
- 2.3. To this end, ARCH and its members are willing to work together and with central government to reach an equitable settlement which provides councils with the potential to develop long term, viable business plans that deliver sustainable homes and communities. Our willingness to work closely with government was signalled at our event on 5th October 2009 at which Communities and Local Government (CLG) officials were present.
- 2.4. We look forward to receipt of detailed proposals from government on the allocation of debt between authorities. Until our members have had the opportunity to model detailed proposals at the local level, we are unable to comment on how the debt settlement would work for individual authorities.
- 2.5. We recognise that there is a need to apply a formula to the determination of the debt settlement in order for the current system to be discontinued. Our members require a replacement of the subsidy system based on a formula that is fair, sustainable and allows local control to be developed and exercised immediately.
- 2.6. ARCH believes that it is important to achieve consensus and to avoid scenarios in which there are 'winners' and 'losers'. A feature of the current subsidy system is that all authorities are effectively losers of differing degrees. Providing that there is a fair and equitable settlement, we believe that there should be no authority that is financially worse off under the new system.
- 2.7. A modelling exercise on behalf of our 56 members was undertaken in which a series of possible debt allocation scenarios were calculated. This found that, on the basis of the proposals in the consultation paper, the average debt of ARCH members is likely to be in line with the national average and might be around £14-15k per property. However, these calculations also highlight a large variation between highest amount at £28,000 per property and the lowest at £5,700. The way in which the formula is shaped and the debt settlement is calculated is critical to

making self-financing proposals work. Self-financing business could be sustainable at certain levels of debt settlement, but not at others.

- 2.8. The exercise found that variations in the date of rent convergence, assumed interest and discount rates, and the level of uplift in allowances and capital grants are all vital elements to be considered in shaping a truly long term sustainable self financing business plan.
- 2.9. Our members are pragmatic and recognise the need to replace negative subsidy with debt or reduce debt in lieu of positive subsidy. However, the local control the proposals would bring must be at a price councils can afford in order to be sustainable. Self financing should mean 'the power to self finance' based on a settlement that enables all authorities to achieve their tenants' objectives. Viability cannot unduly rest on a continued requirement for central support given the likely major future funding uncertainties.
- 2.10. Therefore, overall ARCH supports a move to self-financing as a viable option but swift clarification on the crucial variables is required. We are committed to working with the government to develop these key factors and welcome dialogue at all stages during the forthcoming implementation process.
- 2.11. Our detailed responses to the questions below summarise the outcome of our consultation events.

3. Response to Individual Questions

Question 1: "We propose that the HRA ring fence should continue and, if anything, be strengthened. Do you agree with the principles for the operation of the ring fence set out in paragraph 3.28?"

- 3.1. ARCH members agree that a separate ring-fenced landlord account should continue. There has been a growing lack of clarity to the current system which has built up over many years as estates have become more multi-tenure and housing services more diverse.
- 3.2. We broadly agree with the principles set out in the consultation paper and that standards to be set by the Tenant Services Authority (TSA) should have to take into account both the impact on tenants and be based on the exercise of tenant choice and influence.
- 3.3. In our experience, tenants tend to support the strengthening of the ring fence on the basis of the key principle that council housing income should be spent on council housing. There are also many examples of tenants groups opting to support wider neighbourhood initiatives on the basis of the well being of the whole community.
- 3.4. In addition, the widening diversity of services (such as Anti Social Behaviour, Neighbourhood Management, measures to tackle worklessness) provided by local authorities and the widening needs of tenants and residents make rigid demarcations potentially unhelpful.

- 3.5. ARCH recognise and support the need to ensure that strategic housing services are clearly defined and accounted for as General Fund activities. We also recognise the key role the Tenant Services Authority could play in assessing the costs and funding for different types of services. Any linking of regulation to HRA or General Fund financing must however be seen in the context of local tenant and resident empowerment.
- 3.6. Authorities should therefore have the local flexibility to respond to the needs of communities and the need to address the 'whole place' agenda. Our members want to see clarity and transparency rather than prescription and we urge the government to reflect these principles in updated guidance when it is issued.

Question 2: Are there any particular ambiguities or detailed concerns about the consequences?

- 3.7. ARCH welcomes the recognition that the current system under-funds management and maintenance. We urge the government to reconsider the findings of the research undertaken and to bring forward proposals to uplift allowances by 10% to bring financing into line with housing associations.
- 3.8. Many of our members report ambiguities in the financial treatment of housing services where there is a case for charging to either the General Fund or the HRA. We urge the government to address these ambiguities and uncertainties through its updated guidance.

Question 3: We propose funding the ongoing maintenance of lifts and common parts in addition to the Decent Homes Standard. Are there any particular issues about committing this additional funding for lifts and common parts, in particular around funding any backlog through capital grant and the ongoing maintenance through the HRA system (as reformed)?

- 3.9. ARCH recognises that there are widespread and acknowledged shortfalls in the Major Repairs Allowance (MRA) as evidenced by virtually every stock condition survey undertaken by local authorities. We welcome therefore the Building Research Establishment (BRE) research into finding a better funded solution and welcome the commitment of the government to uplift the Major Repairs Allowance in the debt settlement to cover lifts and common parts.
- 3.10. ARCH is however concerned that the BRE's recommended increase in MRA was substantially in excess of 24% and do not believe that the case for a lower uplift has been successfully made by the government.
- 3.11. The reality for many authorities, particularly retained management authorities with reducing receipts (or where receipts are utilised for General Fund capital purposes), is that the only realistic capital resource available to them has been the MRA. Therefore, the distinction between the capital needs arising from 'backlog' and those from 'ongoing need' are largely irrelevant in this context – the MRA is the only resource available. We believe that, at the very minimum, the backlog element should be added back into the MRA uplift for debt settlement (ie to make it 43%) as

this would give authorities the best chance of developing a sustainable self financing business plan.

- 3.12. Our modelling exercise found that if average assumptions were made towards a 24% uplift, business plans may run into difficulties and rely therefore on an allocation of capital grants, whereas uplifts nearer to those recommended could largely be sustainable with a much lower call on capital grants by a much lower number of authorities.
- 3.13. We recognise that the allocation of the uplift in MRA could potentially differ for each authority and urge the government to publish an authority-by-authority estimate as soon as possible so that members are able to assess the financial issues for themselves.
- 3.14. ARCH welcomes the recognition of future capital expenditure needs within the proposals and notes that there will be a minority of authorities where there will be a need for additional capital investment, centrally provided, in order to make business plans work. In a sense this is similar to the provision of dowry funding for stock transfers.
- 3.15. However, we are concerned that the figure placed on these needs (£6billion) will prove insufficient given that the experience of many of our members is that there may be significant unmet needs that have been masked by the focus on the decent homes standard in the recent period.
- 3.16. We also urge a degree of clarity over the future allocation mechanism for capital grants. Whilst the consultation paper makes reference to stock condition surveys for each authority, it is by no means clear how these might inform either the settlement or the future financing of investment.

Question 4: Is this the right direction of travel on standards and do you think the funding mechanisms will work or can you recommend other mechanisms that would be neutral to Government expenditure?

- 3.17. ARCH supports the continuation of a national minimum standard but recognises that tenants and residents will want to set additional local standards in conjunction with their landlords. We look forward to reviewing the proposals from the TSA towards its new standards framework and believe that it is right for the TSA to regulate those standards in the context of overall direction from government.
- 3.18. However, we are concerned that whilst some elements of the BRE research report are proposed to be funded (either through the MRA or through proposed capital grants), there are other elements which remain under-funded, principally those relating to disabled adaptations and Housing Health and Safety Rating System (HHSRS) related investment.
- 3.19. The consultation paper acknowledges the difficulties in committing to the financing of the rising liabilities in this area. A classic example of this is that a utility company has recently advised a local authority that it should replace water supplies consisting of lead pipes to all its stock. The cost would be £2m and no account of these type of issues has been taken into account as part of the formula.

- 3.20. Nevertheless, ARCH feels it is essential that the government finds a funding solution for these areas in the future, particularly given the rising demand for disabled adaptations from an ageing and increasingly frail population. The reference in the consultation to offsetting locally retained capital receipts is not satisfactory given the current and likely future levels of Right to Buy generated capital receipts.
- 3.21. We feel there may be merit in pursuing an approach in which these liabilities are rolled into the settlement, allocating resources via an increased uplift to allowances, particularly as the rising demand on disabled adaptations is likely to be consistent across the country. This approach could reduce the long term call on centrally financed grant and provide the necessary headroom for authorities to self finance expenditure locally.

Question 5: We propose allowing local authorities to set up sinking funds for work to leasehold stock and amending HRA rules to permit this. Will there be any barriers to local authorities taking this up voluntarily, or would we need to place an obligation on local authority landlords?

- 3.22. ARCH members differ in their views of sinking funds for leaseholders. Whilst sinking funds are a sound suggestion in theory, those authorities with large leaseholder portfolios tend to the view that the time to legislate in this area may have passed, particularly given that much investment has already been committed through the decent homes programme and that leases may need to be changed retrospectively, a process which would be time consuming, expensive and contentious.
- 3.23. ARCH therefore favours the exercising of local flexibility by authorities in consultation with their leaseholders.

Question 6: We propose calculating opening debt in accordance with the principles set out in paragraphs 4.22-4.25. What circumstances could lead to this level of debt not being supportable from the landlord business at the national level?

- 3.24. It is important that the calculation of debt settlement allows authorities to develop long term sustainable and financially viable business plans which meet the needs of the stock, communities and rising expectations of service standards from tenants. Self financing cannot be a system in which the government passes all risks and liabilities to local authorities without providing a realistic basis for their funding.
- 3.25. Whilst we see the logic of a Tenanted Market Value (TMV) approach to securing the debt settlement, and support the principle that debt allocation should be made on the basis of an assessment of need balanced by the rental income resources available in the future, it is difficult to comment on the principles of the settlement without seeing the potential outcomes for individual authorities.
- 3.26. ARCH notes the favourable assumptions made in TMV calculations for stock transfer proposals and supports the use of similar assumptions in bringing forward the self financing settlement.

- 3.27. The modelling work undertaken to inform this response has highlighted that there will certainly be circumstances in which the opening debt could not be sustainable for self financing plans, either locally or nationally.
- 3.28. We understand that the current level of supported debt in the subsidy system amounts to around £20billion (including all ALMO borrowing to 2009). As this amount of debt is part of a system which is already in surplus, ARCH favours an allocation of debt for self financing which is consistent with this amount. We neither support, nor believe that there is an equitable case for supporting, an increased level of debt in the system, even in the short term.
- 3.29. At the national level, the principal consequence of allocating more debt than is currently supported would be to push the entire system into deficit and enforce reliance on borrowing to support investment that would otherwise be fundable through revenue. We feel sure that the government can foresee the multiple problems associated with such an approach including the possible prospect that the system as a whole is not then able to finance future needs.

Question 7: Are there particular circumstances that could affect this conclusion about the broad level of debt at the district level?

- 3.30. The allocation of more debt than is currently supported in the system would mean that a council's self financing business plan would almost inevitably be worse off than their current plan in the early years. Such an approach might also mean that authorities need to rely unduly on further and additional borrowing and/or capital grants thereby undermining the principle of self financing. A self financing HRA must be able to sustain the investment needed as authorities will not be able to turn to other agencies (ie the government) for assistance.
- 3.31. A series of case studies carried out for ARCH support this conclusion: at self financing settlements which reflect the average reallocation of the current level of national debt, business plans are generally sustainable and viable. At levels of opening debt greater than this, viability quickly reduces.
- 3.32. It is essential that debt settlements are actioned as an adjustment to the existing level of supported debt (including ALMO allocations) so that headroom built up by HRAs locally is retained in the new system going forward.

Question 8: We identified premia for repayment and market debt as issues that would need to be potentially adjusted for in opening debt. How would these technical issues need to be reflected in the opening debt? Are there any others? Are there other ways that these issues could be addressed?

- 3.33. ARCH understands that in cases of overhanging debt write off for stock transfers, the cost of premia and other transaction costs are not borne by the landlord business plan. Therefore, given the commitment elsewhere in the consultation paper to providing a similar level of support to self financing and stock transfer, we therefore see no case for loading premia costs into the debt settlement. Any such move would mean that council

tenants would bear the cost of premia while tenants of stock transfer landlords do not.

- 3.34. In addition, the inclusion of debt redemption premia in the debt settlement risks making self financing business plans less sustainable by reducing the resources available locally for investment.
- 3.35. We would caution against any general assumption within the settlement of redemption or reassignment of market loans. Member authorities report unwillingness on the part of banks to reschedule loans in the current climate.

Question 9: We propose that a mechanism similar to the Item 8 determination that allows interest for service borrowing to be paid from the HRA to the general fund should continue to be the mechanism for supporting interest payments. Are there any technical issues with this?

- 3.36. ARCH believes that there can be no adverse impact on General Funds arising from the move to HRA self financing. As is acknowledged in the consultation paper, there could be indirect consequences from the increase or reduction of debt depending on the range and type of loans redeemed or issued and the interest rates prevailing in the market at the point of settlement.
- 3.37. As a matter of principle, any adverse impact on General Funds should be made good through the process of the settlement and we would welcome early proposals from government on the mechanism they intend to adopt. Whilst there may be some merit in seeking support from HRA's where average interest rates are lower as a result of the settlement, we would caution against adopting a blanket approach. Interest rates and the mix of loan portfolios vary considerably and the government is unlikely to achieve a 'one size fits all' approach.
- 3.38. For some authorities, it might be appropriate for increased debt to take the form of a single, low cost, long term Public Works Loan Board (PWLB) loan and there could be attractions at making the settlement in today's benign interest rate environment; others may see more benefit in the taking on of a mixed loan portfolio. ARCH believes that the settlement process should be designed to allow maximum flexibility in allowing authorities to achieve value for money in future treasury management.

Question 10: Do you agree the principles over debt levels associated with implementing the original business plan and their link to borrowing?

- 3.39. ARCH members agree with the assessment in the consultation paper that debt will fall or rise in line with an expected initial business plan and we can confirm from the case study work that was undertaken that this is the likely pattern of borrowing in self financing plans.
- 3.40. We note that in each of these cases there is an expectation of some borrowing to meet needs in the post-settlement period and that it will be essential to secure a self financing plan that allows authorities to borrow accordingly.

- 3.41. We also note that borrowing patterns may quickly vary from the 'original' plan given changes in assumptions, changes in economic variables such as inflation and changes in the needs of the stock. Authorities must not be constrained from taking reasonable steps to meet needs through borrowing provided the investment is affordable over the lifetime of a business plan.
- 3.42. The only consideration should be whether the borrowing is affordable from future rental streams. ARCH supports the application of the Prudential Code as the overall means of managing future borrowing and believes that no more comfort at the national level is required. Failure to recognise such an approach would be to undermine both the principle of self financing and the effectiveness of the Prudential Code.
- 3.43. We recognise that no business can sustain uncontrolled borrowing and note the safeguards in place within housing associations through the role of funders and regulator. ARCH believes that there is a potential role for the TSA to assist authorities in promoting the long term sustainability of their plans though the experience gained in regulating associations and through making comparisons between the debt levels between sectors.
- 3.44. ARCH members remain concerned that the unreasonable constraint of future public sector borrowing would adversely affect the ability to sufficiently manage a self financing HRA. Such unreasonable restrictions would prevent the creation of a level playing field with Registered Social Landlords (RSLs) whose spending would still remain off the balance sheet.

Question 11: In addition to the spending associated with the original business plan, what uncommitted income might be generated and how might Councils want to use this?

- 3.45. As self financing business plans would be set out over 30 years, it is difficult to be precise about the range of different income benefits and expenditure challenges which could move the plan away from its original assumptions. However, it is not difficult to envisage that there could be additional income through non-rent charges, investment into new build and development and through becoming more efficient in service delivery.
- 3.46. It is not unreasonable that authorities and tenants locally would want the opportunity to reinvest income into raising service standards, regeneration, redevelopment and new supply, or a combination of all of these. ARCH believes that the only meaningful test that should be applied in these circumstances should be on the affordability of investment over the lifetime of the plan – and no additional or artificial barriers to investment placed on authorities.

Question 12: We have set out our general approach to capital receipts. The intention is to enable asset management and replacement of stock lost through Right to Buy. Are there any risks in leaving this resource with landlords (rather than pooling some of it as present)?

- 3.47. ARCH welcomes the proposal to allow the retention of Right to Buy (RTB) receipts locally. We believe that this is long overdue and that it should be

brought forward as soon as possible within the next update of the Capital Financing Regulations.

- 3.48. We do not believe that there are any risks in leaving decisions about receipts locally. On the contrary, ARCH believes that the pooling of RTB receipts from HRA authorities for expenditure in areas where authorities have transferred their stock is wholly inequitable, particularly as the receipts from transfer authorities and their landlords are already retained locally.

Question 13: Should there be any particular policy about the balance of investment brought by capital receipts between new supply and existing stock?

- 3.49. ARCH members believe that local people are best placed to take decisions about the use of receipts locally. For some authorities, reinvestment could be prioritised towards new build, for others the priority may be the retro-fitting of existing stock.
- 3.50. However, we believe that it is appropriate to protect the reinvestment of the unpooled 75% element into affordable housing, be that for General Fund or HRA programmes. Local authorities, in conjunction with their tenants and residents, are best placed to take the decisions on the balance of investment going forward and able to respond flexibly to changing needs locally.

Question 14: Are there concerns about central Government giving up receipts which it currently pools to allow their allocation to the areas of greatest need?

- 3.51. ARCH members do not share concerns over the government 'giving up' receipts. Our members' experience is that the current level of receipts will meet a very small proportion of the capital spending needs either of their own stock or in other housing capital programmes. All authorities will need to see their stock and investment needs met in self financing plans.

Question 15: Would any of our proposed changes have a disproportionate effect on particular groups of people in terms of their gender or gender identity, race, age, sexual orientation, religion or (non-political) belief and human rights?

- 3.52. We do not believe that the proposals within the consultation paper are directly discriminatory in themselves towards any of the groups referenced in the question.
- 3.53. The absence of a firm commitment to finance future costs of disabled adaptations might however be deemed as impacting disproportionately on the elderly and vulnerable, particularly given the rising demand for such adaptations. ARCH urges government to address this issue and suggests that information should be collected from all local authorities to enable

future liabilities to be more accurately identified so as to inform proposals as to how this need can be met.

- 3.54. Overall, ARCH believes that council tenants have been treated unfavourably compared to their housing association counterparts and that the tenants of retained management councils have received a lower proportion of resources than those of tenants where the authority has an ALMO. The government now has the opportunity to address some of these imbalances and set council housing on a sustainable long term future in which authorities can adequately support the needs of all the diverse groups of tenants that live in council housing.

Question 16: What would be the direction (positive or negative) and scale of these effects and what evidence is there to support this assessment?

- 3.55. The potential effect of not fully funding disabled adaptation works will clearly be negative but until financial business plans are completed it is too early to quantify the effect on each authority.

Question 17: What would be necessary to assemble the evidence required?

- 3.56. The government could use the process of collecting stock condition survey information to support long term plans as a means to collect information about the potential long term trends in the cost of disabled adaptations and other direct investment for vulnerable tenants.
- 3.57. The increasing diversity of service provision with enhanced levels of personal support can also provide a useful bank of evidence on the increasing vulnerability of council tenants. Many authorities collect data on the status of their tenants and comparisons can be drawn between the incidence of vulnerability and disability in the council stock compared to the average of the country.
- 3.58. ARCH supports all agencies in wishing to eliminate all forms of discrimination and feels sure that the government will want to reflect the fair and equitable treatment of council tenants in the reformed HRA system at this critical time of major financial change.