REPORT TO EXECUTIVE

PORTFOLIO AREA: HEALTH & WELL-BEING

Date of Meeting:	**28th January 2002**		
Public			
Key Decision:	**Yes**	**Recorded in Forward Plan:**	**Yes**
Inside Policy Framework			

Title:	**The Housing Implications of the Local Government White Paper**
Report of:	**Director of Housing and City Treasurer**
Report reference:	**H003/02**

Summary:

Looks at the probable housing finance implications of the December 2001 Local Government White Paper and compares these to the Council's current choice of LSVT as its preferred route to secure adequate housing stock investment.

Recommendations:

The Portfolio-holder for Health and Well-being is recommending to the Executive that in view of the information available at this time there is as yet no convincing case to suggest that there is a better alternative to LSVT to secure the necessary investment in the housing stock.

Contact Officer: Tony Bramley **Ext:** 7300

T Bramley D. Thomas

Director of Housing City Treasurer

14th January 2002

H003/02

The Housing Implications of the Local Government White Paper

1. **Introduction**
    1. On 11th December 2001 the Government published their much anticipated White Paper on Local Government *"Strong Council Leadership – Quality Public Services"* (henceforth referred to as the 'White Paper').
    2. This sets out a range of proposals to fundamentally change the way in which local authorities operate in the future. Running to 149 pages in length it covers the following three main topic areas:

        - **Leading Communities** - Deregulation of activities; increase in powers; emphasis on partnership working.
        - **Quality Services** - Clear priorities and standards; comprehensive performance assessments; targeted support and inspection; extra freedoms for highest performers; simplified best value regime; tough action on failing Councils.
        - **Freedom to Deliver** - Easing of Council tax/benefit restrictions; restricting 'ring-fenced funding'; allowing Councils to borrow prudently; providing freedom to invest; reducing the number of plans/strategies required; lifting many consent requirements; providing wider powers to trade and work in partnership.

    In due course the Executive will receive reports on both the broader strategic implications of these proposals plus any more service-specific anticipated impacts.

1. **Housing Finance Proposals**
    1. Of key interest is Chapter 5 of the White Paper titled *"The Way Forward on Housing Finance"* running to seven pages in total and attached in full as Appendix 1 to this report.

    2. In summary Chapter 5 of the White Paper makes FIVE main proposals:

        [References are to White Paper paragraph numbers].

        - Simplification of the Housing Revenue Account (HRA) with the removal of

rent rebates [5.5-5.11];
- Simplification of HRA subsidy system, with a move to 'real world' rather than 'notional' calculations [5.8-5.13];
- Freedom to borrow against HRA revenue streams – subject to prudential limits and excluding the Major Repairs Allowance (MRA) resources [5.17-5.20];
- Freedom for "Arms Length Management Organisations" (ALMOs) to retain an element of rent increase proceeds to fund additional borrowing [5.21-5.24];
- Simplification of the housing receipt 'set-aside' rules with the creation of a national pooling system for receipts [5.25-5.27].

1. There are no particular surprises in most of these proposals since the majority were trailed in the Local Government Finance Green Paper in September 2000. However, there is one important exception to this generalisation:

- **'ALMO' Freedoms** – This was an unexpected additional freedom included in the proposals. To qualify an ALMO must achieve a whole-service Best Value rating of '3 Stars' or '2 Stars' plus a 'probably/will improve' rating plus an improvement plan for gaining 3 Star status.

1. There are two further comments merited before the next section looks at the probable implications:

- **Timing** – The White Paper signals an intention – subject to primary legislation being passed – to introduce the proposed changes from April 2004, i.e. for financial year 2004/05 [5.19].
- **Funding** – The amounts to be made available to support these changes are due to be established in the next Comprehensive Spending Review in 2002 and will be *"…resource neutral overall."* [5.13 -14 and 5.24].

1. **General Implications**
   1. There has been a huge amount of speculation about the probable content of the housing section of the White Paper in particular as it could have an immediate and direct bearing on the decisions Councils take about how to meet the investment needs of their own housing stock where they are still HRA landlords.
   2. HACAS Chapman Hendy (HCH) have produced a briefing for all their clients on their interpretation of the general implications of the White Paper and this is reproduced in full at Appendix 2 to this report.
   3. In summary this interpretation highlights the following key points:

- Borrowing for HRA capital purposes must be affordable from current and future HRA income streams, excluding the MRA;
- 'Securitisation' [The ability to borrow against the security of the value of capital assets] has been ruled out;*

- Opportunities for rental income 'retention' will be reserved to the best-performing housing authorities;
- With no national increase in housing resources beyond the already published government expenditure plans, delivery of the freedoms remains dependent on a substantial programme of LSVT continuing and by implication means there will be winners and losers in the HRA sector.

  *[This exclusion is set out in Section 4.15 of the White Paper in the chapter *"The Way Forward on Capital Investment".* An extract of this text is attached as Appendix 3].

1. **Revisiting the November 2000 Stock Options Appraisal**
   1. After many months of investigation HCH produced a detailed housing stock options appraisal report in November 2000 and it was on the basis of this that the Council elected to pursue the LSVT option [report H107/2000 to Housing and Care Services/Policy and Resources Committees on 17th November 2000 and then Council on 23rd November 2000].
   2. That report looked at five main options to solve the housing stock investment gap.These were:

   - Stock Retention under the HRA
   - Stock Transfer to an RSL
   - Funding via the Private Finance Initiative (PFI)
   - Funding via an 'ALMO'
   - 'Securitisation'.

   1. The key question for the Council to consider now is:

      'Has the White Paper significantly altered the balance of advantages/ disadvantages of these original choices to the degree that it should now review its earlier decision to pursue LSVT?'

   2. Since the White Paper has not altered the arrangements on either Stock Transfer or HRA PFI there is no need to revisit these options since the previous analysis stands. With 'Securitisation' now ruled out, Section 5 below therefore seeks to determine the potential implications of the White Paper announcements of the two remaining options – **stock retention** and **ALMOs**.

1. **New Options for Housing Investment?**
   1. A major health warning is required before commencing an analysis of the White Paper options: What follows in this section attempts to give officers' best professional estimates of the possible impact of the White Paper announcement. Members must however treat these with caution since they are based on 'headline' DTLR announcements where none of the supporting detailed information which would inspire strong confidence in the predictions

is yet available. This is a situation that could prevail late into 2002/03 or even 2003/04.

2. Stock Retention with Borrowing Freedoms

Working Assumptions:

- The HRA is able to utilise all 'spare' (or so-created) revenue resources outside the MRA to support the cost of borrowing for capital investment in the stock as soon as legislation allows.
- The cost of borrowing is 7.5% pa made up of 5.5% interest and 2% provision towards repayment.
- Carlisle will remain as an authority with a "surplus" on its HRA , which will continue to be contributed to the national rent pool for redistribution to 'poorer' authorities. (In 2002/03 this amount is projected at £ 5.6m.)
- For the purpose of this assessment any other financial implications arising from the White Paper are assumed to be neutral to the HRA.

Result Required:

(a) To release sufficient capacity in the HRA to deliver an additional £31m* of stock investment over the next 10 years to meet the Government's Decent Homes Standard. This would require £2.35m per annum of long-term revenue support.

(b) To release £400,000 of additional capacity in the HRA to match the LSVT's regeneration revenue investment guarantee of £400,000/year.

[* Source: At 2000/01 prices as set out in section 4.9.8 of the HCH Options Appraisal study in report H.107/00 November 2000].

Action Possible:

(a) With the HRA running in an annual operating deficit both in the immediate past and the foreseeable future – such that restraining actions have/will have to be taken - there is as such no 'spare' capacity in the HRA to allocate to additional borrowing costs to support capital expenditure.[For example the HRA no longer makes an annual revenue contribution towards capital spending which could otherwise be used to bring forward investment by borrowing.]

Consequently for this to be an option will require either a reduction in other HRA expenditure and/or increase in income compared to existing HRA business plan forecasts.

Very best estimates suggest that the switch to the 'Supporting People' regime might release up to £250,000/year of current HRA spending for other purposes from 2003/04 onwards. If this was diverted 100% to cover capital investment borrowing costs and could be sustained beyond 10 years this might support additional investment of £3.3m over this period.

The resultant shortfall of £27.7m converts into an annual revenue requirement of £2.1m at the end of 10 years which would still need to be found from HRA operating costs (staff, support costs, repairs and maintenance).

(b) Likewise there is no source for the equivalent of the revenue regeneration of £400,000/year.

(c) The only possibility is that as part of the 2002 Comprehensive Spending Review,the government will determine what (if any) proportion of the increased rent generated by rent convergence that local authorities may be allowed to retain to support increased borrowing and investment.

For Carlisle this would have to be almost 100%, since the revenue required to finance the capital shortfall is of the order of £6 per week per property, compared to the real-terms (net of inflation) average convergence increase of c.£7.00.

Commencement Date: Assuming the legislation is in place on time these arrangements could commence two financial years from now in 2004/05.

1.
2. Arms Length Management Organisation Status

Working Assumption: All as 5.2 above plus the HRA is also able to retain 100% of its rent restructuring-related income to support the costs of borrowing and this commences in 2005/06.

Result Required:

a. Release an additional £31m of stock investment over the next 10 years (see above).
b. Release sufficient additional capacity in the HRA to match the LSVT's regeneration revenue investment guarantee of £400,000/year.
c. Achieve a minimum whole-housing service 2 star plus probably/will improve or 3 star Best Value rating.

Action Possible:

a. See 'action possible' under 5.2. above. Using this assumption gives a base starting position of an additional £3.3m through the re-investment of the 'released' Supporting People-related HRA resources.

b. In order to access the rent restructuring income, the Council would need to obtain the whole-service 2/3 star rating at least the year before the additional resources would be released. While our housing strategy is currently assessed as 'above average' we would need to move this up to the top category of 'well-above average'. Two key services (voids and arrears) are currently in the bottom quartile of performance and would need to see radical improvement before there would be any point in seeking an assessment.

   Based on our current published 10 year rent plan (report FM 2001/02 -103, currently out to consultation with tenants) we estimate an annual average of £284,000 may be generated as 'surplus' through the rent restructuring regime over a 7 year period of 2005/06 – 2011/12. This would support an additional capital spend of approximately £2m by way of revenue contributions over that period.

   [The reason for the truncated period of 7 years and not 10 is that with an assumed start of ALMO status in 2005/06, this only leaves 7 years before the DTLR rent restructuring cut off date is reached (2011/12). Our working assumption is that beyond that date rents simply rise in line with inflation.]

c. Compared to the investment required of £31m, the shortfall of a) + c) is £25.7m

   which converts into an annual revenue requirement of £1.93m which would need to be found from HRA operating costs (staff, support, costs, repairs and maintenance).

d. Likewise there is no source for the equivalent of the LSVT regeneration revenue investment of £400,000/year.

   Commencement Date: Assumes legislation is in place in 2004/05 and that we can also achieve a satisfactory star rating within this timescale to enable the ALMO's extra financial freedoms to commence in 2005/06.

1. Section 6 below moves on to analyse the three main options open to the Council.

1. **The Options Compared**
   1. The table in Appendix 4 sets out an outline comparison of the presumed key differences between the options in Section 5 above plus the LSVT choice and is based on officers' best judgements of the future arrangements plus experience of housing finance matters in the past.
2. **The Council's Choices**
   1. In the light of the foregoing the Council has three broad choices:

      - To abandon the LSVT process;

- To suspend the LSVT process;
- To re-affirm the LSVT decision.

1. Risk assessments have been completed for each of these options and these are attached at Appendix 5.
2. In considering these it is imperative to understand that under HRA Business Planning requirements the Council is now required to demonstrate to the Government Office how it intends to meet both the DTLR's 'Decent Homes Standard' [introduced in 2001] by 2010/11 and to deliver top-quartile Best Value performance indicators.
3. Consequently when the Council makes its next plan submission in July 2002 it will need to show at that time that the option it has selected can reasonably be expected to meet these objectives.
4. Option A – Abandon LSVT

   Justification: Only if the alternative(s) now available are judged to offer a sufficiently secure financially viable alternative at this stage without the need to transfer the ownership of the stock.

   Recommendation: Reject – LSVT still appears to offers the only potentially certain route to the necessary level of investment required.
5. Option B – Suspend LSVT

   Justification: On the basis that the White Paper options may well offer an alternative to LSVT but that further time is required to evaluate the detailed impact.

   Recommendation: Reject – Deferral is not an option – unless the LSVT completes by 31st March 2003 the DTLR will require the Council to resubmit a fresh application. Implications are therefore as above in 7.3.
6. Option C – Continue with LSVT

   Justification: It appears to remain the only route that could deliver the level of stock investment required.

   Recommendaton: Accept – we are already two years into this process and are only 5 months from the ballot start date. To abandon this tried route this close to the definitive test of tenant support for the option when the value of the other options are still open to considerable interpretation may not be seen as prudent.

1. Comments of City Treasurer

1. The City Treasurer's comments are reflected within the report.

2. **Access to Services Implications**
    1. To the extent that at this stage only the LSVT option appears to offer the level of stock and regeneration investment required, this would appear to be the preferred route to minimise access to services limitations.
3. **Environmental Implications**
    1. To the extent that at this stage only the LSVT option appears to offer the level of stock and regeneration investment required, this would appear to be the preferred route to maximise positive impact on the Council's LA21 targets.
4. **Consultative Arrangements**
    1. The report was discussed at the HCG on 14th January 2002 and time permitting by the Tenants' Advisory Group (TAG) at one of their weekly meetings in January 2002 (probably 16th or 23rd).
5. **Recommendations**
    1. The Portfolio-holder for Health and Well-being is recommending to the Executive that in view of the information available at this time there is as yet no convincing case to suggest that there is a better alternative to LSVT to secure the necessary investment in the housing stock.

T. Bramley

Director of Housing

D. Thomas

City Treasurer

Appendix 1

CHAPTER 5

The way forward on housing finance

The new approach

5.1 We are adopting a radical new approach to funding council housing which is consistent with our general policy that high-performing authorities should be eligible for increased financial freedoms. The key elements of our new approach are:

• The housing revenue account (HRA) will be greatly simplified. Rent rebates will be removed from it, making it a straightforward landlord account.

• The HRA subsidy system will also be simplified. Subsidy will eventually be calculated on the basis of the rents that should actually be charged and realistic estimates of the costs authorities need to incur.

• Subject to prudential limits, councils will be free to borrow against the revenues in their HRA, apart from their Major Repairs Allowance (MRA).

• Councils that establish high-performing arms length management organisations (ALMOs) will, within limits set in the spending review, be free to retain the proceeds of their rent increases to the extent necessary to fund the borrowing required to enable them to upgrade their stock to the decent homes standard.

• The current housing ‘set aside’arrangement will be replaced by a simpler housing capital receipts pooling system that will apply to all housing receipts, including those received by debt-free authorities.

The starting point

5.2 Our housing objective is to give everyone the opportunity of a decent home.

5.3 The challenges we face include:

• Bringing all social housing (both council housing and housing owned by Registered Social Landlords (RSLs)) up to a decent standard by 2010. At present we estimate that some 1.7 million social homes fall short of the decent homes standard.

• Tackling homelessness and the severe shortages of affordable housing in certain parts of the country. Addressing the problems caused by the lack of demand for housing in other parts of the country, including in extreme cases the abandonment of some neighbourhoods.

• Tackling disrepair in privately owned housing occupied by low income households. Of the 20 per cent poorest owner-occupiers, 1.6 million households (53 per cent) live in accommodation that does not meet the decent homes standard.

Local authorities have a key role to play in all of these areas, both as providers of services(particularly as landlords) and in ensuring that all interested parties work together to develop and implement solutions within an agreed strategy. The local government finance system needs to support them in this work, both by providing the necessary resources and by providing incentives to efficient delivery.

5.4 Money is often a key component of solutions to housing problems. In addition to

funding from local authorities' own resources there are two main local authority funding regimes:

• Revenue support to council-owned housing is provided through the HRA subsidy system. This is currently some £400 million a year (excluding the support paid towards the cost of the rent rebates that councils are obliged to give those eligible for housing benefit).

• Capital support is provided through the housing investment programme (HIP).

This is currently some £800 million a year. It is used to:

– provide grants to RSLs for the construction of new social homes;

– support improvements to privately owned homes occupied by low income

households; and,

– improve council-owned stock.

For many authorities that continue to be landlords their housing programmes are their

largest single item in terms both of revenue and capital expenditure.

5.5 Our current housing finance systems are extremely complicated and poorly understood. We need simpler and more transparent arrangements that are more sharply focussed on addressing the pressing housing problems we face. In particular, open government demands that councillors and tenants, as well as housing professionals, should be able to understand how the available public resources are distributed and how spending priorities are determined at both national and local level.

Delivering decent council housing: the

revenue

subsidy system

5.6 Council housing has a bespoke revenue finance regime. Broadly speaking, every

authority with 50 or more council dwellings is required to maintain a ring-fenced HRA within its general fund. This is because, uniquely amongst major local authority services, council housing is largely funded by rental income (including the central government subsidy towards the cost of rent rebates) and the Government believes that it would be wrong for council housing either to subsidise or be subsidised by the general council taxpayer.

5.7 The HRA system has been developing in parallel with the rest of local government finance. Following extensive consultations with local authorities, housing professionals and accounting bodies, we have introduced a new financial framework for local authority housing. All authorities owning stock are expected to prepare HRA business plans based on comprehensive housing needs assessments and stock surveys. They are also required to keep their HRA on a resource accounting basis,including making provision for depreciation, which the Government is supporting through the MRA.

5.8 We operate the HRA subsidy system to enable all councils to manage, maintain and improve their stock whilst charging affordable rents. We run the regime as a national system, taking surpluses from the richer authorities and using them, with additional central government funding, to subsidise the poorer authorities.Were we not to run the system on this redistributive basis we would either need to increase central government support substantially or poorer councils would need to increase rents very dramatically. Even those authorities that contribute to the subsidies received by other authorities are still receiving a ‘hidden subsidy’ as they are not required to make a return on the capital tied up in their stock (apart from servicing any debt that may be attributable to the stock).

5.9 The HRA subsidy system does two things:

• it calculates the surplus or deficit an authority ought to have by making assumptions about its costs and revenues. Those assumptions are, however, far out of step with reality: on average councils charge 16 per cent more rent than assumed and spend 25 per cent more on management and maintenance than assumed. Where there is an assumed deficit the authority receives a ‘housing element subsidy’ equal to that deficit. Where there is an assumed surplus, that amount is generally used by the Government to help meet the cost of subsidies to poorer authorities.

• The system also pays rent rebate subsidy to recompense local authorities for the

rebates they are required to allow tenants who are eligible for housing benefit. This is payable up to a limit rent. Should an authority choose to set an average rent

above this level it would be required to meet itself the cost of rebates above the

limit rent.

5.10 In practice, rather than a council with a housing element surplus making a payment to the Government only to receive a larger amount back as rent rebate subsidy, the amount that would be due to be paid to the Government is netted off the rent rebate subsidy and the balance is paid to the authority. Where the housing element surplus exceeds the rent rebate subsidy payable to the authority, no payment is made in either direction, but the council must transfer the net surplus to its general fund. Whilst this netting-off arrangement might make no difference in financial terms, it makes it harder to understand what is going on.

5.11 Overall, the HRA system is not well understood and is very far from transparent.

A number of measures to simplify the system have already been announced including:

- removing rent rebates and rent rebate subsidy from the HRA, thus making the HRA a true landlord account in which the costs and income can be plainly seen;

- introducing an explicit pooling arrangement for the surpluses generated by some authorities, with the proceeds from the pool being used to meet some of the cost of subsidising those authorities that cannot cover their costs from their income. This will do no more than make clear what already happens; and,

- those authorities that have a housing element surplus that exceeds their rent rebate subsidy entitlement will in future pay all of their surplus into the pool and not pay any into their general fund, thus stopping a leakage of funding from council housing.

5.12 Last December's housing policy statement, *The Way Forward for Housin*g,

announced that all social rents are to be set on the basis of a common formula reflecting the value of a property, its size and manual earnings in the area. This will remove the current large discrepancies between the rents charged for similar properties by different councils and RSLs, whilst ensuring that rents remain affordable and generally well below private sector levels. The discrepancies are not only grossly unfair to those who pay their own rent,but they also distort the social rented market.This means that in many cases tenants do not face rational choices between paying more for a better property or less for a less attractive property. It can, in particular, inhibit tenants from moving to a smaller property as they may not make a worthwhile saving in their rent. It also means that the market does not provide RSLs with clear signals about where additional social housing is needed and where it is not.

5.13 The HRA subsidy system needs to be adjusted to reflect rent restructuring. In reduce or increase the aggregate level of resources available to councils nationally.

Indeed, the starting assumption in the forthcoming spending review will be that these

changes should be resource neutral overall. The review will take into account the projected real terms increase in rents in the local authority sector and then consider how the additional resources should be used.

5.14 One of the consequences of rent restructuring is that council rents will, on average, rise by a small amount a year for each of the next ten years, (although this increase will be smaller than it has been over the last ten years). Decisions have yet to be taken on what will happen to the proceeds of these rent increases. Options include:

• allowing local authorities to spend more on management and maintenance, should

there be a need for this;

• allowing certain councils to retain more of their income to enable them to

increase investment in order to achieve the decent home standard. This is discussed more fully in paragraph 5.21 below;

• using the resources for housing or other expenditure outside the HRA.All of these options will be considered in the forthcoming spending review.

5.15 Concerns have been expressed that the effect of moving the assumptions made about rents up to the formula rent might be to reduce the aggregate level of resources available to local authorities. There is no intention that these technical changes should be used either to reduce or increase the aggregate level of resources available to councils nationally.Indeed the starting assumption in the forthcoming spending review will be that these changes should be resource neutral overall.The review will take into account the projected real terms increase in rents in the local authority sector and then consider how the additional resources should be used.

Capital investment in council owned stock

5.16 Currently there are four options for capital investment in the existing council stock:

• Continued direct management of the stock using the resources provided through the MRA and whatever proportion of the authority's HIP/single capital pot allocation and other resources the authority chooses to devote to improving its own stock.

• Establishing an ALMO to discharge the authority's landlord responsibilities.Under this option the stock remains in local authority ownership and the tenants remain tenants of the authority.Additional resources are available if such a company is set up and achieves either a 2* or 3* rating from the Housing Inspectorate.

- Transfer of the stock to an RSL.

- The private finance initiative.

5.17 The removal of the current controls on local authority borrowing will apply to

borrowing for HRA expenditure and will provide a useful degree of flexibility for councils that opt for either of the first two options.

5.18 As with the rest of the general fund, local authorities will be free to borrow to fund increased capital investment within the HRA as long as they have the resources to service the additional borrowing. Authorities may, for example, choose to use some of the resources they currently use to pay for capital expenditure direct from their HRA. This would enable councils to bring forward investment that they might otherwise have been able to afford only over a longer period. This might be particularly attractive for ‘spend to save’ investment that would reduce costs in later years. Councils will, of course, have to ensure that they do not pre-empt resources they will need to meet their maintenance and management liabilities and for renewal expenditure, including unforeseen contingencies. For this reason, authorities will not be permitted to borrow against their MRA.

5.19 Subject to legislation, we would aim to implement the new system by April 2004, or earlier if possible.

5.20 Borrowing funded by HRA revenues will only be available for investment in HRA assets.Similarly, HRA revenues should not be taken into account in determining prudential borrowing limits for non-HRA borrowing.

Additional investment by councils to deliver decent council housing

5.21 The Government recognises that significant additional investment will be needed

in the stock that remains in local authority ownership over and above that which could be afforded using the MRA and the HIP allocations at the current levels. To ensure that the additional resources that are earmarked in the spending review for this purpose are used as effectively as possible, the Government proposes that they should only be made available after councils have established a high performing ALMO. In future, once the new borrowing freedoms have been introduced, such ALMOs will be able to retain a significantly larger proportion of their revenues to enable them to afford the additional borrowing required to pay for the extra investment needed to ensure that all of their housing meets the decent homes standard by 2010.

Such ALMOs will generally still be required to contribute to the redistributive pool that will collect surpluses from the richer authorities and use them to support poorer councils. However, their contribution to the pool will be reduced to allow them headroom they need to fund the necessary investment. The size of the reduction of the pool contribution will be assessed on the basis of the ALMO's draft Business Plans which will be presented when they apply to establish an ALMO.

5.22 There may be some ALMOs that are net recipients from the redistributive pool. Such companies would receive a larger housing element subsidy as well as retaining all of their revenues.

5.23 The additional housing element subsidy paid to some ALMOs and the reduced

contributions to the redistributive pool paid by others will be funded from the proceeds of the rent increases necessary to achieve rent restructuring, not by reducing the net resources available to other housing authorities.

5.24 The precise details of the new system and the sums of money involved will be determined in the 2002 Spending Review. particular, the rent that the system assumes

councils charge needs to be adjusted so that it is equal to the rent set by the rent restructuring formula. Similarly, the rent up to which the Government will meet the cost of rent rebates –the limit rent – needs to be moved to the same figure. These changes will be made gradually over ten years, as will the changes to the rents

actually charged. By the end of t is transitional period, the subsidy system will be based on the actual rents that councils should be charging,not some figure that bears little relation to the real world. The net result will be a clearer, more transparent and fairer system.

Re-investing the proceeds of the disposal of HRA asset sales

5.25 The current capital finance regime requires councils to 'set aside' 75 per cent of the proceeds of the disposal of HRA assets (e.g. income from 'right to buy' sales) to offset debt. As a consequence of this the HRA subsidy paid to an authority with set aside receipts is reduced by an amount that equates to the annual cost of the debt service charges on the set aside receipt. This reduction in revenue support is taken into account when decisions are made about the level of resources that can be provided to support new investment by local authorities. The net effect of set aside is therefore to redistribute a proportion of the capital spending power of HRA receipts.

5.26 The Government believes that it is right that the proceeds of the disposal of council housing assets should be ploughed back into council housing as those assets were largely funded by central government. We therefore believe that a mechanism with a redistributive effect similar to set-aside should be retained in the new capital finance regime. Indeed, without it there would need to be a substantial increase in public expenditure to ensure that the necessary capital spending power was provided in the right place to deliver the local authority element of the decent homes PSA target. The Government also sees no reason why authorities that are currently debt-free should be exempt from the requirement to contribute a proportion of their HRA receipts to a redistributive pool.

5.27 The current set aside mechanism is unnecessarily complex. It will be replaced by a two-part regime which will have the effect of creating a pool of receipts that can be used to fund new capital investment wherever the need is greatest:

- for authorities with debt attributable to their HRA, HRA support for debt charges will be reduced to reflect the proportion of receipts which the authority is required to contribute to the redistributive pool; and,

- for authorities without HRA debt, a specified proportion of the HRA receipts

will have to be paid into the pool.

Funding non-HRA housing investment

5.28 If we are to deliver a decent home for all a great deal needs to be done beyond bringing council housing up to the decent homes standard. In parts of the country there is a serious shortage of affordable homes; in others the lack of demand and the abandonment of neighbourhoods is a major problem. Throughout the country, parts of the private sector stock are in a poor condition. Local housing authorities have a vital strategic role in bringing all relevant parties together to develop sustainable solutions to whatever housing problems exist in their area and region. As part of this, the HIP provides resources for capital investment. These are used, along with authorities own resources, to provide renewal grants to low income owner occupiers and local authority social housing grants to enable RSLs to provide new social housing as well as funding investment in council housing.

5.29 At present 95 per cent of HIP allocations are formulaic and based largely on a range of indicators of housing need. The Department has just completed an annual review of various aspects of the formulae in consultation with local authorities, housing associations and others and some updating of the indices has been possible. However, it has proved impossible to reflect all of the dimensions of need that we would ideally have liked to incorporate in the indicators. This is partly due to the complexity of the problems we face and partly to the lack of suitable data at the district and sub-district level. More fundamentally, doubts have emerged as to whether it is possible to reflect with sufficient precision in a set of formulae the complex pattern of need for housing investment. Indeed, some have implicitly concluded that this is not possible and argued for new funds to be created to tackle specific problems in certain parts of the country. The Department therefore proposes to conduct a fundamental review of the current formulaic approach to allocating HIP resources. In the interim the recently announced revised needs indices will be used for at least the next two annual allocations.

5.30 The Government would welcome views on whether the best solution is to acknowledge the limitations of a formulaic approach and to move to a regime in which, say, within each region 70 per cent of HIP resources are allocated by formulae and the remaining 30 per cent is distributed on the basis of a qualitative assessment of need made by Government Offices reflecting strategic priorities identified in Regional Housing Statements and an assessment of local authority housing strategies. Allocations between regions would continue to be made on the basis of the formulaic approach. This would align the HIP process more closely to that adopted by the Housing Corporation for the Approved Development Programme.

Appendix 2

HACAS CHAPMAN HENDY

Commentary Upon:

"Strong Leadership – Quality Public Services"

Stephen Byers announced on 11th December to the House of Commons the issuing of the long awaited White Paper which is intended to give local authorities " substantial new freedoms to respond to the needs of their local communities".

The effects on individual authorities of the strategic implications for their Council housing will have to be assessed in detail after the 2002 Spending Review. Primary legislation is needed and depending on parliamentary timetables, will be enacted by April 2004.

The general implications nationally are likely to be:

- More resources, funded nationally from the proceeds of rent restructuring, for a few local authorities who can achieve excellent or high-performing ratings from external inspection, and set up Arns Length Management Organisations.
- The Audit Commission will be expected to co-ordinate existing performance regimes, producing a balanced score-card for each Council
- All local authorities will be freer to raise external borrowing, but this will only benefit those who have adequate income to service additional loans
- Housing capital receipts will be freed up but a national reallocation mechanism

will be set up to provide some assistance to those authorities who need extra resources
- Transfer will remain the main option for authorities to fund major investment programmes
- ‘Securitisation’ is not to be permitted
- HRA-PFI will continue but funding mechanism under review

Part 1 of the paper sets out proposals to reform council services and enhance local democracy and community leadership.

Part 11 sets out the details of the proposals for reforming local government finance, and Chapter 5 contain the implications for Housing Finance.

Much of the change in the financial regime underlying the changes had already been signposted in the report by the Capital Programmes Working Party " The Capital Finance Review: a New Prudential System" involving DTLR, the LGA , CIPFA and the Audit Commission, although the White Paper itself is very wide-ranging document.

Certain common principles underlie the proposed changes, namely:

- Freeing Councils to make investment and borrowing decisions based on budgetary constraints and prudent professional financial management, rather than restrictive and prescriptive government rules. *These new freedoms will be available to all local authorities (potentially subject to nationally imposed limits), but*
- There will be further freedoms for high performers. *Each council will be assessed by the Audit Commission as high performing, striving, coasting or poor performing, on the basis of a "balanced score-card" across all its services*
- Government policy objectives generally, (with some high priority exceptions) are to be achieved via outcome targets rather than financial inputs

Freedom to deliver (Part I Chap 4)

Sets out the basic principles for providing greater freedom to borrow, invest, trade, charge and set spending priorities. *Primary legislation will be required.*

The big stories are:

- Freedom to borrow and invest to be achieved through the abolition of credit approvals, and replaced by a prudential regime under which Councils only borrow what they can afford**.** The current set-aside system will be abolished. *This includes housing. As proposed in the Capital Finance Review report, Council housing, which is a service largely supported by rental income, and provided to a restricted group of council tax-payers, i.e. tenants, is still treated separately, and the ring-fence remains*. *Local authorities will no longer need government approval* *to borrow, or to access "other forms of credit" but must be able to achieve balanced budgets, as now. So borrowing for HRA capital purposes must be affordable from current and future HRA income streams. Failure to manage this process wisely could incur government intervention.*

- Mortgaging of local authority property is specifically excluded from these new freedoms. *Securitisation of rental income as a funding mechanism is specifically (Pt II 4.15 & 4.37) mentioned as a funding route that will* ***not*** *be allowed, as being unacceptably risky.*

- DTLR is consulting on giving authorities access to a wider range of funds such as commercial money market funds to ensure they get Best Value in investments. *This would include the investment of housing capital receipts.*

- Greater freedom to trade is envisaged for **any** service in which there is strong performance in delivery. *This could therefore include any services being delivered by a high-performing ALMO.*

The way forward on housing finance (Part II Chap 5)

Billed as a "radical new approach to funding council housing" headline changes are:

- removing rent rebates from the Housing Revenue Account (HRA), which becomes a "straightforward" landlord account
- simplification of the HRA subsidy system is promised "eventually".*In part this will be achieved as actual rents converge with formula rents.*
- subject to prudential limits, freedom to borrow against the revenues in the HRA, with the **exception** of Major Repairs Allowance (MRA); *a code of practice on the development of prudential limits by each authority will shortly be issued by CIPFA for consultation.*
- high performing Arms Length Management Organisations (ALMOs), once established, will, within limits set by the spending review *(i.e. no specific commitment on additional ALMO funding)*, be free to retain the proceeds of their rent increases to the amount necessary to fund the borrowing they would need to upgrade their stock to the Decent Homes standard
- set-aside rules in relation to housing receipts will be replaced by a pooling system that will apply to all housing receipts, including those received by debt-free authorities.

Likely practical implications

Much of the detail and the timing of the implementation is still to be clarified, but issues include:

Changes to the HRA subsidy system

The emphasis is very much on local business planning and asset management, within a national redistributive framework, where richer authorities are to subsidise poorer authorities. However the White Paper acknowledges that the mechanisms are poorly understood and far from transparent.

In addition to changes that had already been previously announced, such as:

- removal of rent rebates and rent rebate subsidy from the HRA;
- pooling of housing element surpluses
- the effect of rent restructuring, which will mean that at the end of ten years, subsidy should be related to the actual rents which are being charged to tenants, not a notional figure

there are a number of new changes flagged by the White Paper, to be considered. These include options for the use of the additional income from restructured rents, which could be

  - retained for spending on management and maintenance, *where there is evidence of need. This would need to be demonstrated through the HRA Business Planning and Asset Management planning process. Would this imply a "bidding" system, removing the current system of formula based management and maintenance allowances?*

  - retained for investment to achieve the Decent Homes standard *only where a high performing ALMO has been established*.

  - used for housing or for other expenditure ***outside*** the HRA. *On the face of it this appears to contradict the ring-fence principle but is in line with the government's policy aims in relation to regeneration of local neighbourhoods and cross-sector initiatives.*

In practice there will be losers as well as gainers. The stated intention is that nationally the aggregate level of resources will not increase. The mechanisms will be considered in the next Spending Review in 2002.

Capital investment in Council-owned stock

How will capital support be allocated?

The single capital pot will remain as the vehicle for allocating general, cross-service capital support, including housing. In 2002-03 it will be allocated on the basis of 95% needs based formulae and a 5% discretionary element, related to performance. Performance refers to service delivery outcomes as well as the quality of corporate capital planning and asset management. High performing or "striving" i.e improving councils are likely to be rewarded in future with higher allocations through the single capital pot, with funds ring-fenced for "coasting " or"poor" performers. *This begs the question of how poor-performers are to improve, and this may be partly answered by the regulation regime which could impose transfer of functions to another provider, placing the Council into administration, or management by a well-performing authority or other public body.*

Increased flexibility

Removal of current controls on local authority borrowing willl apply to HRA expenditure, and will enable a certain degree of flexibility for Councils who retain their housing stock***, with or without an ALMO***. The extra freedoms will, subject to legislation, come into being from April 2004 or earlier and will mean that:

- councils could increase their borrowing to fund capital investment, ***provided they have the revenue resources*** to support the additional loan servicing costs. It is not clear where these resources are expected to come from, although the income used to support revenue contributions to capital are instanced;
- Borrowing supported by Major Repairs Allowances (MRA) will ***not*** be permitted, as the MRA is seen as a safety margin against future disrepair and unforeseen contingencies;
- Borrowing supported by HRA revenues will ***not*** be permitted for investment in other than HRA assets;
- HRA revenues would not "count" as supporting revenue for non-HRA prudential borrowing e.g to support general fund housing purposes such as private sector renewal
- Current HRA-PFI projects can *"expect support to be maintained" but there is a clear implication that the current system, which depends on the allocation of Notional Credit Approvals, will be come under review.*

Achieving the Decent Homes standard

The precise workings of the new system will be announced following the 2002 Spending Review. However the proposals are that:

- High performing ALMOs will be able to retain a ***significantly larger proportion of their revenues*** to enable them to borrow to fund the additional investment programmes they plan in order to achieve the Decent Homes standard by 2010. *What would be the implication for an ALMO that ceases to be high –performing? Would it then be subject to an administration regime e.g. by another neighbouring ALMO?*

- ALMOs will not be exempted from the requirement to contribute housing element surpluses to a national pool, but the level of their contribution will be reduced to allow them the "headroom" they would need to support their borrowing requirements from revenue (primarily rental income). *It is not stated over what period this would apply but presumably it would be over the period required to service the loan*

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- ALMOs in "poorer" authorities would then receive a larger housing element subsidy as well as retaining all of their revenues (rental income). *Would there be any help with the set-up costs?*
- All of the ALMO funding would be met from the proceeds of rent restructuring, and is not intended to have any impact on the level of resources available to "non-ALMO" authorities. *This implies that the ALMO programme would still need to be managed on a national basis to ensure sufficient resources would be available. Given the current difficulties experienced with rent restructuring, this raises a question as to whether the size of the programme will be able to expand significantly in say 2004-05.*

Re-investing the proceeds of the disposal of HRA assets

The proposals are aimed at simplifying the current rules which specify that 75% of all HRA receipts (such as those from the sale of council houses) must be "set-aside", that is assumed to be available to repay HRA debt, and the level of debt servicing costs met through HRA subsidy is reduced accordingly. *The current system means that annual HRA subsidy is reduced to take account of the assumed cost of debt charges on the amount of set-aside receipts. For most authorities this is not significant, unless there is a significant gap between their HRA Subsidy Credit Ceiling, calculated in this way, and their actual HRA Credit Ceiling.*

The set-aside mechanism is to be simplified, with emphasis again on a national "pool" of receipts.

The new regime is to be based on:

- Reducing HRA debt servicing support to a level which reflects the proportion of receipts which the Council is required to pay into the pool; *the effect on the local authority of this mechanism, will be similar to the set-aside rules, in that it will be receiving less subsidy on its debt charges than it is incurring. The authority may then decide what proportion of its capital receipts it will use to fund capital* *investment, rather than to actually repay debt. However the significant difference is that it has the choice of financing new investment through capital receipts, providing the revenue stream is adequate to meet its unsubsidised debt charges. It is not specifically stated whether all previously set-aside receipts will be "released" under this new regime.*

- If a council has no HRA debt, a "specified proportion" of its HRA receipts will be paid into the pool. *This is seen as an intended element of the redistributive mechanisms which will create a national pool of receipts that can be reallocated on the basis of need, but will reduce the financial incentives of stock transfer for some authorities for whom debt –free status would previously have released their set-aside receipts, (except for those previously recycled as Social Housing Grant). No indication is given on how this specified proportion will be calculated.*

Funding non-HRA housing investment

DTLR proposes to conduct a "fundamental review" of the current approach to allocating Housing Investment Programme (HIP) resources, (whereby 95% is allocated on a formulaic basis related largely to housing need indicators) although the recently announced needs indices will be used for at least the next two allocations. Consideration is to be given to increasing the proportion allocated on the basis of qualitative judgements reflecting regional and local strategic priorities. *Again, this would seem more in line with regional development agendas and regeneration ambitions but introduces yet more uncertainty for authorities who are perceived as not being in high-profile deprived areas.*

17th December 2001

Appendix 3

CHAPTER 4

The way forward on capital investment

[Extract Only]

THE LOCAL PRUDENTIAL REGIME

4.13 The local prudential regime is about self-regulation.It will require individual authorities to decide how much they can prudently borrow.They must set limits on the total amount of debt that they can take on. Having set these limits,the authority will be required to adhere to them.They will not be permitted to undertake new borrowings that would take them above their limits. They will be permitted to increase their ceiling for affordable debt in-year only if the new figure is still within prudential limits (for example, if it becomes evident during the year that estimates of revenue income can properly be adjusted upwards). We shall also ensure that local government officers (particularly, the S151 officer) and district auditors have the powers they need to ensure that the legal requirements are complied with. The new system, like the present one, will also apply when authorities obtain assets on long-term credit (such as leasing and hire purchase); authorities using such credit will have to decide whether it is affordable, just as if they were borrowing to buy the assets outright.

4.14 The locally set limit on an authority's borrowing will take account of all sources of estimated future revenue income and the potential calls on the use of that revenue. The amount of revenue income not required for other spending purposes will be potentially available to service the authority's debts and thus offers the best measure of the affordability of new borrowing. Local authority revenues have grown over time, as Government grant and council tax yields have increased in real terms.

Council tax revenue is within the authority's own control, and the introduction of floors and ceilings on formula grant will protect authorities from the sort of annual fluctuations in grant that used to be a feature of SSA. This means that an authority can estimate for a number of years ahead the amount of revenue available to support debt after other essential commitments have been met.

4.15 It is not prudent for authorities to borrow against the security of their capital assets, since the potential seizure of property by creditors would pose an unacceptable threat to the delivery of services. In any case, the main lender to local authorities – the Public Works Loan Board – never requires such security. We shall therefore not remove the long-standing prohibition on the mortgaging of local authority property. Nor shall we allow authorities to 'securitise'– i.e. sell future streams of revenue income, such as rents, in return for immediate one-off payments. The prudential system should achieve all the financial flexibility that is needed and in a much safer way.

4.16 The calculation of the affordability of borrowing will need to be underpinned by

unambiguous definitions of debt and revenue, which are applied uniformly by all authorities.CIPFA, in liaison with central and local government, is developing appropriate definitions and will publish them in a code with which all local authorities will be required to comply under the new legislation. The code will also specify other factors which authorities need to take into account, e.g. the level of reserves and outstanding debt. It will also describe the process to be followed in setting and monitoring prudential limits. The code cannot be finalised and issued until primary legislation on the prudential system is enacted. However, a first draft will be issued for consultation shortly.

Appendix 4

SUMMARY COMPARISON OF OPTIONS

Option	Meets Stock Investment Requirement? [£31m/10 years]	Offers long-term revenue support to capital borrowing?	Subject to Changes in Government policy/budgets?	Subject to Quality Assessment?	

LSVT	Yes	Yes (30 years)	UNLIKELY	No
'White Paper' HRA	No (£3.3m)	No (3 years?)	PROBABLE	No
'ALMO'	No (£5.3m)	No (3-6years?)	PROBABLE	Yes

Appendix 5

Risk Assessment 1

Abandon LSVT Process

Factors	Probability	Impact	Comments
1. Abortive costs for Council on LSVT and corporate preparations	High	Medium	Probable cost of arour Fund if halted by Febr
2. Probable claim for set-up costs from Riverside Group	High	High	Value unknown but lik cost above
3. Delay before investment commences	High	Medium	Earliest start date 200
4. Lack of confidence about adequacy of investment levels under HRA	High	High	Analysis shows amour insufficient under HRA
5. Lack of confidence about sustainability of investment levels under HRA	Medium	High	May only be able to pl linked to Government
6. No certainty that ALMO status can be obtained	Medium	High	Earliest start date 200
7. Disruption to overall Council strategy	Medium	Medium	Requires HCH corpora
8. Sends confusing message to tenants about Council's	Medium	Medium	

intentions			

Appendix 5

Risk Assessment 2

Suspend LSVT Process

Factors	Probability	Impact	Comments
1. Any delay due to a review will almost definitely mean the Council's current LSVT application will lapse 2. Extended delay before investment commences 3. No certainty that ALMO status can be obtained 4. Abortive Costs for Council on LSVT and corporate preparations 5. Probable claim for set up costs from Riverside Group 7. Lack of confidence about adequacy of investment levels under HRA 8. Lack of confidence about sustainability of investment levels under HRA 9. Disruption to overall Council	High High Medium High High High Medium Medium Medium	High High High Medium High High High Medium Medium	Unless LSVT car 2003 the Council from DTLR If a detailed revie an option is then assuming all app 2005/06 Earliest start now Probable cost of halted by Februa Value unknown b cost above Analysis shows a insufficient under May only be able

strategy 10. Sends confusing message to tenants about Council's intentions			linked to Governr Requires HCH cc

Appendix 5

Risk Assessment 3

Continue with LSVT Process

Factors	**Probability**	**Impact**	**Comments**
1. Tenants vote in favour of transfer in August 2002 2. Tenants vote against transfer in August 2002 3. Transfer fails to attract funding support 4. Council/Riverside/DTLR unable to agree on acceptable transfer agreement 5. Transfer cannot be delivered during 2002/03	Unknown Unknown Low Low Low	High High High High High	Transfer proceeds.Inve recovers c.£1.2m of tra Significant abortive cos Council plus Riverside' strategy/ organisationa Housing demand is a c group-based borrowing additional stability Risk arises if minimum with DTLR cannot be m all three parties to do s There is no guarantee transfer is delayed for a