Appendix 1

Government Consultation Paper on the Reform of Council Housing Finance

In 2007/8, the Council paid around £8.7m to the Government in negative housing subsidy – funded from the Council's tenants' rents. This equates to around £1,350 per annum (£26 per week) per tenancy, including tenants in receipt of housing benefit.

The Government has recently issued an important Consultation Paper on its proposed reform of the housing finance system, which will have major financial implications for the Council's Housing Revenue Account – and how much the Council pays the Government.

A proposed response to the Consultation Paper will be considered by the Cabinet at its meeting in October 2009. However, it is considered appropriate that all members are aware of the proposals and issues on this matter.

The Government says that the Consultation Paper is the result of a detailed investigation into the operation of the council housing finance system. It has drawn extensively on the input from a variety of organisations and individuals and, the Government says, has been underpinned by a strong evidence base.

The Consultation Paper is divided into five sections:

Section 1 - describes the background to the review, its terms of reference, working methods and the ways the Government has engaged with stakeholders.

Section 2 provides an overview of the current system for financing council housing, covering the ring-fenced landlord account (the Housing Revenue Account) and the system for redistributing income between councils (the Housing Revenue Account subsidy system).

It describes the current distribution of housing debt within the system and the rules that apply to capital receipts and borrowing.

It also provides an overview of the Decent Homes Standard and social rent policy.

Section 3 covers the future costs and standards of council housing. It describes the allowances within the current system and the evidence gathered during the review about the need to spend in future.

It proposes changes to the framework for allocating costs between the Housing Revenue Account and a local authority's general fund. It sets out a proposal for continuing the Decent Homes Standard in future and how the Government might address energy efficiency.

It also proposes changes to the Housing Revenue Account which would allow sinking funds to be set up for works to leaseholders' homes.

Section 4 describes the options for fundamental reform of the council housing finance system. It covers improvements to the current system which would reduce volatility and improve long term planning – in particular through multi-year subsidy determinations and/or debt allocation.

It also sets out an option for a devolved system – self-financing – which would remove the need for redistribution of revenues in return for a one-off allocation of debt. It describes methods for assessing the level of debt each council would be required to support under self-financing and how this debt would be allocated. It also identifies some potential costs to the general fund from debt allocation and how these could be mitigated or funded.

In addition, Section 4 sets out proposals for managing the amount of new borrowing councils might undertake under self-financing, so that this is consistent with overall public borrowing and spending policies. It considers risks arising from self-financing and how these could be managed. It also includes a proposal to end the pooling of capital receipts, subject to a condition that the currently pooled amounts are reinvested locally in housing.

Finally it describes the implications of the proposed changes on disabled adaptations, on transfer and arms-length management organisation (ALMO) policy and programmes and on local housing companies. It also invites views about any impact on equalities.

Section 5 covers implementation of the proposed reforms. It describes the measures being taken immediately on new council homes in order to remove disincentives to council house building, the powers which would be required to implement self-financing across all councils and stock, and an indicative timetable for implementing the revenue and capital reforms

The following explains in more detail the proposals that will have implications for the Council.

Local authority leaseholders – service charges and sinking funds

The Government's review looked at the issue of leaseholders and the substantial costs that some have incurred from improvements to meet the Decent Homes Standard.

A sinking fund is a reserve of funds that can be built up from contributions from leaseholders (service charges) and used for a number of purposes. Whilst often used to cover expenditure which may be incurred fairly infrequently, such as large scale works, it can also be used to meet other costs that are incurred more frequently, such as redecoration of the common parts. The use of sinking funds allow contributions from leaseholders towards the cost of such works to be spread more evenly over a longer period rather than the full amount being demanded all in one go.

There are a number of reasons why the vast majority of local authorities do not operate sinking funds at present.

The Consultation Paper states that, for *future* sales, the Government will undertake further work to investigate whether:

- the sale price can be adjusted to include a lump sum that covers costs of outstanding work on the property, allowing the local authority to place this element of the sale price in a sinking fund for the property
- provisions allowing for the collection of sinking fund contributions can be introduced into the standard leasehold contract
- more information can be provided for leaseholders on their responsibilities for contributing towards costs of repair and maintenance of the building containing their property and any other estate or communal costs.

The Government will encourage local authorities to establish sinking funds - where they are supported by leaseholders - and will provide more information to encourage leaseholders to make use of sinking funds.

Options for fundamental reform of the system

The Consultation Paper reviews a range of options for reform within two broad models for financing council housing in future:

- **improvements to a national system for funding council housing** in which revenues continue to flow between local and central Government as a result of ongoing assumptions made by Government about landlord costs and income

- **a devolved system (self-financing)** in which rents are retained by councils to spend on their own services, in exchange for a one-off reallocation of debt

All the options share a number of characteristics:

- costs, standards and rents would be based on the same principles.

- local authorities would be required to draw up 30 year business plans based on updated stock condition surveys following the completion of their Decent Homes programme

- all housing capital receipts would be retained locally and would be accounted for alongside housing revenues

A key criticism of the current system is the unpredictability and volatility inherent in an annual subsidy determination process. This, it is argued by councils, makes it hard to plan long term.

The Consultation Paper suggests that one option for addressing this issue would be to move to longer determination periods, of between three to five years, during which time assumptions made about costs and income would not change. This, the Government claims, would facilitate better management and enable plans for maintenance and repairs to be drawn up and adhered to with greater certainty than currently applies. It should also assist procurement, and in practice would improve the incentives for local authorities in running the stock.

Re-allocation of Councils' Debts

Although Epping Forest DC is "debt free" – as are many other local authorities, a number still have substantial housing debt. It has been suggested by the LGA and a number of debt free councils that the Government should pay off all the housing debt held by local authorities (currently in excess of some £18bn), leaving rents to support only the day to day running costs of the stock. However, the Government states that, since this debt was incurred in building and maintaining council housing, it is right that it should continue to be serviced from council rents. It feels that it would be unaffordable and unfair to ask the general taxpayer to support this debt in future.

The Consultation paper comments that the Government could allocate the housing debt of those councils that are not debt free, between **all** local authorities - to leave all councils with a level of debt in proportion to the value of their stock. Besides removing a main driver for revenue redistribution, it would also allow the subsidy position of each council to more closely reflect the relationship between its rental income and the running costs of its stock, providing greater transparency. The Government expresses the view that, while re-allocation of debt is likely to be contentious with debt-free and low debt authorities, those councils will already be supporting debt in other councils through the subsidy system and should be no worse off over time. Rather than indefinitely paying the interest on debt held elsewhere under the current system, these councils would instead have debt that they could manage themselves.

The Consultation Paper explains that an alternative to reallocating debt between all councils, would be to take debt into central Government and instead to charge each council for the cost of servicing an amount equal to the sum they would have been allocated. This would address concerns by councils about taking on debt. It would however require an ongoing relationship between local authorities and central Government in making annual payments. The Government says that one attraction of this approach might be that these payments could be adjusted to reflect changes in interest rates or other factors which related to the ability of councils to pay. The risk is that this would evolve over time into another mechanism for adjusting incomes – not dissimilar to the current subsidy system.

A national ring-fence could ensure that all the money paid into the system would either be redistributed to authorities with deficits or, if there was a national surplus, reinvested in housing. This could provide further transparency about how tenants' rents are used.

Self-financing options

Under self-financing, each local authority would keep the money raised locally from rents and use it to run their stock. This option would require a one-off reallocation of housing debt in order to put all councils in a position where they could support their stock from their rental income in future. The Government says that, without this reallocation of debt, some councils would either have to cut services or increase rents. But with this settlement on debt, the Government's research found that rents set in line with current social rent policy would generate sufficient income to sustain the stock in all local authorities at the higher funding levels.

Under self-financing, the Government would move to what it considers to be a sustainable funding model for council housing. It considers that councils will have enough money from the rental income from their stock to be able to service debt over time and to pay for ongoing maintenance at the Decent Homes Standard, as well as works needed to maintain lifts and common parts. Because of this certainty of funding, councils will be able to plan ahead for works and procure them efficiently.

Housing debt would be allocated to councils on the basis of each council's ability to service it. In principle, the total debt allocated to councils under self-financing could be higher or lower than the current level of debt in the system. This would depend on the value to the landlord of the stock, which in turn is determined by the assumptions made about future costs and rental income.

The opening debt level would be one based on the tenanted market value of the stock.

The principle of debt allocation is that it should achieve neutrality with the subsidy position, to the extent that this can be achieved in commuting an income stream into a capital sum. The Government envisages that the value of the landlord business would be based on the present value of the cash flows in the business – excluding any existing housing debt. If this value was lower than the current notional debt supported by subsidy, a payment would be made by the Government to the Council, sufficient to reduce the notional debt to the level of the valuation. If the value of the stock was higher than the current notional debt level, new debt would be imposed on the council to bring it up to the level of the valuation.

Capital Receipts

Redistribution is also currently applied to capital receipts through the 'pooling' rules. Under pooling, councils are required to pay the Government 75% of the receipts from Right to Buy sales and sales of other HRA assets. Pooled receipts are used by the Government centrally to support other national housing and capital programmes. The Government recently announced changes to the treatment of capital receipts arising from the sales of ***new*** council housing. This now allows councils to keep the full receipt from those sales provided that they are used for affordable housing and regeneration.

The Government considers that there are strong arguments for allowing councils to retain all of their capital receipts i.e. to end pooling of housing receipts.

The main justification for pooling has been that receipts do not arise in the areas that need new capital investment most. It has also been argued that, as central Government provided a large part of the investment to acquire many of these assets, it is right that Government should benefit from a share of the receipt. However, if councils take on direct responsibility for supporting the debt on their operating assets, the Government considers it sensible that councils should also keep the capital receipts arising on disposal of those operating assets.

However, the Consultation Paper states that councils could be required to reinvest some or all of these receipts in new supply or regeneration (particularly where the receipts arose from a sale of a social home). The Government says that this would help ensure that the receipts continued to be reinvested in housing programmes, and in particular new supply.

The Government's preference is to allow local authorities to keep 100 per cent of their Right to Buy receipts, keeping the local discretion over how the 25 per cent currently retained is split between the general fund and the HRA assets, but requiring the additional 75 per cent to be reinvested in housing.

Timetable for changes

Depending on the outcome of this consultation, the Government says that it would wish to move swiftly to have a self financing option up and running.

The Government's current powers allow for individually negotiated agreements between local authorities and central Government to exclude specified stock from the HRA subsidy system. This could, in principle, be used to bring about voluntary self financing. However, to achieve this, the Government says that there would need to be:

- an agreement about the costs of running the stock at the local level
- an understanding about the operational practicalities of the HRA ring fence in the context of self-financing; and
- any significant transaction costs from taking on or writing off debt to be reflected in the proposed debt settlement

The Government considers that it would be possible to set out the terms of such an offer by Spring 2010, subject to satisfactory working with local authorities. However, the Government does not consider it practical to conduct negotiations with over 200 local authorities. So this could only work if all stock owning authorities accepted the terms.

If agreement amongst local authorities could not be brought about, then the Government would need to secure primary legislation to achieve a national settlement. Subject to parliamentary time, a self financing system could be legislated for, and be in operation from, 2012-13.

A copy of the full Consultation Paper can be obtained on line from:

www.communities.gov.uk/housing/decenthomes/councilhousingfinance/housingfinancereview