CIH Response to: Independent Commission on Local Government Finance

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‘Shaping Housing and Community Agendas’

1. Introduction

The Chartered Institute of Housing (CIH) is the independent voice for housing and the home of professional standards. Our goal is simple – to provide housing professionals with the advice, support and knowledge they need to be brilliant. CIH is a registered charity and not-for-profit organisation. This means that the money we make is put back into the organisation and funds the activities we carry out to support the housing sector. We have a diverse and growing membership of more than 22,000 people who work in both the public and private sectors, in 20 countries on five continents across the world. Further information is available at: www.cih.org

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General points

CIH welcomes the establishment of the Commission and is pleased that it will focus (in part) on the financial issues of housing supply and management. This CIH submission concentrates on housing issues although we also make points relevant to welfare reform and to local authority borrowing in general.

Needless to say the Commission's work takes place in parallel with that of two reviews of housing supply – the Elphicke Review commissioned by the government and the Lyons Review commissioned by the Labour Party. CIH has made submissions and more detailed contributions to both of these and many of the points we make here were reflected in those submissions.

Our submission is structured in a similar way to the housing part of the Commission's call for evidence, and covers:

- borrowing
- receipts from sales (including homes and land)
- accounting treatment and rules
- housing benefit
- local council tax support
- central government and Homes and Communities Agency funding
- the new homes bonus
- rents and other fees and charges
- other issues.

Borrowing for housing investment

CIH has long argued for more borrowing freedom for local authority housing investment. Annexed to this paper is the detailed case for change that was put to the Lyons Review,

and which builds on the report *Let's Get Building* published in late 2012 by various bodies including the LGA and CIH, and the more recent update *Treating Council Housing Fairly* published by the National Federation of ALMOs.

Based on recent research by the LGA, it is estimated that councils' housing output could grow to 15-17,000 units per year within five years if borrowing constraints were removed or significantly relaxed. As an illustration, Birmingham City Council currently plans to build over 2,000 new homes in ten years, investing £254 million from its HRA resources. It is unable to borrow beyond its borrowing cap of £1.136bn. If the cap were lifted it could potentially build a further 18,000 new homes by 2031, meeting a quarter of the city's overall housing requirement.

CIH urges the Commission to make recommendations based on the proposals attached. They offer two approaches: initially, government could be asked to relax the borrowing caps in specific circumstances, e.g. for councils already planning to use their full borrowing headroom and whose investment plans require more headroom; at the same time, government could be asked to shift towards borrowing rules based on international conventions, which would make the caps unnecessary in the longer term (although of course measures would continue to be needed to ensure borrowing remains sustainable).

It is worth noting that there are wider arguments for such rule changes within local government, not just for the housing sector. If LA-owned enterprises were treated as they are elsewhere in Europe, their borrowing would not count as part of government borrowing. This is important as if councils' borrowing for non-housing investment were to grow, central government might decide to impose caps in the way it has on HRA borrowing. LA enterprises that could potentially benefit from a rule change include airports and bus and tram companies in the transport sector and a range of other businesses (such as markets) whose costs are met mainly from the income they generate.

It is also worth noting that the potential for rule changes of this kind has implications for the LGA's proposal for a Municipal Bonds Agency. If some types of LA investment were no longer to be counted as government borrowing, then it would be vital for LAs to have access to non-government borrowing sources at competitive rates. The Bonds Agency could do this – and potentially replace the role of the PWLB – if it were constituted so as to avoid being classified as part of government. CIH has made representations to the LGA on this issue, in the context of potential changes to borrowing rules for council housing.

Receipts from sales

CIH's main concern under this heading is the rules relating to receipts from the right to buy. The right to buy (RTB) has not provided sufficient receipts to replace stock and has been accompanied by significant disincentives for councils to build, so that for the majority of the period since 1980 overall new social housing output (including by housing associations) has not kept up with the loss of stock through sales (see Figure 1).

Furthermore, policy has never taken account of the impact of RTB in leaving poorer-quality stock with lower-income tenants and higher per-unit management costs. Since 1980 RTB across Britain has raised over £50 billion through 2.5 million sales, at an average sale price of only £20,000.[1] Over the same period the total of new houses built by social landlords has been half the number sold. Except for the decade to April 2012 when discounts were much lower, the government's first priority has been to promote sales: the average RTB price is now barely one quarter that of an average house on the open market. The second priority has been to repay receipts to the Treasury. Allowing councils to reinvest has been a poor third: sales have recently risen to over 11,000 but output of new homes by councils is still less than one-fifth of this.

Figure 1: Right to buy sales and social housing completions since 1980

Source: DCLG Live Tables 244 and 671.
Note: Includes RTB sales plus sales by HAs under the protected RTB; data for 2013 exclude HA sales.

Radical options for reform could be to end RTB (as is soon to happen in Scotland) or make its use discretionary so that it can continue in areas where it is an effective route into homeownership. However, if it is retained there are strong grounds for changing the rules that apply, especially relating to use of receipts.

The rules about RTB receipts are complex and prevent the full replacement of properties sold. Only one in five councils are able to replace RTB sales and councils regard this as one of their most urgent priorities for reform.[2] There are a number of options which could be considered:

- all receipts to return to LAs for reinvestment in replacement housing or, less radically, reduce the 25% top slice to the Treasury to say 15%

[1] Wilcox, S. and Perry, J. (2014) *UK Housing Review 2014.* See tables 20d and 60.
[2] LGA (2014) *Housing self-financing survey: a survey of councils and ALMOs.*

- like-for-like replacement (i.e. ability to use receipts to replace a social rented unit with another social rented unit)
- the 30% restriction on the extent to which RTB receipts can be used to support new build should be removed or lifted to at least 50%.

The 'cost floor rule' exists to protect a council's recent investment in housing when RTB takes place. Although now applying for 15 years after a sale, it still does not properly protect new units and councils risk not only losing relatively new stock but also getting a receipt which will not cover the outstanding debt. This could be dealt with by:

- exempting from the RTB properties built after the discount change in 2012
- extending the cost floor for those properties so that it applies indefinitely
- adding a rule that no property can be sold at less than its build cost
- limiting the discount to one per cent for each year of the property's age – 60% for a 60-year old property but 20% for a 20-year old one
- reverting to the pre-2012 discount levels and limits.

To prevent RTB homes ending up in the private rented sector, conditions should be placed on sales to ensure that the purchaser uses the property as his/her main residence. Additionally, it should be easier for councils to reacquire property that is later let privately.

Accounting treatment and rules

The main change under this heading relates to borrowing rules (see above). However, there are some other changes which could also benefit local authority housing investment and support self-financed HRAs.

The HRA ring-fence
When self-financing took place, it was originally intended to produce guidance on how the HRA 'ring-fence' should be observed. However, the coalition decided not to proceed with this. Furthermore, under the Localism Act the transitional arrangements for self-financing appeared to give councils the opportunity to make payments from HRA surpluses to the General Fund, and a small number of councils did this before the arrangements expired. Since then, there has been considerable evidence of councils reviewing charges to the HRA and either increasing them or moving new items of expenditure onto the HRA.

CIH understands the pressures LAs are experiencing on their General Funds, and why they may legitimately review charges made to the HRA. But it is important to observe the principle that tenants do not pay twice for services, through their rent and through council tax. CIH has urged the government to reconsider its decision not to issue guidance on the HRA ring-fence. In the absence of such guidance, this is something that could usefully be done by the LGA itself, perhaps in partnership with CIPFA and CIH.

Use of funds within the HRA
Rules which prevent councils from using HRA funds more widely should be changed to allow them to fund mixed-tenure schemes and rent-to-buy schemes in which households can 'staircase' both into and out of full ownership, a particular help to older people. It should also be possible to transfer land into the HRA at nil value to build council homes (as can be done for a partnership arrangement with an HA).

Position of councils with no HRA
The Treasury needs to clarify current rules which act as a disincentive to councils which have closed their HRA from re-investing in housing. It should be easier for councils to build and manage a limited portfolio without opening a new HRA, with properties being managed by a standalone company or HA.

Asset management and council housing stock
The coalition government is currently consulting on rule changes which would require councils to report regularly on the value of their housing stock. CIH has responded to this saying that a much wider approach to effective asset management is required, that should not focus solely on identifying high value properties that could be sold. CIH has set out in more detail what effective asset management means (already being implemented by some local authorities). The Commission could usefully look at asset management as a wider issue, not solely in relation to council housing stocks.

Housing benefit

Housing benefit must be considered in relation to the transition to universal credit (UC) now taking place.
CIH has had a fairly consistent line since 2010 that LAs should be able to assess – or partly assess UC. This should not be difficult if UC is online as in theory all LAs need is login access. It makes sense to help speed up administration as – whether the government intends this or not – people will naturally go to their LA for help. It also makes sense in terms of fraud detection and expertise about the rules for eligible rent. A local administrator will have local knowledge of whether a rent being asked for is about right, whether a property is rented and if so what type of tenure, etc. A central administrator will not be in the same position and there will be much greater potential for fraud.
CIH has made the following suggestions as to a local role:

- *Splitting UC (but not the award) into local elements and national elements*. Local elements would be housing costs and childcare both of which rely on local knowledge. As a minimum, local authorities could verify and award these (subject to the nationally determined ones and overall decisions being retained by UC centrally).
- *Competitive assessment.* Either DWP or the LA can award UC; if the LA 'gets their first' they get the equivalent of HB subsidy for administration (while of course DWP pay the award itself). Local authorities could bid for DWP staff (e.g. pay wages) for DWP DMs to be part of a wider assessment team (like many do already).

One local authority made the very good point that government expects them to provide support in a process over which they have no control. If the LA gives advice then they are on a hiding to nothing, whereas at least in the present system if someone comes in to complain they can do something about it. As it stands, apart from being driven by corporate ethos, there is no incentive to assist claimants; LAs are better advised to just redirect claimants back to DWP.
Finally without online access (albeit only used if requested by customer) then LAs cannot really help. There is no way of telling whether either one of their tenants or any other tenant is entitled, so for example they cannot do preventative homeless work.
Steps are being taken for social landlords to be able to obtain 'trusted partner status' in relation to UC claims. This may help resolve some of the issues about claimants who are council tenants but does not address the wider issues just raised about helping non-tenants, especially those in the private sector or at risk of homelessness.

Local council tax support

There are considerable problems resulting from the shift of responsibility to local authorities for council tax (CT) support, principally because in the current year councils lose around £400m that was previously provided by central government to reduce council tax bills for residents on low incomes. The *Independent* has reported that (among others) 409,000 disabled people have seen their CT increase, while 112,000 carers have also been hit.[3] The effects have been disproportionate because councils have been banned from reducing support to pensioners, who make up 2.2 million of the 5.9 million who used to get support. The Citizens Advice Bureau says that one in five people reporting debt problems are now facing CT arrears, while research by the Institute for Fiscal Studies found that entitlement had been reduced for 2.5 million working households by an average of £160 in the last financial year.

The new arrangement is not a truly local scheme it is just a way of making cuts in expenditure and passing responsibility to local level (or appearing to). If it was truly local there would be some councils that offered enhanced council tax rebate (CTR), but none do. All councils use either the 'default scheme' (in effect zero change to entitlement from the old scheme) or something worse.
Funding arrangements are unfair as a result of the fact that pensioners are protected. It means that those with high pensioner caseloads have to cut harder in their working-age scheme. The "10%" cut is therefore much higher than that for working-age claims (not just those with high pensioner caseloads).
The switch from AME to DEL funding is also wrong and wholly unfair. Councils may be managing reasonably well at the moment but what happens when the next economic downturn happens and need starts to increase? – especially if (as is almost always the case) the effect of a downturn is not evenly spread across the regions or even within regions.

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[3] *Independent*, 28 July 2013 'Council tax rises hit Britain's poor hardest'.

Because it is now treated separately rather than being aligned with housing benefit, CTR undermines some of the positive work-incentive gains that will be obtained from universal credit. At best it increases the marginal 'tax' rate under UC from 76% to 90% - worse for those with inferior local schemes.
The legal arrangements for local schemes are an administrative nightmare. The prescribed requirements regulations (CTRP) set the minimum framework – but only for pensioners. No council in reality writes its own scheme (and would be foolish to do so due to legal challenges). What they do is adopt the default scheme (CTRD) – and then vary it (if they wish). In the vast majority of schemes this simply means adjusting the maximum eligible CTR down from 100% of the CT to a lower amount (that happens to balance the books). Changes are made to the CTRP regulations to reflect wider changes (such as the benefits uprating and immigration law as it affects benefits) – but not to the CTRD.
In fact the CTRD regulations have expired but most councils still refer to them as to the rules for their local scheme. The CTRD scheme should as a minimum be recast each year (or amended from the previous version). In effect it should be a model scheme which would save on administration and potential technical legal challenges. A model scheme would not undermine local discretion – LAs would not be obliged to adopt it and could vary it as they wish. A council would be most unlikely to write its own scheme from scratch as it would be both expensive and legally risky.

CT may be a local tax but (apart from a few details such as discounts for very limited classes) it is a nationally determined tax: only the level for band D is local. A uniform CTR scheme would therefore help to ensure fairness. Funding should (as a minimum) be based on the baseline, e.g. much like the pre-1988 scheme. Ideally, CTR should be inside UC (but then it would not be local at all). However it would be possible to have a scheme that is equivalent to being inside UC but retains local administration. It would be very simple to set rules so that:

- A household eligible for UC is also eligible for 100% CTR.
- If not, then CTR is worked out as tapering away at the same rate as UC (65%) from the (income) point at which the household's UC tapers to zero. So, for example, if the income at which the household lost UC was £1,500 per month, the CTR would taper away at 65% for any income above that point.

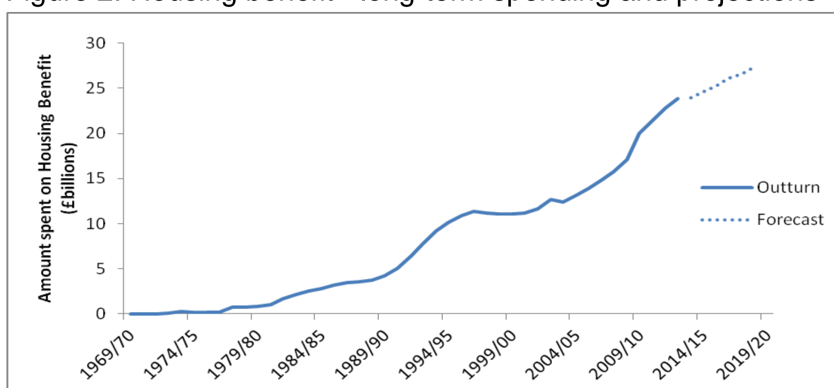
CIH urges the Commission to consider the issues of compatibility between council tax rebate and universal credit in its report.

Central government and Homes and Communities Agency funding

Affordable Rents and the shift from investment towards spending on benefits
The 2010 Spending Review saw capital investment in housing cut by 63% in real terms – the biggest cut to any government capital budget and a fundamental shift in government support. The gap was left to be filled, in part, by the introduction of Affordable Rent (AR) to generate extra revenue. This threatens the role of the social sector in providing lower-cost homes because the new rents are close to 80% of market levels (in London currently 69%).

Not only are AR rents higher, but AR lettings tend to be allocated to similar proportions of benefit-dependent households as social rented ones – putting extra costs on the benefits bill and trapping more tenants in the benefits system.[4] At almost £25 billion, the housing benefit bill has grown to over 3% of public expenditure (Figure 2). Despite welfare reforms which have cut entitlements, expenditure is still growing, suggesting a budget which is out of control. About half a million more people now receive HB than in 2010, including many in low-paid work.

Figure 2: Housing benefit - long-term spending and projections



Source: DWP.

The case for shifting expenditure back from 'benefits to bricks' has been argued by IPPR and other bodies.[5] There is a huge contrast between the planned £3 billion investment in affordable homes over the next three years, and over £40 billion that will be spent over the same period in helping social tenants pay their rents. Yet in the 1970s only 20% of public spending on housing was on rent subsidies with the rest channelled directly into housebuilding.[6] If the same ratio applied today, an additional £19 billion a year would potentially be available, funding 175,000 new homes.

There is a strong case for brave, structural reforms to the current system. Without such reform, supply- and demand-side measures can only ever treat the symptoms of the housing crisis – providing a small shot in the arm without curing an increasingly sickly beast. Such a transition is essential in creating a healthy and more sustainable housing market for future generations. Although the urgency of current housing need will require immediate measures, only by undertaking deeper reforms and rebalancing this mismatch will the government truly address housing need over the long term.

This cannot be a simple policy U-turn but requires a careful and considered approach to economic management in the middle to longer term. As the IPPR shows, a number of

[4] Pawson, H. and Wilcox, S. (2013) *UK Housing Review 2013,* p.91.
[5] IPPR (2014) *Benefits to bricks: Mobilising local leadership to build homes and control the benefits bill*.
[6] Stephens, M., Whitehead, C. and Munro, M. (2005) *Lessons from the past, challenges for the future of housing policy: An evaluation of English housing policy 1975-2000*.

factors such as demographic change and rent pressures have not only increased the benefits bill but also made the system more vulnerable to downturns in the economic cycle. By reducing the amount of genuinely affordable homes and leaving the private rented sector as the only option for many in need, successive governments have effectively broadened the base of dependant households, more vulnerable to changing economic conditions and to rent rises.

While many of the macroeconomic impacts of a recession fall outside the scope of housing policy, the historic undersupply of housing and distorted tenure patterns are factors that can be tackled directly. A healthier economy and housebuilding industry would also go a long way in redressing the imbalance in expenditure. But it is important that any housing/welfare policy decisions are subjected to the test of whether they help to achieve the shift away from benefits spending and towards investment or whether they make it worse.

The current Affordable Homes Programme creates significant problems against this yardstick. It requires AR to be charged for most new homes and for a proportion of current lettings to be converted to AR. Homes sold through right to buy also have to be replaced with AR units. During 2012/13 alone, there was an estimated loss of almost 35,000 social rented units due to conversions to AR as well as sales, mainly in the HA sector but also including some in LAs.[7] In 2013/14 and 14/15 losses are likely to be much higher as in total over the three years conversions alone are projected to rise to almost 100,000.

There is a clear need for a rethink about central government and HCA funding, and especially about its reliance on AR. Arguably, AR has resulted in the worst of both worlds: a product which gets a smaller amount of subsidy, charges rents 55% above social rents but then goes to the same people as social rented property would do. It would be better to revert to a proper mix (as there used to be until 2010) between social rent on the one hand and genuine intermediate rent/shared ownership options for those on modest incomes but not dependent on housing benefit.

Details of the current HCA programme

Not all councils or new build schemes need grant. However, in addition to the argument set out above there are more modest changes to current rules which should be considered. They include:

- Grant is dependent on letting properties at Affordable Rent when this may not address local needs and LA assessments of tenants' ability to pay. Councils currently plan 50% of their new build output to be at social rents. HCA funding should not be refused simply because AR rents will not be charged.
- Grant is also now dependent on LAs showing they have considered asset sales and/or conversions to AR rents. However, this may not be appropriate: councils

[7] Calculation based on local authority housing statistics (LAHS) and HCA SDR returns for 2012/13.

should be able to show that their asset management strategies have properly considered/rejected these options.

The New Homes Bonus

The New Homes Bonus (NHB) pays councils the equivalent of six years of extra council tax for every newly built house or empty one reused, with a supplement for new affordable housing. It is a mix of new funding and top-slicing from formula grant. Total allocations will be £2.2bn over 2011-15, of which £1bn is additional money.

The NHB was expected to stimulate an extra 144,000 homes over ten years. This is a modest target compared with the falls in output due to the ending of regional housing targets.[8] The NHB is also modest compared to incentive schemes in other countries (e.g. Switzerland) where local tax is a much bigger proportion of local authority budgets, so an increment to such tax is also much bigger.[9]

The NAO criticised DCLG claims for the NHB as unreliable and its impact as difficult to identify.[10] After six years, payments could grow to £1.6 billion with some councils gaining substantially while others suffer big losses. High value areas are big winners whereas northern councils, even when championing housing growth, receive small shares of NHB (see Figure 3). Furthermore, the government has recently decided to pool 35% of the bonus to share among LEPs, further reducing the incentive.

Figure 3: NHB undermines the resource base of large urban authorities

	Topslice £m	NHB Grant £m	Net £m	Topslice £/dwelling	NHB Grant £/dwelling	Net £/dwelling
Birmingham	-22.675	15.082	-7.593	**-52.79**	35.11	-17.68
Liverpool	-11.138	5.394	-5.744	**-51.39**	24.89	-26.50
Manchester	-11.268	8.674	-2.594	**-50.84**	39.14	-11.70
Newcastle	-5.728	3.629	-2.099	**-45.88**	29.07	-16.81
Nottingham	-6.088	4.177	-1.910	**-45.59**	31.28	-14.30
Sheffield	-9.181	5.954	-3.227	**-38.27**	24.82	-13.45
Bristol	-6.429	9.479	3.050	**-33.44**	49.31	15.86
Leeds	-10.066	10.984	0.918	**-29.50**	32.19	2.69
Windsor & Maidenhead	-0.821	2.152	1.331	**-13.26**	34.77	21.51
Richmond upon Thames	-1.457	2.440	0.983	**-17.63**	29.53	11.90
Wokingham	-0.890	2.730	1.840	**-14.05**	43.09	29.04
Hampshire	-9.498	19.664	10.166	**-16.68**	34.53	17.85
Surrey	-8.603	19.483	10.880	**-17.96**	40.66	22.71
England	-700.000	916.194	216.194	**-30.03**	39.30	

Source: Core Cities / Newcastle City Council.

[8] Research in 2012 suggested these falls amounted to 272,720 houses across England. See Tetlow King Planning (2012) *Research on the Impact of the Impending Revocation of Regional Strategies on Proposed and Adopted Local Housing Targets across England.* London: Policy Exchange.
[9] Pawson, H. and Wilcox, S. (2010) *UK Housing Review 2010 Briefing Paper.* Coventry: CIH.
[10] NAO (2013) *The New Homes Bonus.* London: NAO.

If NHB fails to achieve worthwhile extra output, it becomes simply a redistribution mechanism in which low-value areas lose out on central government support. Its extra costs could be better used in direct investment. If an incentive mechanism is required, it would be worthwhile re-examining the merits of the previous government's Housing and Development Grant.

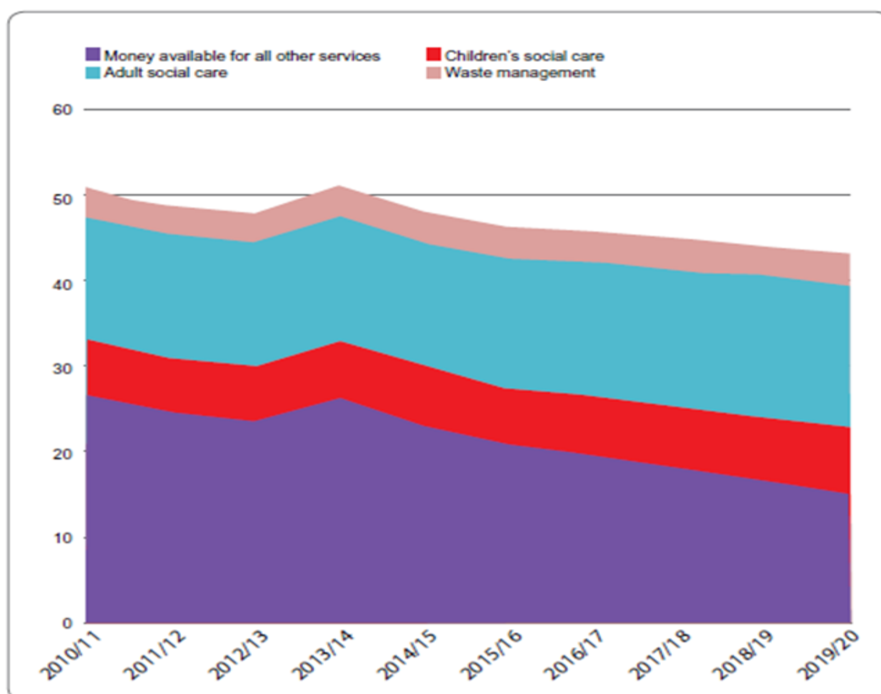
Rents and other fees and charges

The government has halted the process of convergence of social sector rents, which means that councils have less potential than they otherwise would to finance part of the costs of new build from rental income. LAs need to be able to sensibly structure their rents, taking into account local circumstances: the convergence policy allowed more scope for this to happen. Policy should revert to that set by the previous government, to allow social rents to converge within a reasonable timescale, as councils were required to assume when they set their HRA business plans.

One of the hangovers from the old HRA system is a provision called the rent rebate subsidy limitation, which limits LA rent increases through a clawback mechanism on the subsidy they receive towards housing benefit costs for their tenants. This is an anomaly which could sensibly be replaced in considering an up-to-date regulatory frame work for LA rents, aligned with that for housing association rents.

Other housing issues

Figure 4: Projected local authority spending to 2019/20



Source: LGA (2014) *Future Funding Outlook 2014.*

Most local authority work to support housing supply is financed from councils' General Funds, which are under severe pressure. As Figure 4 shows, once spending on protected services has been accounted for, local authority spending on other services will have fallen by 43% in cash terms (more in real terms) by the end of the decade, compared with 2010/11. The LGA points out that, even within these other services, some such as concessionary fares are likely to have to be protected, so the cuts on truly discretionary services will be even more severe.

The implications for housing are considerable. General Fund spending on housing in England has already fallen by more than a quarter since 2010/11.[11] In relation to promoting housing supply, strategic housing teams, planning teams and estates/property management staff are seeing cutbacks in response to pressures to maintain other frontline services. This has inevitably affected capacity and availability of skilled staff to promote housing development and create partnerships with the private sector and others, and will severely affect capacity to respond to the current Elphicke and Lyons Reviews of housing supply.

Furthermore, despite the coalition government maintaining the previous government's policy aim of preventing homelessness, resources for such work have also been drastically affected by cuts in funding. While the government has protected the relatively small sums that DCLG allocates centrally, how they are spent is entirely at local discretion. In any case, the bulk of funding for advice, support and other services comes from General Funds: nearly three-quarters of General Fund housing expenditure goes to a combination of homelessness, supporting services and housing strategy and advice services, all of which contribute towards assisting homeless people in different ways (e.g. housing options services, enforcement of private sector tenancy rights, facilities for victims of domestic violence, etc.).

Finally, the private rented sector has doubled in size and now provides homes for four million households, more even than the social rented sector. Local authorities have the main role in monitoring conditions in the sector yet this service, too, has been drastically affected by cuts, just as it should be growing.
There is no easy answer to this, but it must be made clear to government that continuing cuts in local authority spending are undermining policies such as boosting private housing output, raising standards in the private rented sector and preventing homelessness, and that the services that provide these non-HRA housing functions are under severe threat.

Where possible, the Commission should look at ways in which councils could pay to maintain or improve service levels through higher direct charges, whether for planning permission or for licensing or accreditation schemes to improve the quality of private

[11] DCLG (2013) *Local authority revenue expenditure and financing in England: 2012 to 2013 final outturn*. London: DCLG.

rented accommodation. There is a case for aiming to fund the whole cost of such services from charges, to relieve pressures on funding areas such as homelessness prevention.

Appendix

BORROWING RULES AND COUNCIL HOUSING
A summary of the arguments and options for change

Local authorities in England have considerable capacity to build more homes but are restricted in doing so by the borrowing caps imposed when council housing became self-financing in April 2012.

This paper assesses the potential for relaxing or removing these caps and the additional output that would result.

Why do it?

There are six main reasons for giving councils more borrowing freedom, of which the most important is their potential extra output of new housing:

Potential extra output
Since 2010, councils have been building about 1,500 new units per year – as against only 2-300 for many years before that. Output received a further potential boost when council housing became self-financing in April 2012. According to a 2013 survey by ARCH, *Innovation and Ambition* (IAA), councils' current plans mean their output should rise to 4-5k per year over the next five years. The 2012 report by NFA (with CIH, LGA and ARCH) *Let's Get Building* indicated that, without the constraint of the borrowing caps imposed as part of self-financing, the potential *extra* output would be a further 12k units per year over five years. In total, therefore, LA output might rise to 16-17k, at least for a period, if the caps were relaxed or removed. These figures have an element of speculation but are indicative of the potential 'locked up' in councils' self-financed HRAs and which could be fully released if extra 'prudential' borrowing caps were allowed.

Achieving the 200,000 output target
The 2013 report by Savills for the G15, *Additionality of Affordable Housing,* suggested that a 200,000 annual target would require (and could be based on) the following achievable output levels from each sector: private – 130,000; housing associations – 55,000; local authorities – 15,000. The LA output levels indicated above are therefore an essential part of a 200,000 house programme and can only be achieved by giving LAs more borrowing freedom.

Using available borrowing capacity
Councils are in a strong position to borrow. Their average debt per dwelling is only around £17k – which is similar on average to HAs but HA debt is disproportionately held by

developing associations. Councils typically have a gearing ratio (ratio of debt to equity) 50% lower than that of developing HAs. *Let's Get Building* indicated current headroom of £2.8bn within the caps but additional borrowing capacity of at least £20bn if the caps were relaxed/removed.

Putting less reliance on grant
Councils' current plans show little expectation of receiving HCA grant – the IAA survey showed expected grant contributions of only £4-20m annually for a total capital investment programme (including significant investment in existing stock) of £1.5-1.7bn annually up to 2015/16. Councils fund their investment mainly from reserves, revenue contributions, capital receipts and borrowing financed from rents.

Building at social rents
Soon all HCA-funded output by HAs will be at Affordable Rents. However, councils retain capacity to build at social rents and many wish to so (or to produce a mix of social rent and Affordable Rent output). The IAA study indicated that 50% of LAs' planned output is at social rents.

Releasing LA land
Finally, much potential development land is linked to existing estates – whether redevelopment of obsolete property or use of spare land such as underused gardens, garages, etc. Councils (as landlords) are in the best position to release such land, taking into account residents' views.

What are the borrowing caps?

Caps on borrowing were imposed on each council in April 2012, based on calculations under the old HRA subsidy system. Their impact is arbitrary – some councils that need it have no or limited headroom, others have significant headroom and may not need it. Although all council borrowing affects government debt, HRA borrowing is the only part that is capped. Caps do not apply in Scotland, where councils can and do borrow within prudential limits, currently building almost to the same levels as in England (over 1,000 new units annually).

What are the options around relaxing the caps?

Essentially there are two strategic options:

Option 1: relax or remove the caps *within current borrowing rules*
- no major change in the current regime for council housing finance
- *but* means extra government borrowing.

Option 2: a *change of borrowing rules* to those that apply internationally (see below)
- removes LA housing borrowing from the main measure of government debt

- LAs would no longer have access to the PWLB and need to rely on the financial markets
- LA housing businesses operate within the same market disciplines that apply to HAs
- brings the UK into line with our competitors and accounts separately for borrowing by public corporations (including ALMOs and directly managed council housing).

An alternative approach to the removal of the borrowing caps is to pursue a ladder of changes within option (1). These might be:

- a controlled bidding round for councils near to their borrowing caps, linked to new build plans
- lifting the caps to a new set level to make an additional allowance for new build for every council (as was originally planned in the self-financing deal under the Labour government in 2010)
- an index-linked debt cap that increases over time to reflect inflation

This staged approach could be planned to lead to the full removal of the caps linked to new arrangements to ensure that any new borrowing is sustainable (i.e. potentially leading to option 2).

Criteria for the government allowing phased changes could include robust governance arrangements, business plan viability and sustainability, track record of delivering new build programmes, deliverability of schemes, value for money, etc. as would be required for private sector borrowing from the financial markets.

Under option 1, government could at any time re-impose borrowing controls, either in specific cases or across the sector. This is therefore a low-risk option but with the major disadvantage that all the extra borrowing is 'on the books'.

Are there other alternatives to get borrowing 'off the books'?

The other alternatives have all been explored or are already used:

- Stock transfer is the most obvious. Most councils who now retain stock or have ALMOs are now unlikely to consider transfer as (a) they will have rejected it previously and (b) incentives are now limited.
- Options to build on the ALMO model so that the council retains a stronger interest in the stock than is the case with transfer were explored in the 2011 NFA report *Building on the potential of ALMOs to invest in local communities.* None have so far proved feasible in practice.
- Other options, such as 'municipal housing companies' in which the LA has a controlling share (as in Sweden) would only avoid borrowing constraints if there were to be the same rule changes as under option 2.

What change in borrowing rules would be required for option 2?

The UK's fiscal rules are based on targets for controlling the level of Public Sector Net Debt (PSND) as a proportion of GDP. However, PSND is a uniquely British measure; the main international measure of debt is General Government Gross Debt (GGGD). Currently, GGGD is about 90% of GDP while PSND is lower at about 75% (principally because PSND nets off the value of government financial assets). While it focuses on PSND domestically, the government has to report GGGD levels to comply with the Maastricht Treaty and it is the main measure used by the IMF, OECD, etc for international comparison. Whatever rule changes the UK government makes, it still has to abide by Maastricht rules which are monitored by EU-wide bodies such as Eurostat.

The main difference in the sectoral coverage of PSND is that it covers the whole of government, including public corporations, while GGGD includes only central and local government borrowing. Council housing and ALMOs as a sector are classified as 'public corporations' by the ONS (which is responsible for sectoral classification in the UK under EU accounting rules). Other public corporations include bodies such as the East Coast Mainline, British Nuclear Fuels, Royal Mint, local airports, bus and tram companies, etc. Public corporations account for only about 1% of public spending although for a higher proportion (13%) of capital investment.

The government has flexibility to decide whether or not any or all public corporation borrowing counts towards its domestic debt measure, as in any case it will be excluded by the international measure. A topical example is the part-nationalised banks, which are excluded from PSND and do not affect the UK's GGGD as they are public corporations. Changes of classification occur fairly often: for example Network Rail has recently been reclassified as a government body, increasing PSND by 2% of GDP. Further education colleges have been reclassified twice in the last few years and are now in the private sector despite the public subsidy they receive. A future government may well do the same with academy schools.

A change in rules could therefore be either:

- a general change (presumably as part of a new set of fiscal rules) towards measuring UK debt by accepted international criteria (including switching from PSND to GGGD as the main measure of debt); or
- a specific exemption for council housing, to treat its debt as outside the *current* debt measure (PSND); this would still comply with international measures since council housing debt is already excluded from GGGD.

Under either, there could of course be reporting arrangements (as there are with the banks) so that the new 'off balance sheet' borrowing is transparently monitored.

The case for change and further details of what would be required are set out in *Let's Get Building* and in the recent summary and update by NFA, *Treating Council Housing Fairly.*

What further changes would be needed if LAs were to have the same borrowing freedoms as HAs?

The options above have become much more viable since self-financing began in April 2012, since councils have already put in place more realistic business plans, have in many cases separated out their HRA debt and are already making decisions about the more effective use of incomes, balances and reserves. The extent to which councils would need to further change their governance and accountability arrangements depends on whether option 1 or option 2 were to be pursued (and of course stages in option 1 could be used as steps to option 2, allowing time for and conditional on the necessary institutional changes).

Under option 2, to properly put council housing on a similar basis to housing associations with (for example) access to bond markets, other reforms would be needed. Briefly, these are:

- full separation of HRA from non-HRA debt where this has not yet taken place
- reporting and monitoring arrangements for total debt at national level
- financing of new debt (and, if possible, refinancing of old debt) from non-government sources (i.e. not the PWLB, which is part of government); the LGA's proposed municipal bonds agency represents one route to do this
- comprehensive code of practice for self-financed council housing – this would incorporate the CIPFA Prudential Code
- a review of the mechanisms that would permit councils to borrow on the basis of their HRA income streams and assets (i.e. as HAs do) and the regulatory framework that would apply
- robust governance and risk management arrangements for each council housing business that provide the level of assurance and comfort that bond market investors require.

The last three points are vitally important as councils would be moving into new territory: at present their borrowing is guaranteed against their whole income stream and ultimately back by government. New arrangements would be needed that meet the expectations of private funders who will require robust arrangements in case of default. Among the options that will need to be considered are:

- how 'arms length' the council housing business should be – can it be run successfully from within the council or should LAs be required to put their assets in the hands of an ALMO (i.e. a wholly owned company)?
- whether council housing businesses should be regulated by the HCA and if so what changes this would require.

A staged approach to reform, as advocated in this paper, would create time to resolve these issues and for the new mechanisms to be put in place.

Wider obstacles to reform

Both *Let's Get Building* and *Treating Council Housing Fairly* look in detail at the obstacles to these changes, and the former specifically considered City opinion in a separate study commissioned from Capital Economics. The main obstacles are resistance to change by the Treasury and possible adverse reaction from the markets. The main arguments in addressing these obstacles include:

- The UK is simply bringing itself into line with international rules.
- These rules already apply to foreign public corporations operating in the UK, e.g. transport companies such as Arriva and energy companies like EDF.
- In the housing sector, LAs and HAs effectively do the same job and should follow the same rules.
- While it can be argued that council housing will still have an implicit government guarantee:
    - protection could take the same form as with HAs, i.e. tenants and homes are protected but a failing organisation might need to be taken over by another entity so as to achieve this
    - many bodies in the private sector (banks, utility companies) also effectively have a government guarantee, as we have seen.
- Transparency will be maintained and indeed strengthened.
- Market disciplines will apply, whereas they do not apply now.
- Overall controls will still be in place and in any case the potential sums involved are small in the context of overall expenditure and borrowing.

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