Starving Council Housing of funds

Time to re-address the Council housing 'debt settlement'

In April 2012 a new Council Housing finance system, 'self-financing', was introduced. The system had been designed by the New Labour government but was introduced by the coalition government. Housing Minister Grant Shapps said that the new system would "give Councils the resources they need to manage their own housing stock for the longer term - correcting decades of under-funding". In fact under-funding was not corrected but built into the new system (see Appendix). Councils did have more money than they had under the previous system because what was known as a 'negative subsidy' was ended. In 2005 the Audit Commission reported that 82% of local authorities were subject to 'negative subsidy', meaning they received no subsidy and had to make a payment to central government from their rent income. According to the Audit Commission this comprised some £630 million a year. Whilst some of this was redistributed to other Councils, in the four years from 2008 tenants' rents *subsidised the Treasury* to the tune of almost £1.5 billion[1]. It was predicted that if the old system, the 'housing subsidy system', continued, then eventually all local authorities would suffer from 'negative subsidy', largely as a result of year on year rent increases above the level of inflation.

Most Councils supported the introduction of 'self-financing' because of the ending of 'negative subsidy'. However, there was a price to pay. In winding up the 'housing subsidy system', the government introduced a 'debt settlement'. What was said to be the national housing debt was split between local authorities which still owned housing stock.[2] The term 'debt' implies that this was money borrowed. However, this was not the case. Much of the 'historic housing debt' (the original borrowing to pay for the cost of building programmes) had long since been paid off. A government document explained how the 'debt' for the 'debt settlement' was determined.

“In order to bring about this change, there will be a readjustment of each local authority’s housing debt. This will give each local authority a level of debt it can support, based on a valuation of its council housing stock. If this valuation is lower than the amount of housing debt which is currently supported through the Housing Revenue Account subsidy system, Government will pay off the difference. If the valuation is higher than the debt supported by Housing Revenue Account subsidy, the local authority will be required to pay Government the difference."

When they carried out the calculations on this basis, 136 authorities had to take on extra debt whilst 34 received payments from the government to reduce their debt. Those that had to take on extra debt were given a 'loan' by the Public Works Loan Board (an executive agency of the Treasury) which they 'paid' to the government. It was of course a paper transaction between the PWLB and the Treasury. The Councils have to repay the 'loan' to the PWLB, together with annual interest charge. The 'debt settlement' produced an £8 billion surplus which the Treasury pocketed.

Moving the goalposts

1 UK Housing Review 2015.

2 You can find the level of debt your local authority was given here: http://www.gov.uk/government/uploads/system/uploads/attachment_data/file/6252/2077606.pdf

To prepare for 'self-financing' Councils had to draw up 30 year 'business plans'. Under 'self-financing' the only income Councils receive is the rent their tenants pay[3]. There was no government subsidy. This was why it was called 'self-financing'. The business plans were based on, amongst other things

- An estimate of the rental income over 30 years. Councils had to follow the national rent formula: an increase in line with the retail price index (RPI) plus 0.5% + a maximum of £2 extra per week[4];
- An estimate of the management and maintenance costs;
- An estimate of the number of homes that would be sold under 'right to buy'.

Calculations over such a long period are necessarily algebraic, very rough estimates based on many variables including inflation rates. Any changes resulting in the loss of income would therefore have an impact on the amount of work that Councils could do on their housing stock. Even if you ignore the question of whether or not the funding levels were adequate when 'self-financing' was set up, what is clear is that changes the government has introduced since 2012 have *undermined the financial basis of the business plans*. The 'debt' that each Council received was based on the estimated value of their stock, in large part determined by rental income over the life of the business plan. Further proposals which the new Tory government are seeking to introduce will blow an even bigger hole in the finances of Councils' Housing Revenue Accounts.

- Firstly, the coalition government decided to replace the previous rent formula with a new one; an annual increase of CPI plus 1%. This meant that the income on which the 'debt settlement' was based would be less than estimated in the 30 year business plan. Yet the government offered no compensation to Councils. Both Councils and Housing Associations complained about this. Unfortunately, instead of pressing for a reduction of the 'debt' as a result of the loss of income, most of them demanded the right to continue raising their tenants' rent higher than the CPI + 1% formula would allow.

- Secondly the coalition changed the basis of 'right to buy' (RTB) legislation, increasing discounts available and cutting the qualifying period from five to three years. As a result there has been a large increase in RTB sales. Councils therefore lose the rent income from those properties over and above the original lower estimate of sales. Sales were less than 3,000 a year prior to 'self-financing' but increased steeply to 11,216 in 2013-14 and 12,304 in 2014-15 (DCLG Housing Statistical Release 25th June 2015).

- Thirdly, the new government is proposing to cut rents by 1% a year for four years from 2016. The Housing Revenue Accounts will not only fail to increase their income in line with inflation but it will *fall absolutely*. According to the Office for Budget Responsibility housing providers will lose an estimated 12% of their expected income by 2020. The Chartered Institute of Housing has estimated that Councils will

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3 They also receive service charges though these were not included in the calculations and minor amounts of income from rents from shops and the like.

4 The extra was associated with the New Labour government's policy of 'rent equalisation' by which Council rents would be increased until they reached the higher level of Housing Association rents by 2015/16.

lose £2.56 billion over four years and £42.7 billion over the 30 year life of their 'business plan'. The Association of Retained Council Housing (ARCH) has a lower estimate but it is still £2.1 billion. They reckon that to accommodate this loss would imply a reduction of 21.5% in spending per unit of housing.

- Fourthly, the government is proposing to extend 'right to buy' to housing associations. In order to pay compensation to them for the difference between the sale price and the market value[5] they are proposing to force Councils to sell 'high value' Council homes on the open market when they become vacant. Councils will have to hand over *all receipts* from these sales to the government. Whilst we await the detail in the forthcoming Housing Bill, at the national level this will mean that some Councils will lose a significant amount of rental income. The previously published figures for what constitutes 'high value' was on a regional, rather than a local basis (see the 'high value' table in "Right to Buy 2" throw out the Bill)[6]. If the measure of 'high value' remains the same, some areas will escape relatively lightly others will lose a majority of their 'high value' stock. Inside Housing has recently revealed the results of a Freedom of Information request to stock owning local authorities. Whilst some by this measure have no 'high value' stock others would have to sell a third or more of their 'high value' homes, some more than 50%.

- Fifthly, the government is proposing to introduce a compulsory 'pay to stay' policy whereby 'high earning' households (£40,000 in London, £30,000 elsehwere) will have to pay up to a market rent[7]. Whilst we have yet to see the detail this could mean paying up to double their Council rent. This would inevitably lead to more applications to take advantage of RTB, and the loss of more rental income for Councils.

Reopen the 'debt settlement'

When the coalition government introduced 'self-financing' it said that it would retain the power to reopen the 'debt settlement' but only "if a change is made that would have a substantial, material impact on the value of the landlords business". Clearly the loss of 12% of expected income would have such a material impact on it. The estimated value of the stock was one of the key factors in the 'debt settlement'. The industry magazine *Inside Housing* reported that David Hall, an independent consultant who was involved in the creation of the 'self-financing' system said that the debt settlement would have been £10 billion lower if the changes to the rent formula had been included in the calculations.

There are clear grounds for, at the very least, revisiting the 'debt settlement'. The government gave itself the power to do so. The easiest way to deal with the problem - significant loss of rental income - would be to write off some of the 'debt'. This would cut the amount of debt and interest payments that each Council has to pay to the PWLB from its rental income. We believe there is a strong case to write off all this bogus 'debt' (see appendix). However, compensating each Council's HRA for the loss of rental income (the difference between the original estimates and the loss of rent resulting from government

5 We don't yet know whether they will receive 100% of the loss.

6 http://keepourcouncilhomes.wordpress.com/2015/06/16/right-to-buy-2-throw-out-the-bill/#more-1025

7 This is actually below the average household income. As ARCH has pointed out 2 adults working full-time on the minimum wage would earn together £27,000.

policy) is an absolute minimum, without which a deterioration in the quality of the housing stock is guaranteed. A decline in income will create a backlog of work and will increase future costs of dealing with the resulting deterioration of the stock. This is not just a financial or economic factor. These are peoples' homes. Failure to fund the HRAs adequately will adversely affect the quality of life of existing and future tenants. The coalition government is starving Council housing of the funds which it said in 2012 would "give Councils the resources they need to manage their own housing stock for the longer term..."

Martin Wicks
August 24th 2015

Appendix

'Debt' and the underfunding Council housing

The New Labour government's own research showed that in order to address the estimated backlog of work of £19 billion, an increase in funding of around 67% would have been necessary. But the increase under 'self-financing' was 27% for the Major Repairs Allowance and 5% for the Management and Maintenance Allowance.

The so-called housing debt was something of a moveable feast. In 2004/5 it was £12.7 billion. However, the New Labour government added the ALMO[8] programme to the 'historic debt' - £5.7 billion. In 2009 the debt was estimated to be £17 billion yet in March 2010 the government published a prospectus that proposed launching self-financing with an increase in debt at national level from £21.49 billion to £25.1 billion. The coalition government proposed a greater increase in the debt level to £28.14 billion.

The House of Commons Council Housing Group, in a major report showed how the Treasury had been milking Council rents for years. Between 1994/5 and 2008/09 Council rent paid was £91.382 billion but the allowances that Councils received were only £60.052 billion. The value of discounts on RTB sales between 1979 and 2009 was £32.557 billion. Between 1994/5 to 2008/09 'negative subsidy' cost council housing £7.854 billion over and above debt payments.

The Defend Council Housing group and others had long argued the case that the 'debt' should be written off. Even the Local Government Association (the organisation of local authorities called for debt write off at the time of the consultation on 'self-financing'. They said:

“We will continue to press for cancellation of the historic 'debt' which Councils spend more than £1.3 billion yearly servicing. Councils have repaid a large proportion of this historic 'debt' and will within eight years have spent more money servicing that debt than the debt itself.

Since the introduction of Right to Buy (RTB) in 1980, approximately 1.8 million council properties have been sold. Councils are only able to keep 25% of the sales receipts with

8 Arms Length Management Organisations were a means of circumventing ballots of tenants. The cost of the programme for these bodies was simply added to the national housing 'debt' impacting on the rent of all tenants.

75% going to the Treasury for general spending. Prior to 2004, councils could use sales receipts to pay off debt. Since 2004, the revenue from council house sales in England has been £6.2 billion of which councils have only been able to keep £1.5 billion. If Councils had been able to retain the additional £4.7 billion and use it to reduce their debt this could have been reduced to less than £9.3 billion.

Cancellation of council 'debt' would allow the provision of 80,000-90,000 new affordable homes over the next five years, delivering approximately £35 billion additional investment to the English economy, over a 50% return.

With nearly two million people on council house waiting lists, debt cancellation would also help to reduce housing benefit bills and the public cost of homelessness, and would allow councils to house homeless families more quickly.”