Communities and Local Government

Council housing: a real future

Impact Assessment

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Council housing: a real future

Impact Assessment

March 2010
Department for Communities and Local Government

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Contents

Impact Assessment

Summary: Intervention & Options		
Department /Agency: **Communities and Local Government**	**Title:** **Council Housing: a real future Impact Assessment**	
Stage: Consultation on Prospectus	**Version:**	**Date:** 24 March 2010
Related Publications: Review of Council Housing Finance Consultation		

Available to view or download at:
http://www.

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What is the problem under consideration? Why is government intervention necessary?
The Housing Revenue Account Subsidy (HRAS) system is the current redistributive system for financing council housing. The system redistributes income from areas where there is assumed to be a surplus to areas where the income does not match needs. However, this system is unsustainable. It will not deliver sufficient funding to maintain council homes to a good standard, and its inherent volatility makes long term planning difficult for authorities. The review aims to find a new system that is sustainable, long-term and consistent with wider housing policy.

What are the policy objectives and the intended effects?
The policy objectives are to produce a system for financing council housing that is: fair, transparent and sustainable in the long-term. A system that supports tenant involvement in decisions about their homes and locality and enables councils to deliver efficient and effective housing services in their area. The system should be affordable for the taxpayer and it should integrate with wider housing policy and the role of the regulator.

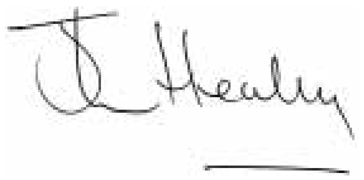
What policy options have been considered? Please justify any preferred option.
A number of options were considered in phase one of the Review, however it was evident from responses to the consultation that a self-financing option rather than a variation of the current system was strongly favoured by authorities.
This is the second phase of the review. Self-financing was identified as the most viable option for system reform. Under this approach, councils would keep their own rental income in exchange for a one-off debt redistribution.

When will the policy be reviewed to establish the actual costs and benefits and the achievement of the desired effects?
We will work within the local government performance framework and in partnership with the Tenant Services Authority to gather information about the impact of these reforms in aggregate and on individual local authorities. We propose to conduct a formal review of the impacts within 3 years of implementation and to report on the outcome.

Ministerial Sign-off For Consultation Stage Impact Assessments:

> ***I have read the Impact Assessment and I am satisfied that, given the available evidence, it represents a reasonable view of the likely costs, benefits and impact of the leading options.***

Signed by the responsible Minister:



Date: 25th March 2010

Summary: Analysis & Evidence

Policy Option:	Description:
Self-financing	**An improved vesion of the current system – with increased allowances, and reduced volatility.**

COSTS

ANNUAL COSTS		Description and scale of **key monetised costs** by 'main affected groups'
One-off (Transition)	**Yrs**	Cost to Exchequer of Increased Management and Maintenance and Major Repairs Allowances (annual average – £529m, NPV over 30 years £9.724bn) One off cost to Local Authorities of implementing new system – negotiation of business plans (£32.1m).
£32.1m	1	
Average Annual Cost (excluding one-off)		
£529m	30	**Total Cost** (PV) **£10bn**

Other **key non-monetised costs** by 'main affected groups'

Loss of efficiency from ending pooling of right to buy reciepts. Risk of mis-management of resources by local authority resulting in bailout.

BENEFITS

ANNUAL BENEFITS		Description and scale of **key monetised benefits** by 'main affected groups'
One-off	**Yrs**	Increase in efficiency due to authorities' ability to plan long-term (£338m to £413m p/a, NPV range over 30 years of £6.2bn to £7.6bn). Homes maintained to a decent standard without the need for additional capital investment programme in future, saving the estimated costs it would generate (£9.7bn-£12.2bn range).
£9.7bn to 12.2bn	1	
Average Annual Benefit (excluding one-off)		
£338m to £413m	30	**Total Benefit** (PV) **£16.6bn to £19.1bn**

Other **key non-monetised benefits** by 'main affected groups'

Improved quality of housing provided to tenants and associated knock-on effects, new council houses built, spreading benefit to more people – health, employment opportunities. Better disabled facilities, improved leaseholder management. Opportunty for new build on the back of income from rent and sales.

Key Assumptions/Sensitivities/Risks

Stock levels will stay at current level, overall national rent policy will remain unchanged, Management and Maintenance costs, and Major Repairs costs at the level of need indicated by review research (and increase at the assumed rate). Risks – that assumed levels of income and allowances are insufficient for particular authorities' circumstances. That borrowing constraints constrain local authorities' short term cash flows, reducing their flexibilty to deal with short-term income and expenditure mis-matches.

Price Base Year 2009	**Time Period Years** 30	**Net Benefit Range** (NPV) **£3.9bn**	**NET BENEFIT** (NPV Best estimate) **£6.144bn to £10.044bn**

What is the geographic coverage of the policy/option?	England			
On what date will the policy be implemented?	2011/12			
Which organisation(s) will enforce the policy?	TSA and CLG			
What is the total annual cost of enforcement for these organisations?	£0			
Does enforcement comply with Hampton principles?	Yes			
Will implementation go beyond minimum EU requirements?	Yes			
What is the value of the proposed offsetting measure per year?	£0			
What is the value of changes in greenhouse gas emissions?	£0			
Will the proposal have a significant impact on competition?	No			
Annual cost (£-£) per organisation (excluding one-off)	Micro	Small	Medium	Large
Are any of these organisations exempt?	No	No	N/A	N/A

Impact on Admin Burdens Baseline (2005 Prices)		(Increase – Decrease)
Increase of £	Decrease of £	**Net Impact £**

Key:	**Annual costs and benefits: Constant Prices**	**(Net) Present Value**

Evidence Base (for summary sheets)

Background to the review

1. The review of council housing was announced in a written statement to the House of Commons by the Housing Minister on the 12th of December 2007.

2. Subsequently, a consultation document: *Reform of Council Housing Finance*, was published on 21 July 2009[1]. Alongside this, various documents detailing the research commissioned as part of this project were also published along with a Review of Council Housing Finance: Impact Assessment.

The review had the following guiding principles:

- Tenant involvement in local decision-making about the homes in which they live should be strengthened, with greater choice and mobility introduced into the system;
- Standards and services at similar costs should be provided to all tenants regardless of which landlord (Local Authority or Housing Association) owns the property;
- Similar properties should have similar rents regardless of landlord and that we should work towards achieving this in a timescale which maintains affordability for tenants;
- Where appropriate, the system should allow more flexibility and greater devolution to the local level, supported by some degree of control and appropriate safeguards;
- The system of funding council houses should not work against the broader policy of helping more tenants into work;
- Local authorities will continue to be landlords;
- There will be a single cross-domain regulator;
- The system should enable landlords to deliver improved efficiency and cost effectiveness in services;
- To introduce greater transparency into the system and reduce administrative burden where possible.

3. The July 2009 consultation outlined two potential broad options for reform;

   - The first entailed improvements to the current system, with longer determination periods of three to five years and either a redistribution or centralisation of debt.

[1] http://www.communities.gov.uk/documents/housing/pdf/1290620.pdf

- The second was a devolved system of responsibility and funding known as "self-financing," Where each local authority could use the entirety of their rental income to finance housing services and repairs.

4. Responses to the consultation indicated that the favoured option for replacing the present Housing Revenue Account Subsidy (HRAS) system was the self-financing option. This would allow the local authorities (LAs) to finance housing services from the rent they collect on properties they own and take control over the financing of their housing stock. This would be in exchange for a one-off allocation of housing debt.

5. A total of 224 responses were received, 155 of these from individual councils. A wide range of other organisations participated. These included bodies representing social housing providers, Arms Length Management Organisations (ALMOs), professional organisations, government departments or agencies, tenant groups, regional organisations, lobby groups, political groups, private companies, charities and trade unions. Of these respondents, only 6% of respondents disagreed with the principles of self-financing and 9 out of 10 authorities who responded were in favour of self-financing although there were reservations expressed with regard to details of the offer and in particular the debt levels implied by self-financing.

6. Issues surrounding the allocation of debt were very important for respondents, with the condition that the amount of debt allocated at the local level is acceptable the most important of these.

7. Strong support for self-financing evident in the consultation responses is likely to reflect the fact that the principles behind self-financing have been developed over a period of time with extensive stakeholder participation.

8. The previously considered option of improvements to the current system is not being considered any further. This is because it was regarded by LAs as not addressing the problems of the current system as clearly as a self-financing option of reform.

9. Since the consultation on phase one of the review concluded, further work has been carried out, adding detail and further depth to the initial analysis of the preferred option of self-financing for council housing finance. It has mainly focused on the distribution of housing debt allocations, and on modelling expected future costs and income for each LA. This further work has led to the publication of the self-financing "Prospectus[2]". This document adds detail regarding the parameters of the self-financing offer for consultation.

2 CLG Prospectus, Council Housing: A Real Future, 2010

10. The initial requirements for a new system of council housing finance remain. They are that a new system should:

- Be fair and affordable to both tenants and taxpayers;
- Be transparent, giving a clear and accurate picture of the balance for local support from central and local government;
- Agree minimum standards of service and accommodation;
- Ensure social rents which provide a platform for social and economic mobility for tenants;
- Ensure landlords will continue to improve the quality and efficiency of services;
- Ensure the Government is not exposed to unacceptable fiscal risks;
- Provide more certainty and less volatility in funding of council housing.

The current system

11. The current HRAS housing finance system is a redistributive system based on notional estimates of income and costs. It takes account of a variety of costs associated with operating social housing. These include:

- Management allowance;
- Maintenance allowance;
- Major Repairs Allowance;
- ALMO allowance;
- PFI allowance;
- Caps and limits adjustments and,
- Interest costs on debt.

12. Presently, annual estimates of the costs of each of these components are made centrally, taking into account an authority's individual circumstances, its type of stock and its relative need with respect to other LAs with an HRA (taking into account factors such as deprivation and incidence of crime).

13. Income is assumed on the basis of guideline rent charged for tenanted properties, with an assumption made of 2% voids. Formula rent is determined by a formula which weights property values and average manual earnings for each LA, and takes account of the composition of their housing stock, according to the number of bedrooms. Authorities are assumed to progress toward formula rent over time via adjustments to their guideline rent.

14. Where assumed costs are greater than assumed income, government provides subsidy to make up the shortfall. Where the reverse is true (assumed costs are less than assumed income) subsidy is paid to central government. Any surplus amount is returned to Treasury.

15. In recent years the system has generated a growing aggregate payment to Treasury and this has been part of the impetus driving the need for reform of the system.

Treatment of Debt

16. In the current subsidy system, an allowance is paid to councils to compensate authorities for interest costs on an assumed notional level of debt, the Subsidy Capital Financing Requirement (SCFR). This level of debt can be positive or negative, and the interest cost is determined by the Consolidated Rate of Interest (CRI). This is an interest rate which is a combination of interest costs on actual (external and internal) borrowing and the annual average 3 month LIBID.

17. These debt payment costs can form a significant portion of an authority's annual HRAS entitlement and debt levels can vary significantly between authorities. In aggregate, annual debt servicing costs accounted for under the HRAS system are expected to be around £1bn in 2010/11.

Capital Receipts

18. Under the current system, 75% of receipts from sales under Right to Buy (RTB) and other sales to owner occupiers are pooled centrally and paid over to the Secretary of State (subject to a few concessions covering the retention of administrative and recent improvement costs). The remaining 25% is retained by the LA and may be used for any capital purpose.

19. For sales of dwellings which are not to owner-occupiers and sales of other housing assets (e.g. shops, garages and vacant housing land), authorities may retain all the receipt, provided it is used for affordable housing or regeneration projects. Any receipts not used in this way are paid to the Secretary of State: 75% from disposals of dwellings and 50% from the sale of other assets.

20. For sales under Social Homebuy LAs retain 100% of the receipt, provided it is used for affordable housing.

21. The receipts pooled to central government are recycled to LAs as part of larger housing grants. Retained receipts can be used by LAs for any capital project.

Rents Policy

22. Government policy is currently based on the concept of 'similar rents for similar properties in similar areas.' In 2002 this manifested in a policy of rent restructuring, bringing LA rents closer to RSL rents over time through a process known as "convergence". This was done keeping in mind the principles that rents should be set at a level that facilitates work incentives within the Housing Benefit system, and which produces rents which are fair within districts and around the country, and are affordable to people who pay their own rents. At the same time, the importance of rents as a funding source for new supply was recognised (particularly in the Registered Social Landlord – RSL – sector), and it was also recognised that rents should not be so low as to overly increase the costs of new supply nor cause problems to the viability of RSLs.

23. The initial formula rent level is calculated formulaically, 70% based on local earnings and the composition of their housing stock, according to the number of bedrooms and 30% based on property values in the area. This same formula is used to calculate rents in both the RSL sector and the LA sector. Individual authorities' guideline rents then converge toward formula rents over time implying LA and RSL rents also converge. Initially rents were expected to converge over 10 years, however in recent years the Government has not fixed a date for convergence to be completed. In setting the guideline rents in annual HRA subsidy determinations, Ministers have taken into account a number of factors, including the affordability of rent increases for tenants. Under the central scenario modelled by PriceWaterhouseCoopers for a self-financing offer, rents are expected to converge 5 years after the start of self-financing.

24. If a rent increase generated by the rent restructuring formula is in excess of RPI+1/2%+£2, the LA can receive compensation for the difference between the guideline rent and the higher of their actual rent or what the rent would have been if it had increased at RPI+1/2%+£2 per year since the beginning of rent restructuring. They claim this compensation through the "caps and limits" system, one year in arrears.

25. A limit rent is set in each year's HRA determination. This provides a mechanism for protecting public expenditure by providing a cap on the level of housing benefit an authority will receive for its tenants from central Government.

Rationale for intervention

26. The current Housing Revenue Account Subsidy System is not presently delivering funding to council housing in an effective and sustainable manner.

- It is unpopular because:
- It is volatile and does not allow long term planning;
- In recent years, after redistribution has occurred, there has been a net surplus paid to central government, fuelling resentment in the sector;
- Evidence suggests that in the future, the current system will not deliver sufficient funding to maintain homes to a good standard and that there are components of management and maintenance costs (relating to shared/communal areas) which are not being funded under the current system;
- There is concern over the perceived disconnect between rents and the services that are being provided. Rents are increasing but tenants do not feel that services are being properly funded; and,
- It is complex and difficult to understand. Furthermore, in recent years there have been a number of ad-hoc adjustments designed as temporary fixes to repair specific issues as they arise. These "fixes" have tended to add to the existing complexity in the system.

Do nothing scenario

27. The current system is centrally administered, with a high degree of central control over local decisions, with limited accountability. The framework has changed relatively little between years, and many important decisions, such as rent levels are set annually from central government. These levels can be volatile and makes it very difficult for LAs to effectively plan ahead.

28. Research undertaken for the review has highlighted the need to increase management and maintenance funding for LAs. Without extra funding:

- There would be insufficient funding to maintain homes to a decent standard. Homes would gradually fall into a state of disrepair, meaning the standard of living could deteriorate considerably with subsequent knock-on health, economic and social effects among social housing residents. Alternatively, there would need to be a very large capital investment in the future much like the recent decent homes programme to bring the homes back up to a habitable standard.

- There would continue to be volatility in annual determinations, meaning authorities could not plan effectively into the future. This would mean inefficient contracts would continue to exist and works carried out when the funds are available rather than when they are needed.
- There would be limited ability (and incentive) for LAs to add to the supply of social housing by leveraging its rental income.
- If under funding continues, transfer may become an increasingly attractive option for LAs, which would lead to a reduction in LA owned housing stock.

The proposed new system

29. Initially, phase one of the review examined a range of options for reform. These included a variant of the current system, whereby revenues continue to flow between central and local Government as a result of ongoing assumptions made by Government about landlord costs and income, but over longer determination periods. Responses to the consultation strongly favoured the alternative option of a devolved system of self-financing whereby rents are retained by councils locally, in exchange for a one off debt settlement. The amount of debt allocated to each authority is calculated on the basis of what the business is able to support.

30. There is no proposed change to rent policy under self-financing relative to the current system. Under self-financing, adherence to rent policy would be secured through:

    - **Continuation of the limit rent**. The limit rent would continue to be set in a way that allows LAs to recover all income from rents which are set in adherence with social rent policy.
    - **Via Tenant Services Authority regulation**. We expect to direct the Tenant Services Authority (TSA) to set a rent standard that will apply to LA landlords. This will enable the TSA to regulate compliance with national rent policy, including through the use of enforcement powers where necessary. (We have already issued such a direction in relation to non-LA social housing landlords).

31. Work in phase two of the reform of council housing finance has built on the findings in phase one, with the key result being that details of the proposed new system can now be disaggregated to LA level. This is included in the report by PricewaterhouseCoopers (PwC), titled ‘Modelling Business Plans for Council Landlords: Report on model inputs, assumptions and outputs’. In this report, a methodology for distributing the uplifts recommended in the earlier research is demonstrated.

32. PwC has estimated each authority's rental income and its management, maintenance, major repairs and other costs over the 30 year period for a given level of stock. It also included adjustments for PFI initiatives already in place and due to sign before April 2011. The difference between the two was then discounted at a rate of 6.5% to generate a net present value of the net revenue stream. This discount rate was chosen by PwC as it reflects that the actual costs incurred by an authority in managing, maintaining and repairing properties may not necessarily be fully reflected in the complex allowances used in the NPV calculation, due to specific peculiarities that may exist and unforeseen costs that may arise and that local authorities will need to manage this risk. It is also consistent with the discount rate used for housing transfer valuations. (Note while this discount rate has been used for the purposes of NPV calculations within the self-financing model, the standard green book discount rate of 3.5% has been used throughout this impact assessment for the valuation of costs and benefits to society).

33. Thus housing debt is allocated to each LA on the basis of their ability to service it, using updated figures for costs of management, maintenance, major repairs and income to estimate the present value of their future income and costs.

34. The starting point for PwC's estimates was the guideline rents and allowances calculated in the 2010/11 HRA determination.

35. Under self-financing, it would be expected that each LA would produce an individual 30 year business plan. The cash flows would be determined by forecast rental income less their uplifted costs of repairing and maintaining stock, and their debt servicing costs. The value of the stock would be calculated from the present value of the net cash flows.

36. The housing debt of each LA would be adjusted to reflect the value of its stock, entailing either a capital payment to or from Government. In aggregate, the total debt allocated to LAs under self-financing would be higher than the current level of notional debt supported by the system. This is because it is dependent on the value of the stock to the landlord, which in turn is determined by the assumptions made about future costs and rental income.

Summary of costs and benefits

37. The following table details the estimated costs and benefits for the reform:

	Costs	Benefits
Self-financing model	Increased Management &Maintenance, Major Repairs: £529m per year for 30 years – NPV £9.724bn.	Efficiency savings due to ability to plan long-term and optimise the cycle of repairs and replacements planned over 30 years. Est. NPV range of £6.2bn to £7.6bn.
Net Benefit £6.6bn to £9.1bn	Cost of implementing a new system: Estimated £32.1m (based on £181.5k/LA for 177 LAs).	Improvements to quality of life, health and work opportunities – not possible to be monetised.
	Cost of rescuing failing authority: not possible to cost.	Homes are maintained to Decent Homes standard, saving need for large separate capital programme. Est. NPV range from £9.7bn to £12.2bn
	Possible efficiency cost from loss of pooled Right to Buy receipts. Not possible to estimate.	
	Loss of receipt from authorities with positive stock valuation who opted for transfer.	More ability to build new homes – with subsequent increased income and sales.
	Total = £9.756bn + cost of rescuing failing LAs+ loss of transfer receipts.	**Total = £15.9bn to £19.8bn** + improvement to quality of life

Sources and details of costs and benefits

Costs

Increased Management and Maintenance Costs and Major Repairs Allowance

38. Research was commissioned during the initial stages of the Review of Council Housing Finance to assess the appropriateness of allowances in the HRAS System compared to costs. This was constituted of the *Evaluation of Management and Maintenance Costs in LAs*[3], conducted by the Housing Quality Network (HQN) and the *Review of the Major Repairs Allowance*[4], conducted by BRE.

[3] CLG research, Evaluation of Management and Maintenance Costs in Local Authorities http://www.communities.gov.uk/publications/housing/managementmaintenancecosts

[4] CLG research, Review of the Major Repairs Allowance

39. HQN research indicated that authorities currently spend around 5% more, on average, than their allocated allowance on management and maintenance costs. BRE research[5] concluded that in order to properly fund the existing housing stock, it was necessary to increase MRA allowances by an average of 24%.

40. Subsequent work commissioned from PwC[6] built on these estimates, adapting them slightly as it sought to use the information contained in the report to disaggregate the uplifts on allowances to LA level.

41. While PwC based their work on the earlier HQN and BRE research, they made a number of small changes:

- That 100% rather than 95% of stock should be used to calculate overall allowances uplifts.
- Cost assumptions regarding medium and high rise flats were altered slightly to provide more maintenance funding.
- It was also decided as a policy decision in conjunction with CLG, that there should be a floor on aggregate combined management, maintenance and major repairs uplifts of 10%.

42. After these adjustments, the combined average management and maintenance uplift in allowances is 5.4% and the average uplift in MRA allowances is now 27.4%. This produces a national average MRA per dwelling of £904 per dwelling per year and average management and maintenance allowances of £1,936 per dwelling per year.

43. Combined, the uplifts in allowances amount to £529m per year. Over 30 years, discounted at a 3.5% discount rate this has an NPV of £8.724bn. See Annex for details of the annual costs and calculation of the NPV.

44. The three charts below show the proposed distribution of uplifts in management and maintenance and major repairs allowances by LA. Combined, the range of uplifts are between 10% and 15.36%.

45. We propose to implement a 'collar' which would ensure that all local authorities get a minimum 10% aggregate uplift in their combined allowances. The net present value cost of this collar is around £50m at a 7% discount rate, which is included in the cost calculations.

5 http://www.communities.gov.uk/documents/housing/pdf/157773.pdf

6 Modelling Business Plans for Council Landlords: Report on model inputs, assumptions and outputs, 2010

Figure 1: Percentage increase in MRA allowances

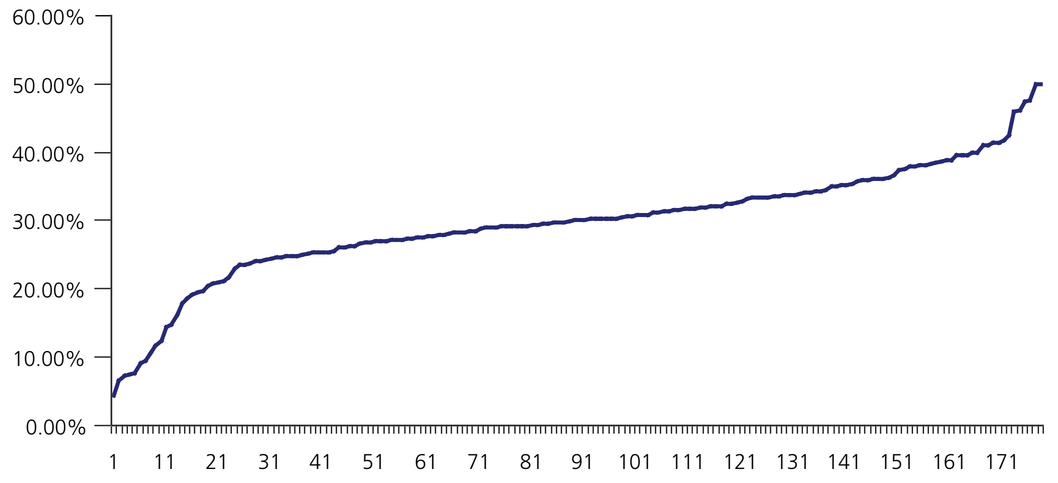


Figure 2: Percentage increase in M&M allowances

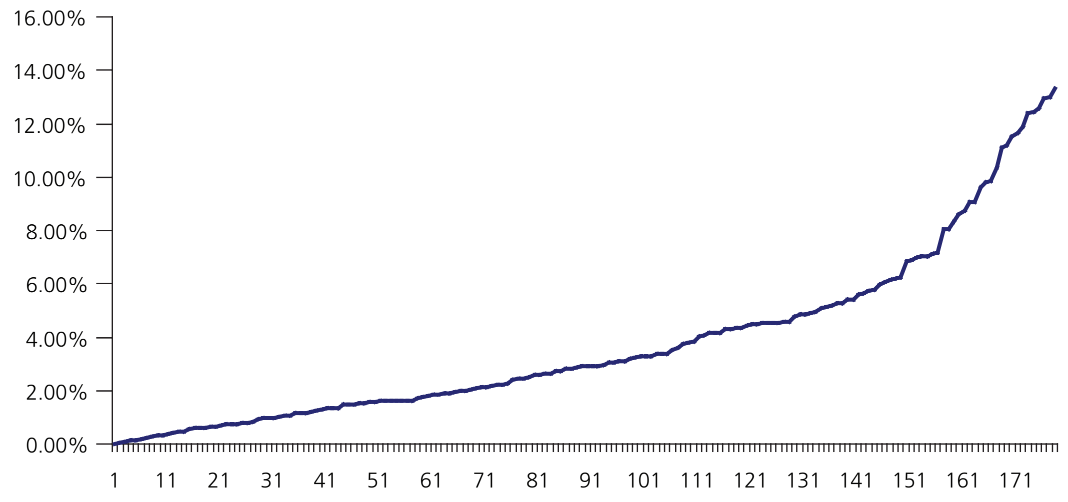
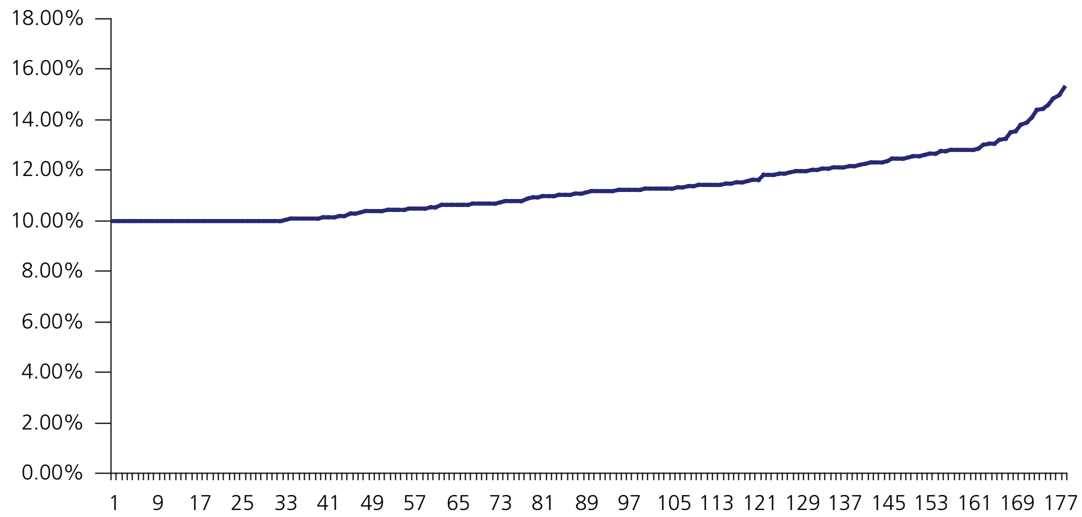


Figure 3: Percentage increase in combined allowances



Cost of implementing a new system

46. This is an estimate of the cost of increased staff time required to implement a new system and the cost of any new processes or increased regulation. These costs are expected to be relatively low. The LAs are already responsible for ongoing management, maintenance and operation of their stock. However, the change in the financing of social housing and any voluntary agreement by LAs will be likely to require consultation with tenants, the production of a 30 year business plan and an up to date stock condition survey being carried out.

47. Estimates are based on information collected for the Impact Assessment for Exempting some Local Authorities from the HRA Subsidy System, published by CLG in November 2008[7] as part of the wider assessment for the Housing and Regeneration Act. This estimated a cost of £180k per authority for setting up a self-financing system. This can be broken down to; producing a business plan (£20k), consulting with tenants/residents (£60k), and a stock condition survey (£100k). Adjusting for inflation since November 2008 gives a value of £181,583 per authority. This figure was multiplied by the number of authorities currently with open HRAS accounts (177 in the 2010/11 determination) to reach a final figure of £32.1m.

[7] http://www.communities.gov.uk/publications/housing/housingregenactimpactassess

48. The information was based upon estimates from six LAs representing a wide range of local circumstances. The detailed modelling work by the authorities was based on updated stock condition surveys and tested a range of assumptions and sensitivities.

49. Their work was scrutinised and supported by a group of representatives from a range of housing bodies and other experts in the field, who met regularly as a contact group. These estimates were presented in the phase one consultation without disagreement.

50. In a self-financing offer, an LA's opening level of debt, as calculated by PwC could be higher or lower than the notional debt allocated to the authority under the current HRAS system (its SCFR). For those where the debt level generated by the model was lower than the SCFR, Government would pay that LA a capital sum equivalent to the difference between the two. For those where the SCFR was higher, the LA would pay Government the difference.

51. There are likely to be premia payable for early redemption of loans by LAs who will receive a capital sum from Government to reduce existing debt. This debt premia cost will be paid by central Government. However, this premia cost is fiscally neutral, as it is also paid to central Government via another arm – the PWLB.

Loss of LSVT Receipts

52. If self-financing proposals (and associated uplifts) do not go ahead, or are delayed, it is possible that councils will consider voluntary transfer to RSLs as the only means available of generating sufficient resources to provide decent quality social housing. In particular, authorities with estimated "positive value" stock (i.e. an estimated stock value above their current debt level) may be tempted to transfer their stock to an RSL. This may mean a loss of receipt to Government which is currently 20% of the residual value upon completion of the transaction/sale to the Registered Provider.

53. However, this issue is primarily one of timing, once self-financing is implemented there should be equity in terms of public funding between transfer and self financing.

Loss of pooled portion of capital receipts

54. There is a possible efficiency cost from the loss of pooled housing capital receipts mostly arising from RTB sales. Previously, 75% of the receipts have been pooled and re-distributed to those areas most in need. By retaining receipts locally, the funds may not be allocated efficiently to the areas most in need.

55. In recent years there has been a sharp fall in RTB receipts. In 2008/09, right to buy receipts totalled approximately £229 million, down from £2.6 billion at the beginning of pooling in 2004-05. Factors driving this decline have included:

- Mortgage approvals in the private sector have been difficult to obtain in the current economic environment;
- The discount on right to buy sales was significantly reduced on all applications made after April 2005.

56. It is very difficult to predict the level of RTB receipts in future years. There has been a slight increase since the first quarter of 2009-10, but it is not certain whether this will be maintained, although it is extremely unlikely that receipts will return to the level that they were in 2004-05 in the foreseeable future.

57. Social Homebuy receipts are negligible given the scale of self-financing proposals. In 2008-09, Social Homebuy sales generated only approximately £8.2 million. 100% of these receipts are already retained by LAs, provided they are used for affordable housing purposes, so these will be unaffected by self-financing.

58. There is a potential cost of rescuing failed authorities if the new system does not work, or unforeseen circumstances occur that make the system unsustainable. The modelling carried out during the review suggests this is unlikely to happen but it is not impossible. If it did happen, the authority would first of all turn to its General Fund for extra capital before requesting a bail-out from Central Government. The authority could also be forced to sell its assets to a RSL. It is not possible to assess the probability of this occurring, nor the potential cost to central Government, given this will depend on why the authority failed as well as size and duration of any funding gap.

Benefits

Efficiency Savings emanating from ability to plan long-term and optimise the cycle of repairs and replacements planned over 30 years.

59. One of the key complaints from councils, tenants and stakeholders about the current national subsidy system is that volatility within the system makes long term planning very difficult. There can be changes in allowances, rents and borrowing allocations at very short notice.

60. Arguably, in recent years this volatility has become even more pronounced. Most recently, central government has halved previously announced guideline rent increases in consecutive years at short notice, in order to ensure council rents remain affordable in the current economic environment. While most authorities welcomed the moves, the complex nature of the system meant these last minute changes were challenging to implement for both central government and LAs.

61. In addition, local responsibility and accountability is weak, and the current system adds a lot of prescriptive operational detail to what should be a strategic relationship between landlords and central government.

62. Under a self-financing regime, authorities will have much greater flexibility to plan into the future. Repairs and maintenance work can be carried out at most optimal times and authorities can negotiate more efficient contracts with this in mind. The March 2008 CLG report, "Self-financing of council housing services: Summary of findings of a modelling exercise[8]" key areas authorities felt they could gain efficiencies under self-financing were:

- Better rates through long term partnering arrangements with predictability of resources, allowing contractors to plan labour and develop a long term approach to the supply chain.
- Efficiencies in the client side: long term planning could allow client side overheads to be reduced permanently.
- Ability to carry out works when required leading to reduced cost of patching up elements prior to their eventual renewal.
- Packaging works: the ability to package works effectively over the long term allows efficiencies to be delivered.
- Environmental programmes: incorporating environmental works into planned sustainability programmes.

63. LAs estimated these efficiencies combined are worth around 10% of gross stock condition survey investment over 30 years, a total of £382m in cash terms for all six authorities (an average of £63.7m per authority)[9].

64. If this average is then multiplied by the number of LAs currently holding stock within the HRAS system (177), this equates to a saving of £11.3bn. Discounted at a rate of 3.5%, the present value of these savings is £6.9bn.

65. Efficiency savings between LAs will differ, so it is fair to assume some uncertainty over the magnitude of these savings. A range of +/–10% of these efficiency savings gives a range of benefits between £6.2bn and £7.6bn.

Maintaining Homes to a Decent Standard

66. The uplifted allowances will have the primary impact of maintaining homes to a decent standard. If current funding levels were continued into the future the homes would gradually fall into a state of disrepair and would eventually either become unfit for habitation or would require a separate large capital program to bring them up to standard.

8 http://www.communities.gov.uk/publications/housing/selffinancingservices

9 http://www.communities.gov.uk/documents/housing/pdf/selffinancinghousing.pdf

67. By 2010 the current Decent Homes program will have cost over £40 billion bringing more than one million homes up to a decent standard. It is not unreasonable to estimate than a program of a similar size would be required in 30 years time to bring the homes back up to standard if allowances are maintained at their current level. This has been used as an upper estimate. As a lower estimate, the proportion of the cost generated by LA housing stock in the current Decent Homes program has been used, which was around £32 billion. For the estimates in this assessment we have spread these costs over 10 years from year 30 to year 40. Calculating the NPV of such savings at a discount rate of 3% gives a range of £9.7bn to £12.2bn, calculations are included in the annex.

68. Even this estimate could potentially be understating the cost of the not providing LAs with uplifted allowances. Aging population (and consequently an aging profile of tenants) may also mean costs associated with repairing homes to a decent standard with appropriate age related modifications are higher over the coming years relative to the previous program, due to an increase in basic requirements.

Ability for councils to fund construction of new housing stock

69. The ability of LAs to retain their rental income should encourage some authorities to invest in new social housing stock. Recent reforms which have allowed councils to retain the rental income arising from newly constructed stock demonstrated considerable appetite for this with 4000 new units expected to be produced by 2011/12.

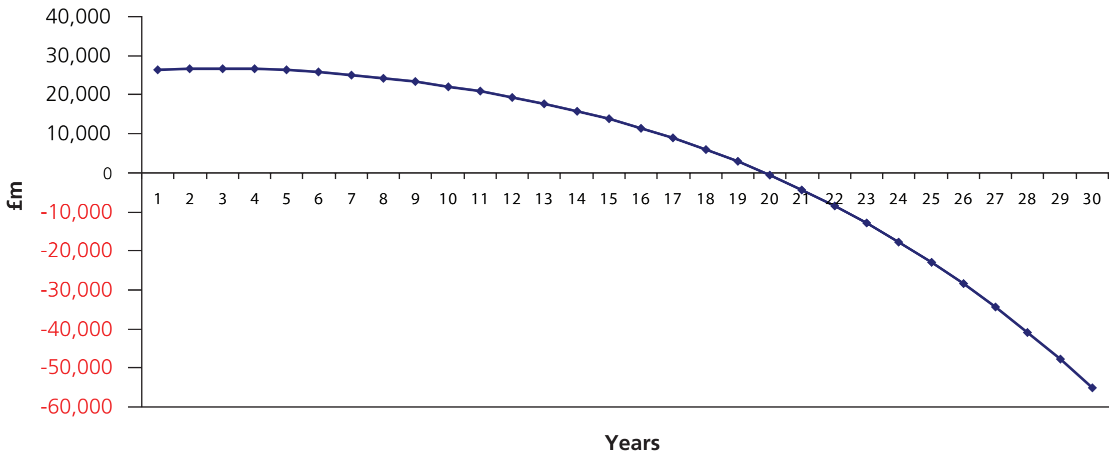
70. Accurately estimating the increased capacity for further new build going forward is challenging.

71. An indication of the absolute upper limit of funds which might be available for new build would be the gap between the expected debt level in a given year and the opening debt level, as a lower debt level indicates the LA is running an operating surplus. This increases over time as rental income is assumed to grow faster than costs, with the difference assumed to go toward repaying debt (interest and principle), which then generates a reduction in the debt. An example of the indicative debt profile as calculated by PwC, assuming a 6.5% real discount rate and a 5% borrowing interest rate is shown below.

72. However, if authorities choose to, they may decide to only make interest payments on their debt, potentially freeing up more income to finance investment in new housing stock.

73. In reality, LAs will be faced with many competing demands for any surplus income. Appetites to invest in new stock (and support debt generated by new stock) will differ between LAs, as will demand for new social rented housing, borrowing costs, and timings of repairs and maintenance required.

Figure 4: Indicative debt profile



Non-monetised benefits for which there is insufficient evidence to accurately quantify

74. Some of the potentially largest benefits can not be effectively monetised. These include the improvements to quality of life an improved housing finance system would bring about. It should improve the quality of the stock, and relate rents to the quality of accommodation provided on a local scale. This in turn, may lead to improved health, education and work opportunities for tenants relative to the current situation.

75. Central Government will receive a surplus in the initial debt settlement. This will offset the interest lost on forecast HRAS surpluses. The transaction is fiscally neutral, though, as it is a transfer of debt from central government to local government.

Key sources of evidence

76. There are several sources of evidence that have been vital components in deciding the options available for the review and the likely costs.

Evaluation of Management and Maintenance Costs[10]

77. Phase one of the review commissioned the Housing Quality Network (HQN) to evaluate the costs of the landlord business in day to day management and ongoing maintenance. Its main findings were:

- LAs are spending about 5% more on management and maintenance than allocated in their allowances.
- This difference is made up by a gap of 8% on management compared to the allowance and 3% on maintenance.

[10] http://www.communities.gov.uk/publications/housing/managementmaintenancecosts

- Expenditure on management in LAs is some 5% lower overall than comparable expenditure in the RSL sector.
- However maintenance expenditure is 4% more than in Large Scale Voluntary Transfer RSLs (the most direct comparators).
- Efficiency savings in core management costs (e.g. rent collection, allocating homes etc), and increasing demands from tenants and government have led to an increasing amount of spend of management costs on traditionally 'non-core' services (e.g. anti-social behaviour activities, helping tenants move into work etc). It is estimated that these 'non-core' activities now make up approximately 40% of all management costs.

78. From these findings the review concluded that the need to spend on management and maintenance was 5% higher than current allowances.

Review of the Major Repairs Allowance[11]

79. As part of the phase one work, BRE carried out a review of the current Major Repairs Allowance (MRA) and whether it was delivering sufficient funding to maintain homes to a decent standard over a 30 year period. It also included additional aspects such as maintenance of lifts and the external environment. Its main findings were:

- The current MRA is out of date. Both the lifetimes used, the assumed costs, and the components included do not reflect current or future needs.
- The MRA should be increased by an average of 24% over 30 years. Although the large part of that spending is likely to be needed towards the end of that 30 year period.
- The costs in this paper assume the need to spend is 24% higher than the current allowance.

Rents and Service Charges

80. Work carried out by Professor Steve Wilcox was:

- Analysis of affordability of rents and changes over time – this suggested that affordability levels of rents had stayed at about the same level since 2000 compared to both average earnings and the private rented sector. LA rents are about 63% of the level of their market value[12].
- International comparison of rents policies – there are broadly 4 ways in which social rents are set across Europe each with their pros and cons. Several countries are moving towards a more property based system similar to England.

[11] http://www.communities.gov.uk/publications/housing/repairallowancereview

[12] CLG research, Analysis of Rents for the Review of Council Housing Finance http://www.communities.gov.uk/publications/housing/rentspolicyanalysis

- Investigation of impact of increasing rent levels, and changing rent formula – an increase in rent would raise more funds for council housing but would have undesired costs in the increasing housing benefit bill, impacts on the inflation rate and wider economy and negative impacts on work incentives. It could also have negative social and health effects.

81. What the evidence suggests we should do:

    - The principle of similar rents for similar properties should remain in place and rent restructuring should deliver equalisation. The principle is generally supported by tenants and is delivering rents that are affordable.

Debt

82. A debt settlement should be made to bring LAs' SCFR up to their NPV valuation. This NPV is based on forecast of their income and costs over the next 30 years. This is calculated for each LA in the model commissioned from PwC, and their methodology is explained in their report, *CLG: Modelling Business Plans for Council Landlords.*

Implementation plan

83. Any implementation plan will depend on responses to this consultation on the prospectus. It will also depend on whether authorities choose to adopt self-financing voluntarily. Depending on the outcome of consultation, the Government would wish to move swiftly to have a self-financing option up and running. The department plan to be able to offer a voluntary self-financing settlement in 2011/12, following which, the remaining LAs would be moved to self-financing through legislation.

Monitoring and evaluation plan

84. We will work within the local government performance framework and in partnership with the Tenant Services Authority to gather information about the impact of these reforms in aggregate and on individual local authorities. We propose to conduct a formal review of the impacts within 3 years of implementation and to report on the outcome.

85. Fundamentally, self-financing is a long term 'letting go' policy and therefore we are consciously moving away from a situation of close central monitoring of stock numbers, debt costs, rent and subsidy and towards a more hands-off strategic relationship. This is not a policy we could easily pull back from; it is a transformation of approach.

86. There are, however a raft of legislative and democratic checks and balances on the activities of LAs regarding council housing. These include; the Audit Commission, the Tenants Services Authority, District Auditors, tenants, local voters and council tax payers.

Specific impact tests

Competition Assessment

87. No impact on competition. Social Housing is not a competitive market.

Small Firms Impact Test

88. No immediate impact on small firms as the changes are concerned with the local authority housing sector only.

Legal Aid

89. No immediate legal impact relative to the existing system.

Sustainable Development

90. The increased allowances will increase funding for the LA housing sector. This may be spent on environmental improvements for LA housing.

Health Impact Assessment

91. An improved funding mechanism for council housing will improve the standard of the home which has been shown to have large positive health impacts. According to Shelter (www.shelter.org.uk) those living in poor housing are more than twice as likely to suffer from poor health.

Race/Disability/Gender Equality

92. We have undertaken a screening of the reform of council housing finance for race, disability and gender equality. On the basis of the screening, which included analysis of responses to the consultation in July last year, we do not believe that any specific equalities impacts will arise. However, we are aware that this decision has been taken on the basis of limited evidence and respondents are invited to provide details of any likely differential impact on different equalities groups. Local authorities are reminded to consider the need for Equality Impact Assessments when making policy decisions under self-financing.

Human Rights

93. Improved housing standards could possibly improve educational opportunities. 8% of children living in sub-standard accommodation lose out on a quarter of their schooling, according to Shelter. The causality of this is debatable, however, and improving housing may not automatically improve educational achievement.

Rural Proofing

94. The allowances take account of rural/urban locations and adjust needs accordingly. All areas will benefit from increased allowances.

Specific Impact Tests: Checklist

Use the table below to demonstrate how broadly you have considered the potential impacts of your policy options.

Ensure that the results of any tests that impact on the cost-benefit analysis are contained within the main evidence base; other results may be annexed.

Type of testing undertaken	Results in Evidence Base?	Results annexed?
Competition Assessment	Yes	No
Small Firms Impact Test	Yes	No
Legal Aid	Yes	No
Sustainable Development	Yes	No
Carbon Assessment	Yes	No
Other Environment	Yes	No
Health Impact Assessment	Yes	No
Race Equality	Yes	No
Disability Equality	Yes	No
Gender Equality	Yes	No
Human Rights	Yes	No
Rural Proofing	Yes	No

Annexes

Calculation of net present value figures:

Real discount rate of 3.5% has been used for all NPV calculations below as per green book guidance.

a) Calculation of cost of increase in allowances

Year		Discount factor	Current allowance	Uplifed allowance[1]	Extra cost per year	NPV of extra cost
0	2010	1	£4,601,863,775	£4,601,863,775	£–	£–
1	2011	0.966183575	£4,600,807,795	£5,129,519,704	£528,711,909	£510,832,762
2	2012	0.9335107	£4,600,807,795	£5,129,519,704	£528,711,909	£493,558,225
3	2013	0.901942706	£4,600,807,795	£5,129,519,704	£528,711,909	£476,867,850
4	2014	0.871442228	£4,600,807,795	£5,129,519,704	£528,711,909	£460,741,884
5	2015	0.841973167	£4,600,807,795	£5,129,519,704	£528,711,909	£445,161,241
6	2016	£0.81	£4,600,807,795	£5,129,519,704	£528,711,909	£430,107,479
7	2017	0.785990961	£4,600,807,795	£5,129,519,704	£528,711,909	£415,562,781
8	2018	0.759411556	£4,600,807,795	£5,129,519,704	£528,711,909	£401,509,934
9	2019	0.733730972	£4,600,807,795	£5,129,519,704	£528,711,909	£387,932,303
10	2020	0.708918814	£4,600,807,795	£5,129,519,704	£528,711,909	£374,813,819
11	2021	0.684945714	£4,600,807,795	£5,129,519,704	£528,711,909	£362,138,956
12	2022	0.661783298	£4,600,807,795	£5,129,519,704	£528,711,909	£349,892,711
13	2023	0.639404153	£4,600,807,795	£5,129,519,704	£528,711,909	£338,060,590
14	2024	0.61778179	£4,600,807,795	£5,129,519,704	£528,711,909	£326,628,590
15	2025	0.596890619	£4,600,807,795	£5,129,519,704	£528,711,909	£315,583,179
16	2026	0.576705912	£4,600,807,795	£5,129,519,704	£528,711,909	£304,911,284
17	2027	0.557203779	£4,600,807,795	£5,129,519,704	£528,711,909	£294,600,274
18	2028	0.53836114	£4,600,807,795	£5,129,519,704	£528,711,909	£284,637,946
19	2029	0.52015569	£4,600,807,795	£5,129,519,704	£528,711,909	£275,012,508
20	2030	0.502565884	£4,600,807,795	£5,129,519,704	£528,711,909	£265,712,568
21	2031	0.485570903	£4,600,807,795	£5,129,519,704	£528,711,909	£256,727,119
22	2032	0.469150631	£4,600,807,795	£5,129,519,704	£528,711,909	£248,045,526
23	2033	0.453285634	£4,600,807,795	£5,129,519,704	£528,711,909	£239,657,513
24	2034	0.437957134	£4,600,807,795	£5,129,519,704	£528,711,909	£231,553,152
25	2035	0.423146989	£4,600,807,795	£5,129,519,704	£528,711,909	£223,722,853

Year		Discount factor	Current allowance	Uplifed allowance[1]	Extra cost per year	NPV of extra cust *(Cont)*
26	2036	0.408837671	£4,600,807,795	£5,129,519,704	£528,711,909	£216,157,345
27	2037	0.395012242	£4,600,807,795	£5,129,519,704	£528,711,909	£208,847,677
28	2038	0.38165434	£4,600,807,795	£5,129,519,704	£528,711,909	£201,785,195
29	2039	0.368748155	£4,600,807,795	£5,129,519,704	£528,711,909	£194,961,541
30	2040	0.356278411	£4,600,807,795	£5,129,519,704	£528,711,909	£188,368,639
[1] Uplifted allowance as caculated in PwC model						**£9,724,093,443**

b) Benefits of Maintaining homes to a decent standard

If homes are not maintain to a decent standard, there will need to be a large capital expenditure program in the future to bring them back to a standard fit for habitation. For this paper we have assumed a £40b programme (the same spend as the Decent Homes program) spread over 10 years from year 30 to year 40 as an upper limit. This gives an NPV of £12.2b. As a lower estimate, we have taken the proportion of the current decent homes spend which has been generated by LA social housing stock (about 80%), applied it to the £40bn and spread this evenly over 10 years. This gives an NPV of £9.7bn.

Upper estimate

Year		Discount Rate	Capital spend (£ millions)	NPV of Capital spend (£ millions)
31	2040/41	0.345901	4,000	1,383
32	2041/42	0.335827	4,000	1,343
33	2042/43	0.326045	4,000	1,304
34	2043/44	0.316549	4,000	1,266
35	2044/45	0.307329	4,000	1,229
36	2045/46	0.298378	4,000	1,193
37	2046/47	0.289687	4,000	1,158
38	2047/48	0.281249	4,000	1,124
39	2048/49	0.273058	4,000	1,092
40	2049/50	0.265105	4,000	1,060
			Total	12,156

Lower estimate

	Year	Discount Rate	Capital spend (£ millions)	NPV of Capital spend (£ millions)
31	2040/41	0.345901	3,200	1,107
32	2041/42	0.335827	3,200	1,075
33	2042/43	0.326045	3,200	1,043
34	2043/44	0.316549	3,200	1,013
35	2044/45	0.307329	3,200	983
36	2045/46	0.298378	3,200	955
37	2046/47	0.289687	3,200	927
38	2047/48	0.281249	3,200	900
39	2048/49	0.273058	3,200	874
40	2049/50	0.265105	3,200	848
			Total	9,725

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