

Why Labour should write-off the fictional Council housing 'debt'

In order to stop the rise in Housing Benefit payments the government has imposed on local authorities which still own their Council housing stock, a 1% cut in tenants' rent, for four years, starting in April of this year. By this and other policies Council housing is being seriously under-funded. In order to understand the extent of the problem and what to do about it it's necessary to appreciate how Council housing is financed under the system known as 'self-financing'.

'Self-financing'

In April 2012 a new Council Housing finance system, 'self-financing', was introduced. The system had been designed by the New Labour government just before it lost the 2010 General Election and was implemented 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). Most 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 government subsidy and had to make a payment to central government from their rent income. According to the Audit Commission at the time 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 billion¹. 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 they would be able to keep all their rent income. 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. The so-called 'debt' was in large part the result of 'creative accountancy' by the Treasury, fleecing tenants who would pay for this 'debt' through increased rents.

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'

¹ UK Housing Review 2015.

² The level of debt for each local authority can be seen here:

http://www.gov.uk/government/uploads/system/uploads/attachment_data/file/6252/2077606.pdf

whilst 34 received payments from the government to reduce theirs. 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 Councils 'paid' to the government. It was of course a paper transaction between the PWLB and the Treasury. **The 'debt settlement' produced an £8 billion surplus which the Treasury pocketed.** This was in effect a subsidy to the Treasury taken from Council tenants' rent. Councils have to repay this 'loan' to the PWLB, together with annual interest charge. Rent used to pay off this 'loan' is money that cannot be spent on the upkeep of tenants' homes.

Moving the goalposts

To prepare for 'self-financing' Councils had to draw up 30 year 'business plans'. Under this system the only income Councils receive is the rent their tenants pay³. 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 week⁴;
- An estimate of the management and maintenance costs;
- An estimate of the number of homes that would be sold under 'right to buy' and hence the amount of rent income which would be lost.

Since local Housing Revenue Accounts receive no subsidy their only income is from the rent and service charges paid by tenants, with a few minor sources such as shop or garage rents. Consequently anything which reduces this income depletes their resources and has an impact on the maintenance of their housing stock. Since the introduction of 'self-financing' in 2012 subsequent government policies have *undermined the financial basis of the business plans*. Now further proposals which the 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, no adjustment of the 'debt' in line with lost income.
- 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 in England 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) as a result of increased discounts.

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. The rationale seemed to be that if Council rents and Housing Association rents were the same then Council tenants wouldn't bother voting against 'transfer'.

- Thirdly, the new government is proposing to cut rents by 1% a year for four years from April 2016. The Housing Revenue Accounts will not only fail to increase their income in line with inflation but it will *fall absolutely*. The Office for Budget Responsibility estimated that housing providers will lose 12% of their expected income by 2020. The Chartered Institute of Housing estimated that Councils will 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) had a lower estimate but it was still £2.1 billion. They reckon that to accommodate this loss a reduction of 21.5% in spending per unit of housing will be necessary. In the case of Swindon the impact of the 1% rent cut alone will be the loss of £22.8 million income from rent over 4 years, leading to a cut back of more than £5 million in spending on renewal of key components such as kitchens, bathrooms, roof etc, over 2 years.⁵
- Fourthly, the government is extending 'right to buy' to housing associations. In order to pay compensation to them for the difference between the sale price and the market value they are proposing to force Councils to sell 'high value' Council homes on the open market when they become vacant. This will mean that Councils will lose even more rental income. The only figures for what might constitute 'high value' were published by the Conservative Party prior to the General Election (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* 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%. As of the beginning of March 2016 Councils are still waiting to hear how 'high value' will be determined.
- Fifthly, the government is proposing to introduce a compulsory 'pay to stay' policy whereby 'high earning' households (£40,000 in London, £30,000 elsewhere) will have to pay up to a market rent⁷. Whilst we have yet to see the detail this could mean paying up to double the Council rent. This would inevitably lead to more applications to take advantage of RTB since, given the big discount, it would in many places be cheaper to buy than to pay market rent. Increased RTB sales would mean the loss of more rental income for Councils. Anybody facing a big rent increase who was unable to gain a mortgage would face impoverishment or being forced to move.

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 as will other government policies. The estimated value of the stock was one of the key factors in the 'debt settlement'. *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.

⁵ See <http://keepyourcouncilhomes.wordpress.com/2016/03/14/underfunding-of-council-housing/>

⁶ <http://keepyourcouncilhomes.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.

There are clear grounds for revisiting the 'debt settlement' and we are calling on Labour to demand that the government reopens discussion on the 'debt' which was handed out to Councils. 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 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 it. 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 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..."

Labour and the 'debt'

Thus far Labour has failed to address the problem of under-funding of Council housing which was built into the 'debt settlement' and which has been exacerbated by changes in government policy which we listed above. As we understand it Labour opposed the rent cut because of the impact on the finances of Councils and Housing Associations. In our view this was a mistake. Even under the CPI + 1% formula tenants were facing rent increases above inflation each and every year. Rather than supporting this Labour should have addressed the question of the bogus 'debt' which is eating up resources.⁸ Payments of the principal and interest mean handing over hundreds of millions of pounds a year to the government rather than spending it on tenants' homes and building new ones.

We believe that Labour should adopt a policy of writing off this bogus 'debt', thus providing local authority Housing Revenue Accounts with hundreds of millions extra each year to spend on their homes. In the meantime, given the funding crisis which Councils face under this government, Labour should be pressing them to at least write-off some of this debt, in line with the loss of income resulting from government policy changes since 'self-financing' was introduced in 2012. This lost income makes the 'debt' more onerous since a greater proportion of rental income has to go towards servicing it. According to *Local Government Financial Statistics England 2015*, in 2014-15 slightly over £2 billion of local authority HRA income of £8.533 billion was spent on debt charges and interest payments. The rent cut beginning in 2016 will drive up the percentage of income spent on the 'debt' even further.

Obviously writing off this 'debt' will mean that the Treasury will lose the annual payments. However, a commitment from Labour to write it off would be a recognition of the injustice of imposing this fictional 'debt' on tenants and the £8 billion windfall it delivered to the government. The consequences of implementing this write-off will be socially positive in that it will enable more work to be carried out by Councils, improve the homes of tenants and create jobs and more income to the Treasury via tax and national insurance.

Funding of Council house building

One final point on the question of funding a Council house building programme. One of the means of funding such a programme is said to be ending the 'debt ceiling' under which Council borrowing

⁸ New Labour's rent formula meant year after year above inflation increases for Council tenants. This was one of the main reasons for the housing benefit bill rising significantly. The CPI + 1% formula would continue above inflation increases. Rather than opposing the rent cut Labour should have demanded 'debt' write-off to cover the loss of rent income.

is restricted. There's a fundamental problem with this. Under 'self-financing', increasing local authority HRA borrowing would mean that *existing tenants would be funding new building* because it's only they who pay for HRA 'debt' through their rent. The more rent income which goes towards borrowing then the less there is available for the maintenance and renewal of existing stock. Adding more debt to the 2012 'debt settlement' would add to the injustice suffered by Council tenants.

In 2012 the Local Government Association reckoned that debt write-off would provide Councils with the resources to build between 80-90,000 homes over 5 years. This would be a larger scale than current building but it would be insufficient to address the housing crisis. This underlines the fact that central government subsidy is required for new Council house building on a large enough scale to begin to seriously address the housing crisis.

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on behalf of **Swindon Tenants Campaign Group**

March 2016

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 ALMO⁹ programme of £5.7 billion to the 'historic debt' - which all tenants would pay for. In 2009 the debt was estimated to be £17 billion yet in March 2010 the coalition government published a prospectus that proposed launching 'self-financing' with an increase in debt at the national level from £21.49 billion to £25.1 billion. They further increased the 'debt' 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 campaign 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'. It 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 75% going to the Treasury for general spending. Prior to 2004, councils could use sales receipts to pay off debt.

⁹ 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.

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.”

Local Government Association