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Rent Rebates and Local Authority Housing Revenue Accounts

Since the previous Government reformed local housing authorities' revenue funding in 1990 local authorities and their tenants have argued for an end to the process by which Housing Revenue Account surpluses are used to offset the cost of Rent Rebates. This system has been referred to as the 'tenants' tax' and has led to the formation of the Daylight Robbery Campaign by local authority tenants.

The Government announced its intention in June 1999 to go ahead with proposals for a new financial framework for Housing Revenue Accounts; this will involve the introduction of resource accounting and the removal of Rent Rebates from Housing Revenue Accounts.

This paper provides background on the current system and outlines proposals for the removal of Rent Rebates. It discusses some of the implications for local authorities, particularly 'negative subsidy' authorities, in the light of the proposals.

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Summary of main points

- Local authority Housing Revenue Accounts are a record of revenue expenditure and income relating to local housing authorities' stock.

- The previous Government introduced a new Housing Revenue Account subsidy system with effect from April 1990.

- A controversial aspect of this system is that for authorities whose assumed income exceeds their assumed expenditure on the Housing Element of their Housing Revenue Accounts subsidy on the Rent Rebates (housing benefit) given to their tenants is reduced.

- This system has been criticised because the rent payments of 'better off' tenants not in receipt of Rent Rebates help to meet the cost of giving financial help to poorer tenants via housing benefit. This has been called a 'tenants' tax' and has led some tenants to form the Daylight Robbery Campaign to argue for changes in the subsidy system.

- The Government confirmed in 1999 that it intended to introduce resource accounting into the Housing Revenue Account and that, as part of this process, Rent Rebates would be removed from the Housing Revenue Account.

- A consultation paper, *A New Financial Framework for Local Authority Housing: Resource Accounting in the Housing Revenue Account*, was published by the DETR in November 1999. This paper set out proposals on detailed arrangements for removing Rent Rebates from the HRA.

- Although tenants and local authorities are generally in favour of the introduction of resource accounting, the financial implications for some authorities, particularly those who are in 'negative subsidy' is a cause for concern.

- The Government has given a commitment to introduce transitional measures to ease the process of transfer to the new system for 'negative subsidy' authorities. A consultation paper was published in August 2000, *A New Financial Framework for Local Authority Housing: Resource Accounting in the Housing Revenue Account - transitional measures for negative subsidy authorities.* It sets out various options for the calculation of these transitional measures and the time period in which they should operate. Local authorities and other bodies had until 29 September to submit comments on these proposals.

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I Introduction

Local authority Housing Revenue Accounts (HRAs) are often referred to as 'landlord' accounts. They are a record of the revenue expenditure and income relating to local housing authorities' own stock. Authorities have been required to keep an HRA since the *Housing Act 1935*. Prior to 1990 authorities had discretion to transfer sums out of the HRA to the general rate fund (the predecessor to the General Fund) and to support the HRA with contributions from the general rate fund.

Another feature of the pre-1990 subsidy system was that Exchequer subsidies on housing and Rent Rebates[1] were calculated and paid independently. This meant that an authority could receive no housing subsidy but their qualifying expenditure on Rent Rebates would be subsidised in full.

The operation of the HRA subsidy system that has been in existence since 1990 is explained in the next section. The most controversial aspect of this system is that authorities that are deemed to be 'in surplus' on the Housing Element of their HRAs[2] receive reduced subsidy on the Rent Rebates given to their tenants. As a result, the system has been criticised because the rent payments of 'better off' tenants not in receipt of Rent Rebates help to meet the cost of giving financial help to poorer tenants via housing benefit. Thus the cost of assisting these tenants is, wholly or in part (depending on the financial circumstances of each authority) borne by other tenants rather than by tax-payers at large. This can be contrasted with the way in which subsidy is met for the payment of Rent Allowances (ie housing benefit for private tenants and tenants of registered social landlords). Rent Allowance subsidy is paid direct to local authorities by central Government; the normal subsidy rate for this expenditure is 95%. A lower rate of subsidy is payable in specified circumstances.

Using tenants' rent payments to offset the cost of Rent Rebates has also been criticised on the ground that any surpluses arising on the HRA should be used to repair and improve tenants' homes.

The subsidy system has been branded a 'tenants' tax' and has led to the formation of the Daylight Robbery Campaign by local authority tenants to argue for an end to the process of using rental income to subsidise Rent Rebate payments.

II How the subsidy system works

The *Local Government and Housing Act* 1989 introduced major changes in the revenue funding of council housing. From 1 April 1990 the existing housing subsidy, rate fund contributions (local contribution) and the Rent Rebate Element of housing benefit subsidy

[1] Housing benefit for council tenants.
[2] ie their notional income exceeds their notional expenditure.

were replaced with a single Housing Revenue Account Subsidy. In theory Housing Revenue Account subsidy bridges any gap between the income and expenditure items on the Housing Revenue Account (HRA).

The principal **income** of the HRA comprises:

- rents net of rebate
- HRA subsidy

the **outgoings** are:

- loan charges
- management and maintenance spending
- surpluses transferred to the General Fund

Central Government pays housing subsidy to authorities with positive entitlements to subsidy. Local authorities with a negative subsidy entitlement must transfer the corresponding amount out of their HRA to another account; in effect their General Fund Revenue Accounts. The 1989 Act prohibited any future transfers from the General Fund to the HRA. HRA subsidy is calculated on the basis of notional, not actual, figures. An authorities subsidy entitlement is the difference between notional expenditure and notional income.

Under the pre 1990 system Exchequer subsidies on housing and Rent Rebates were calculated and paid independently. This meant that an authority could receive no housing subsidy but their qualifying expenditure on Rent Rebates would still be subsidised in full. The inclusion of Rent Rebate subsidy within the new HRA subsidy marked a fundamental change in the financing of housing benefit for council tenants. When the cost of Rent Rebates is excluded from the subsidy calculation, a majority of authorities have a notional surplus of income over expenditure, these surpluses are, under the current system, used to offset the cost of Rent Rebates. The table over the page illustrates how the subsidy system works in practice for three authorities with different financial circumstances.

The table shows that South Cambridgeshire is a ‘negative subsidy’ authority. The surplus on the Housing Element of its HRA more than pays for expenditure on Rent Rebates with the result that it is able to make a net transfer to its General Fund: South Cambridge does not receive any HRA subsidy. Hartlepool has a surplus on the Housing element of its HRA which is offset against its Rent Rebate expenditure. Because Hartlepool’s expenditure on Rent Rebates exceeds its available surplus it receives net HRA subsidy. Newcastle City Council does not have a surplus on the Housing Element of its HRA therefore it receives net HRA subsidy towards its Rent Rebate expenditure and also expenditure on management and maintenance.

Table 1

Example Housing Revenue Accounts: 1999/00
£ million

	South Cambridgeshire	Hartlepool	Newcastle
Housing Element			
Expenditure	12.3	15.4	82.8
Revenue	21.4	17.8	75.2
Subsidy	-9.2	-2.4	5.4
Rent rebate element			
Expenditure	7.5	11.9	43.8
Subsidy	6.6	12.3	44.1
Subsidy limitation [(a)]	0.9	0.1	0.0
Total net subsidy	0.0	9.9	49.5
Transfer to General Fund	1.7	0.0	0.0

(a) see pages 10 & 11 for an explanation of Rent Rebate Subsidy Limitation

The DETR's 2000 Annual Report notes that the estimated gross cost of Rent Rebates in 2000/01 will be £4.2 billion. After taking into account Housing Element surpluses, the subsidy paid by the Government towards the cost of rent rebated will amount to £2.7 billion.[3] In other words, around £1.5 billion of Housing Element surpluses in the HRA will be used to offset the cost of rent rebates.[4]

III Why the 1990 subsidy system was introduced

Two key objectives seem to have underlain the introduction of the new subsidy system. First, to reduce local authority discretion over the relationship between rents and management and maintenance spending, and second, to regain a lever under the three-quarters of authorities that were no longer receiving housing subsidy.

The amalgamation of housing and Rent Rebate subsidy brought all but a few authorities 'into subsidy' and, therefore, under pressure to follow the Government's guidelines. The Government of the day was concerned that those authorities in surplus on their HRAs were able to keep these surpluses and could transfer them out of the HRA to spend on other services. The DoE's 1988 Consultation Paper gave the following reason for the change:

> Because local authorities borrow on a historic cost basis, the cost of their borrowing is effectively eroded by inflation, even at its current level. As a result there is a growing trend towards more and bigger surpluses in HRAs. In the past this was generally offset as new capital projects at current prices entered the account...It follows that HRAs in general

[3] Cm 4604, table 4g
[4] ibid

> will increasingly generate surpluses...It is essential that those surpluses should not be available to be used as a cushion for bad practices and inefficiency. [5]

Instead of introducing an explicit "negative housing subsidy" under which authorities deemed to be in surplus would have had to make payments to central government, the Government of the day chose to net HRA surpluses off the amount authorities were deemed to need to cover Rent Rebates.

IV Rent Rebate subsidy limitation

The HRA subsidy system was changed again in with the introduction of the Rent Rebate subsidy limitation in April 1996. This provides a disincentive to local authorities to increase their rents above DETR's guideline rent increases to raise more money for HRA expenditure.

On 21 November 1995 the then Housing Minister, David Curry, issued a consultation paper setting out proposed arrangements to discourage authorities from increasing their rents by more than the Government's guideline increase.[6] The paper proposed that HRA subsidy would not be paid on any additional Rent Rebate expenditure resulting from authorities increasing their average actual rents by more than their guideline rent increases.[7] The background to this was explained as follows:

> Average actual rents have been increased by more than the Department's guideline in five out of the six years since the introduction of the HRA subsidy system in 1990/91. The Exchequer has had to meet the resultant large, unplanned, cost of the additional rent rebates arising from the increases.
>
> The Government is concerned that the existing subsidy arrangements - whereby the additional rent rebates arising from rent increases above guideline are subsidised at a rate of 100% at the margin - do not provide authorities with a sufficient incentive to control expenditure.
>
> The Government recognises that some of the increases in the past have been due to the transitional problems that authorities faced following the introduction of the HRA subsidy system. Now that the system has bedded down, the Government believes that it should be possible for authorities to provide council housing without recourse to further increases above guideline. Limiting subsidy on rent rebates will provide authorities with a proper incentive to finance improvements in service to tenants from efficiency savings rather than further rent increases above guideline.

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5 para 10

6 Deposited Paper 3/ 2369

7 As part of the annual HRA subsidy determination the DETR makes decisions about the level of increase in local authority rents and the amount of expenditure on management and maintenance. The amount of subsidy received reflects these decisions. Guideline rent increases are issued by the DETR but local authorities may increase their rents by more or less than the guideline amount.

Thus from 1April 1996 if an authority increased its rents by more than the guideline rent increase notified by the Department of the Environment (now the DETR), it had to ensure that the 'additional increase', ie the amount by which the actual rent increase exceeded the Government's guideline, generated sufficient income from those tenants who did not qualify for a rebate to ensure that the HRA did not fall into deficit.

The DoE was prepared to consider requests for special determinations to dis-apply the rule in whole or in part where authorities could show that they faced exceptional circumstances outside their control. Any exemptions that were granted were not automatically carried over into the following financial years.

A. Rent Rebate subsidy limitation under Labour

The Labour Government has maintained this 'capping' policy. The Department's commentary on the draft Housing Revenue Account Subsidy Determination 1998/99 said:

> Ministers have considered carefully the case for changes in the system of rent rebate subsidy limitation for 1998/99, including whether to allow authorities to increase their rents above a guideline up to a specified threshold without any subsidy penalty. Subject to consultation, they have decided not to amend the system that operated in 1997/98. Ministers are very conscious that changes in the system of rent rebate subsidy limitation that led to increased spending on HRA subsidy on rent rebates would have to be offset by savings from other expenditure programmes.[8]

However, the Government amended the rent rebate subsidy limitation system that operated in 1999/2000 so that the effects of limitation were mitigated for authorities that rebated an above average proportion of their rental income.[9] Authorities that rebate *more* than 61% of their rental income received rent rebate subsidy as though they rebated 61% of their rental income;[10] otherwise the system remained unchanged from 1998/99. The system will also remain unchanged in 2000/01.[11]

The consultation paper, *A New Financial Framework for Local Authority Housing: Resource Accounting in the Housing Revenue Account*,[12] clearly indicates the Government's continuing desire to have a means by which it can influence local authority rent levels:

8 para 35
9 Commentary on the Housing Revenue Account Subsidy and Item 8 Determinations 1999-2000
10 The DETR has collected information from authorities that shows that the national average proportion of rental income rebated is around 61%.
11 Commentary on the HRA subsidy and item 8 determinations 2000/01, and on a determination amending the subsidy determinations for 1998/99 and 1999/2000, para 35
12 DETR, November 1999

> That part of the current subsidy system which deals with rents and Rent Rebates also provides a means by which central Government can exercise a measure of influence over an authority's rents. The system does not control rents; the only control it provides is over the size of the subsidy paid to each authority. Although, of course, the level of central Government subsidy will have an indirect effect on the policies adopted by most authorities. Ministers will want to influence rents partly because of their concerns about the levels of rents charged to those in social housing, partly because of the effects on Rent Rebate subsidy, and partly because of the wider economic implications of spending by authorities.[13]

V Developments under the Labour Government

By the mid 1990s the issue of low paid council tenants subsidising the housing benefit of other tenants in receipt of benefit was achieving increasing prominence. Tenant groups and a number of local authorities argued that the Government should cover the cost of council tenants' Rent Rebates, and that councils should be able to use their HRA surpluses for purposes within the remit of the HRA, for example repairs and improvements to the council stock.

Nick Raynsford made the following statement on the new Government's approach to HRA subsidy in response to a PQ in July 1997:

> **Mrs. Ballard**: To ask the Secretary of State for Social Security what plans she has to change the rules on housing benefit to ensure that local authority tenants are not subsidising, through rent levels, the housing benefit of other tenants.
>
> **Mr. Raynsford**: I have been asked to reply. Under the housing revenue account subsidy system, an authority's entitlement to subsidy for its council housing is based upon various assumptions about its relative income and expenditure. If the cost of rent rebates is excluded from the subsidy calculation, most local authorities have a notional surplus of income over expenditure. These surpluses are used to offset the cost of rent rebates. We have some sympathy with local authorities' concerns about this aspect of the subsidy system and have embarked on a review of the HRA subsidy system as part of the comprehensive spending review of housing.[14]

Responding to an Adjournment Debate on the subject of housing subsidy in February 1998 Nick Raynsford noted:

> The argument that a change to the current arrangements for housing revenue account subsidy will release additional funds for investment has one fundamental flaw: the cost. It would have a price tag of about £1.3 billion. The Government's ability to target resources for housing investment would be reduced because that £1.3 billion would have to be compensated by savings elsewhere, given our commitment - which my hon. Friend recognised - to living within the inherited financial framework. That is the position we have adopted and that is why we cannot reverse this decision in the immediate future.[15]

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[13] ibid, para 2.5.4

[14] HC Deb 23 July 1997 cc 586-7W

[15] HC Deb 27 February 1998 c 688

On 22 July 1998 the Government announced the outcome of the Comprehensive Spending Review on housing. No reference was made in this announcement to the use of HRA rent surpluses for offsetting the cost of Rent Rebates and it was assumed that this practice would continue for the time being. However, during a conference organised by the Daylight Robbery Campaign in mid-November of that year the then Minister for Housing, Hilary Armstrong, announced that the Government had decided to consult with authorities on whether Rent Rebates should be taken out of the HRA. She reportedly said:

> As to the specific issue which is the subject of this conference, I can assure you that you have made your message loud and clear. I can tell you today that we have decided to consult authorities on whether rent rebates should be taken out of the HRA and funded in full. If rent rebates are taken out of the HRA when resource accounting is introduced, my overwhelming concern will still be that the huge amount of subsidy which my department provides for housing is well spent where it is most needed.[16]

This announcement gave rise to speculation over whether local authority housing departments would receive an extra £1.3 billion a year to spend on repairs and renovation or whether the effects of any change would be financially neutral given the Government's spending plans for housing over the next three years.

The DETR published a consultation paper, *A New Financial Framework for Local Authority Housing: Resource Accounting in the Housing Revenue Account,* in December 1998. This paper proposed the removal of Rent Rebates from the HRA and HRA subsidy calculation and the introduction of a new Major Repairs Allowance (MRA).

Resource accounting represents a fundamental change in the method of accounting for local authority housing. The Government's view is that the current system does not encourage efficient investment and that the new approach will be more business-like and transparent. Applying resource accounting principles to the HRA will mean:

- replacing actual debt charges with a measure of the cost of capital. This will be based on a cost of capital charge that will reflect a 6% return on the value of assets and a charge for depreciation/major repairs; and
- the rent subsidy will be removed from the HRA and be transferred to the non-HRA General Fund.

Resource accounting involves a move away from historic costs to current values. The consultation paper described it as a method of measuring on a consistent basis the resources used over the lifetime of houses, rather than simply the cash spent on them each year. The argument is that historic debt charges do not reflect the true costs of the capital tied up in

16 'A taxing time', *Housing Today,* 19 November 1998

housing assets, nor the true level of subsidy.[17] Further information on resource accounting can be found in Library Research Paper 99/97, *The Government Resources and Accounts Bill.*

Separate consultations have taken place on the calculation of the MRA. In brief, it is proposed that each authority will be eligible for MRA, in addition to the current management and maintenance allowances, to contribute to the upkeep of their stock. The impact of the MRA on the HRA subsidy system will be to reduce assumed surpluses and increase assumed deficits in most individual cases and overall at a national level. This will occur because an authority's assumed level of expenditure will be increased by the amount of additional support provided through the MRA. The consultation paper states:

> The introduction of the MRA will affect the distribution of resources between authorities because the size and location of assumed surpluses and deficits will change. The scale of these effects will depend on the way in which the MRA is calculated, and its size.[18]

Responses to the consultation exercise indicated 'general support for the principle involved'. The majority of respondents agreed that it was right to regard local authority housing as a national programme and that assumed surpluses in authorities' housing accounts should be retained within housing and redistributed through a pooling mechanism.[19]

Hilary Armstrong announced that the Government would legislate to remove Rent Rebates from the HRA and that further consultation would take place over how HRA surpluses would be redistributed to 'ensure that resources go to councils with the greatest need.'[20] Resource accounting will proceed from April 2001[21] but primary legislation will be required to remove Rent Rebates from the HRA. The MRA can be introduced without legislation and it is expected that it will also be introduced in April 2001.

VI The implications of removing Rent Rebates from HRAs

The removal of Rent Rebates from the HRA will leave it as a 'pure' landlord account. Three consequences of the change have been identified:

a) it will be no longer possible to offset surpluses from the Housing Element of the HRA against Rent Rebate subsidy because the calculation will revert to something

[17] DETR, *A New Financial Framework for Local Authority Housing: Resource Accounting in the Housing Revenue Account,* December 1998

[18] para 3.2.3

[19] HC Deb 23 May 2000 c 437W

[20] HC Deb 22 June 1999 c 338W

[21] Local authorities have been required to draw up shadow accounts during 2000/01 in order to become familiar with the process and iron out any practical difficulties.

similar to the pre-1990 system where there was a separation between the calculation of the Housing and Rent Rebate Elements;

b) there will need to be a different means of accounting for Rent Rebate subsidy in an authority's accounts; and

c) Rent Rebate subsidy limitation will need to operate differently.

A. Calculation of the Housing Element

In *A New Financial Framework for Local Authority Housing: Resource Accounting in the Housing Revenue Account*[22] the Government proposed that a calculation should continue to be carried out for each authority individually to establish the size of its surplus or deficit. It is proposed that the calculation will be based on seven elements:

- Assumed expenditure on management, expressed as a management allowance.
- Assumed expenditure on maintenance, expressed as a maintenance allowance.
- Assumed rental income based on guideline rents in the authority.
- An assessment of loan charges attributable to the HRA.
- Assumed expenditure on the upkeep of the stock. For the purposes of the calculation, the DETR will assume that the full amount of the actual Major Repairs Allowance to be paid to the authority will be spent on upkeep in the year in which it is paid. (In practice, authorities might transfer the MRA to their Housing Repairs Account to provide for additional flexibility in the handling of their maintenance programme.)
- An assessment of mortgage interest income and, where appropriate, investment income attributable to the HRA.
- Rental/interest payments under certain leasing/deferred purchase arrangements entered into before 1990.

The Government proposes to pool the surpluses assessed for each authority and to redistribute them to authorities that are in assumed deficit. The assumed surpluses will be paid to the DETR to be pooled and redistributed. A new duty will be placed on local authorities to make payments into the redistribution pool.

The principle underlying this approach is that the subsidy of local authority housing should be considered as a national programme 'because of the scale of resources provided by taxpayers centrally and because of the mismatch between where resources are needed and where they are found.'[23] Against this background the Government proposes to ensure that the resources represented by these surpluses should remain within housing.

[22] DETR, November 1999

[23] ibid, para 4.3.1

B. Payment of Rent Rebate subsidy

The Government proposes that the full cost of Rent Rebates and the subsidy paid in respect of those Rebates should be accounted for within an authority's General Fund. The favoured approach is that the HRA should be credited with gross rental income made up of:

- tenants' rental contribution to the authority, that is, the rent on which Rent Rebates are not granted, and
- the rent on which Rent Rebates are granted.

The Government is also considering whether to make changes to the basis of payment of Rent Rebate subsidy.[24]

C. Rent Rebate limitation

The Government views the case for retaining Rent Rebate subsidy limitation as 'strong.' The proposed approach under the new system is to limit the amount of subsidy paid into the General Fund to meet the cost of Rent Rebates up to a maximum average rent that will be determined annually for each authority. Authorities will be able to set rents above this limit and will have to grant Rent Rebates to eligible tenants, but the extra cost of doing this will not attract subsidy from central Government. Instead, these costs will have to be met by the HRA.

An authority facing a limitation of Rent Rebate subsidy will receive less subsidy to its General Fund than the cost of Rent Rebates granted. In order to avoid a deficit appearing on the General Fund authorities will be placed under a duty to make good any shortfalls arising out of any such limitation from their HRAs 'thus making clear the cost to tenants of the authority setting rents in excess of guidelines.'[25]

VII 'Negative subsidy' authorities

A. Background

Some 60 authorities in 1999/2000 had a surplus on the Housing Element of their HRAs that was greater than the Rent Rebate Element. The effect of this is that once the cost of the Rent Rebate Element is offset, the authorities still have an assumed surplus, ie they are in 'negative subsidy'. These authorities, like all other authorities, are under a duty to balance their HRAs and must transfer the assumed surplus to their General Funds annually under the provisions of section 80(2) of the *Local Government and Housing Act 1989.*

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[24] ibid, section 5.4
[25] ibid, para 5.3.4

For some 'negative subsidy' authorities transfers to the General Fund involve significant sums which represent a substantial proportion of their General Fund income. The November 1999 consultation paper[26] gave examples of the impact on two negative subsidy authorities of the removal of the transfer with no change in spending:

> Authority A would have to increase its Council Tax in 1998/99 from £113 (in Band D) by £139 to £252. Its 1999/2000 Council Tax was £115.
>
> Authority B would have had to increase its Council Tax in 1998/99 from £94 by £113 to £207. Its 1999/2000 Council Tax was £98 and would have been £236 without the transfer from the HRA.[27]

In these authorities council tenants are subsidising council tax payers; there is also concern that this money (£100m in 1999/2000) represents a significant drain on housing resources.

There are three broad classes of authority in which 'negative subsidy' arises:[28]

- Many of the authorities that took responsibility for property from the New Towns Commission when the Commission was wound up. The debt transferred from the Commission was commuted in 1996 and they have relatively little other debt.
- Authorities that have large and active HRAs but very little debt, and few tenants eligible for Rent Rebates so there is little Rent Rebate subsidy to be paid. The number of authorities in "Negative Subsidy" in this class has been increasing over recent years.
- Authorities that have a small number of properties in their HRA – typically stock has transferred to Registered Social Landlords – and there is a significant income, often from the assumed investment of the "set aside" resources generated by the transfer.

B. The impact of the Government's proposals

The Government says that 'it is no longer acceptable that there should be substantial transfers from the HRA to the General Fund.'[29] The November 1999 consultation paper noted that the introduction of the Major Repairs Allowance from April 2001, which will be included in the calculation of subsidy entitlement, would reduce assumed surpluses so that 'negative subsidy' authorities will make smaller transfers to their General Funds. In addition, the introduction of pooling arrangements in 2002 or 2003 will mean that

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26 *A New Financial Framework for Local Authority Housing: Resource Accounting in the Housing Revenue Account*
27 ibid, para 6.2.1
28 ibid, para 6.1.2
29 ibid, para 6.4.1

assumed surpluses for ‘negative subsidy’ authorities will be added to the pool and distributed as part of the HRA subsidy.

Authorities in ‘negative subsidy’ are alarmed about the financial implications of the introduction of resource accounting for the HRA. Tony McWalter talked about the position of Dacorum council in a June adjournment debate:

> My hon. Friend the Minister knows that I have a specific complaint about the effect of the new system of resource accounting on my constituency. The change to the new system is for the general good, but it needs to be implemented with considerable care in the labyrinth of local government finance.
>
> The local government authority in my area, Dacorum, is an excellent example of its kind. A Labour administration from 1995 introduced a series of measures designed to tackle poverty and to initiate what we would now call a new deal. It pioneered many such beneficial initiatives, including a close relationship with local police, pre-dating the Government, which has resulted in an area of low crime and recent record falls in crime rates.
>
> Dacorum is debt-free. That is one of the reasons why it could be proactive and support so many of the services not taken up by Hertfordshire county council. Voluntary services seem to be making up for many of the deficiencies of a social services system that is stretched to breaking point. One such organisation is the local Council for Voluntary Service, under the inspirational leadership of Mrs. June Street, who was recognised by Her Majesty for the quality of the work that she has done for the people of Dacorum.
>
> If the local authority faced extraordinary resource difficulties, as Hertfordshire did, at least we had a voluntary service system supported by Dacorum borough and free of some of the impediments faced by many borough councils. That made a huge difference to the quality of life of many of the most needy people in my area.
>
> For years, Dacorum has not asked permission from the Government to borrow. Inevitably, its housing stock decreased markedly under the right-to-buy proposals, but it remains strongly the landlord of choice for the many people who cannot afford to buy, even at discounted prices. Rents in the area are 6 per cent. lower than in Stevenage, and if a large-scale voluntary transfer of the stock were proposed, residents of Dacorum would say, "No way!" The council supports a number of housing initiatives outside the housing revenue account, including a women’s refuge and a centre that supports those with mental health difficulties.
>
> The net effect of the moves was that Dacorum, through selling houses and the contentious sale of a large playing field, which was technically a housing asset, was able to liberate itself from governmental spending constraints. It was able to use the interest on capital receipts and the receipts themselves to tackle poverty, deprivation, desperation and social malfunction, especially when it was led by a Labour councillor, Julia Coleman, between 1995-99. In my view, in its use of

resources, Dacorum borough council operated as a council should. It does not operate in that way now.

In its finances, the council faces the equivalent of planning blight, even catastrophe. It is tempting to be party political and say that the reason is that, since May 1999, it has been run by a minority Conservative administration. However, that accusation would be unfair. The Government have established a new system of organising local government finance that could be massively prejudiced against Dacorum and significantly damaging to other new towns, including Bracknell, Harlow and Crawley.

What is the origin of the blight, which means that my pensioner constituent will not receive help to get her bath, and that pensioners who enjoy a game of bowls at an economical price will be denied it? What threatens the budgets of dozens of voluntary organisations, which deliver services to the elderly, the mentally handicapped, the homeless, the mentally ill and those who need supported employment? The origin of the misery is that Dacorum has what is called "negative housing subsidy", and assets that exceed its liabilities. That makes it technically debt-free. It has debts, but they are covered by its assets.

Since an Act of Parliament in 1989, Dacorum has not received any borrowing authority to build or improve its houses, which number about 12,000. It had a negative housing subsidy, which it was required by law to put into its general rate fund. That meant that, this year, £8 million "profit" on the council housing budget subsidised general rate activities. In addition, the council is regarded as having what is technically called a mid-year subsidy credit ceiling, which is also negative--about £36 million. That mid-year subsidy credit ceiling, which is negative subsidy, is deemed an asset on which it can make interest.

Negative subsidy is a funny term. The whole system is built around the idea that councils are up to their ears in debt and that they want to borrow. A council that has managed its affairs well, whose policies anticipated many of the Government's policies and which is not in debt and is delivering a high quality product to its people is somehow deemed an affront to the system. Hence the ridiculous language of negative subsidy. The mid-year subsidy credit ceiling system is deemed to deliver the council interest of £2 million on its assets. The sum is the item 8 credit that appears in the title of the debate on the Order Paper.

The £8m in the council's general rate fund, which is 41 per cent. of the council's revenue, is threatened because the Government want no transfers from housing funds to the general rates. The straight implication is that Dacorum would have to slash its annual revenue budget by £8 million. Hundreds of local organisations would close their doors forever. A council that does so much good will, alas, no longer be able to do that.[30]

[30] HC Deb 22 June 2000 cc 548-9

A further aspect of the Government's proposals that will affect 'negative subsidy' authorities is the treatment of investment income in the HRA. Currently it is assumed that debt free authorities receive interest on their investments in the HRA. To varying degrees, this assumed income contributes to the amount of negative subsidy 'surplus' of individual authorities. If all surpluses are to be pooled in future, the DETR has said, 'at the simplest level, the assumed amount would be transferred to the pool rather than to the General Fund.'[31]

Responding authorities said that this would mean that capital receipts would have to stay invested in order to achieve the assumed interest income. Alternatively, if receipts *are* spent so that the investment income can not be achieved, other General Fund income would have to be paid into the HRA. This would in turn be paid into the 'pool'.

Inconsistencies in the treatment of debt free authorities have also been highlighted. The HRA subsidy system continues to assume a notional set-aside from all capital receipts arising from the sale of HRA assets (eg the sale of council houses under the right to buy) as provision for debts. However, debt free authorities normally do not have to set aside any part of the capital receipts received by them because they have no debts to cover. These authorities have tended to spend, save or plough back the interest on their capital receipts. The effect of assuming a notional set aside has been to increase the amount of investment income assumed to be received each year in the HRA.

Tony McWalter has commented on the potential effect of requiring the transfer of assumed interest from capital receipts to the HRA and then into the 'pool':[32]

> A second line of attack was recently offered by the technical advisory group to the Department. The group notes that for a decade local authorities that have been borrowers have been required to put aside money to cover their debts. That generated a resource that the Government could use for a national housing initiative. Debt-free authorities, however, did not make such provision. They did not put aside money to cover their debts, because they had no debts. They spent capital receipts, as they were fully entitled to do; or they saved them, and ploughed the interest into improving the quality of life of their citizens. That is certainly what Dacorum did. New rules for resource accounting now assume that they did not spend the money, and effectively require such authorities to pass the interest to the Department even if they no longer have the interest-earning capital.
>
> I make the point because it has particular significance for other new towns. They regard this as retrospective legislation with a vengeance. Fortunately for Dacorum and for Hemel Hempstead--the same does not apply to some other new towns--at least Dacorum still has the money. It is still receiving interest, and it could meet the bill. The only misery--in fact, a major series of pieces of misery--that the item

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31 *A New Financial Framework for Local Authority Housing: Resource Accounting in the Housing Revenue Account*, para 6.3.2

32 Known as item 8 credit arrangements.

> 8 transfer could cause would lie in the fact that Dacorum might then have no capital programme. After all, it has money, so it has no need to borrow--but look! It must not spend its money, or it will not be able to make its £2 million deemed interest payments to the Department.
>
> The item 8 transfer would also mean that Dacorum would lose £2 million from its general rate fund, as part of the overall £8 million lost. It would never be able to get a capital programme going, because--this is a crucial point--new towns lack the land assets that older councils have.
>
> Some might think this series of penalties rather steep for a new town that makes its contribution to the £160 million a year that is raised by such towns for the Treasury through what used to be the Commission for New Towns, and is now English Partnerships. Some might consider such a penalty an absolute injustice to an authority that has made far fewer demands than others on Treasury resources, and which has made no contribution to the public sector borrowing requirement for a decade. Some will say, "If this is what happens when things are managed well, what is the point of managing well?"[33].

The DETR is currently undertaking a review with the Local Authority Associations of the treatment of capital charges in the HRA and HRA subsidy. One of the suggestions under consideration is that HRA assumed investment rules should be dispensed with altogether.

C. Transitional measures

The November 1999 consultation document included a commitment to introduce transitional measures to allow time for 'negative subsidy' authorities to adjust to the new arrangements. Chris Mullin restated this commitment in June 2000:

> The housing revenue account must change. It will move to a resource accounting basis, making more transparent the cost of capital tied up in assets and providing additional resources to maintain it over the longer term. In due course, subject to Parliament's approving the necessary legislation, we propose that it should once again become a pure landlord account, no longer confusing housing activities with the personal support given to individual tenants through rent rebates.
>
> In tonight's short debate, I shall not explain the intricacies of the existing system or our proposed changes. They can be found in the speech made by the Under-Secretary, my hon. Friend the Member for Stretford and Urmston (Ms Hughes), on 8 February in a debate which I believe my hon. Friend attended.
>
> As my hon. Friend will appreciate, under the existing system resources are lost to housing at a time when there is a continuing need for them. That will all change with the introduction of the new financial framework. First, when we introduce

33 HC Deb 22 June 2000 cc 550-1

> the major repairs allowance next year, there is likely to be a substantial change in the amount of subsidy paid to authorities. That is essential in order to provide the revenue resources that authorities need to maintain their stock. As a result, authorities that are currently in negative subsidy, such as Three Rivers, which is in or near my hon. Friend's constituency, could go out of negative subsidy altogether and again be entitled to receive subsidy. Others, such as Dacorum, may remain in negative subsidy but at a lower level, with more rental income retained within the housing revenue account to spend on their stock. In either case, there will be consequences for the general fund.
>
> The system will change again when we are able to take rent rebates out of the housing revenue account. When that happens, we propose to capture all assumed surpluses, including all those which currently are offset against rent rebates. We have recently confirmed our intention to introduce the pooling of those surpluses. They will then be redistributed to authorities in deficit. When that change is introduced, negative subsidy authorities will no longer be able to transfer resources to their general fund. Along with all other surplus authorities, they will be required to pay their overall surpluses into the pool for redistribution to other housing authorities. That will ensure the most effective use of scarce resources. It will mean that housing resources are retained within housing.
>
> We recognise that for negative subsidy authorities the changes may cause difficulties elsewhere. That is why we have said that we shall introduce measures to enable them to make the transition to the new system. Those measures will operate from next April. My hon. Friend pointed out that his local authority was attributing some of the cuts or the inability to provide services this year to the impending changes. I can say only that so far there is no basis for that as the changes do not come into effect until next April.
>
> We are also reviewing the assumed investment rules to see whether there are any grounds for amending them next year. The local authority associations are fully involved in that review, and I understand they are keeping negative subsidy authorities informed of progress. I have already confirmed that we believe that the current rules are generally sound in principle. However it may be justified to make some changes for debt-free authorities, which I understand would include most of those currently in negative subsidy. That could go a long way towards reducing the difficulties that they face as they move to the new system.[34]

A further consultation paper was published in August 2000: this paper deals specifically with the transitional arrangements that might be introduced for 'negative subsidy' authorities.[35] A significant point to note is that the Government has drawn authorities' attention to its reserve powers to protect taxpayers from excessive increases in Council

[34] HC Deb 22 June 2000 cc 552-4

[35] *A New Financial Framework for Local Authority Housing: Resource Accounting in the Housing Revenue Account – Transitional Measures for Negative Subsidy Authorities.*

Tax and the implications of Council Tax Benefit subsidy limitation.[36] This would seem to underline the Government's intention not to tolerate steep Council Tax increases that local authorities might attribute to the new subsidy system.

In the absence of transitional measures some negative subsidy authorities might still be able to make a Continuing Transfer to their General Funds after the introduction of MRA, albeit at a reduced level (stage 1). At stage 2 there will be no Continuing Transfer because any remaining surpluses will have to be paid into a central pool.

With transitional measures, authorities taking advantage of them will be able to transfer a Maximum Amount from their HRA to their General Funds for the period in which the transitional measures are in operation:

- At stage 1 the Maximum Amount will be the sum of the Continuing Transfer and the Transitional Amount. At this stage authorities will receive no extra resources: there is no net cost to the Housing vote and the resources available to other authorities are not affected.
- At stage 2, there will be no Continuing Amount so the Maximum Amount will always be equal to the Transitional Amount. In the absence of transitional measures these authorities would have to make a larger contribution to the central pool. Authorities benefiting from the transitional measures will therefore keep the resources that they would otherwise have to make available for distribution as HRA subsidy. This will mean that either the total amount available for distribution as HRA subsidy is reduced by the sum of the Transitional Amounts, or additional resources will be required to make up the difference.

The August 2000 consultation paper sets out 5 options for the period of time during which the transitional measures might operate and 2 options for calculating the annual amount of the transitional measures for each authority.

The five options for deciding on the time period are:

- On the basis of a judgement of how long is required; a period of 5-10 years has been suggested.
- By allowing an authority transitional measures that last for as long as it has been in 'negative subsidy'.
- Calculating measures so that the Council Tax Equivalent for an authority changed by no more than an annual percentage amount' 5% per year has been suggested.
- Calculating measures so that the Council Tax Equivalent for an authority changed by no more than an annual fixed amount; £10 per year has been suggested.

36 ibid, para 2.6.2

- Reducing the transitional measures annually by a fixed amount for each authority; an amount of between £200,000 to £500,000 has been suggested.

In terms of calculating the annual amount of the transitional measures for each authority, the two possibilities are:

- To provide a 'smooth annual reduction in the difference between the transfer 'with' and 'without' the new financial framework'. This option would provide a continuation of the present variation in the resources actually transferred from an authority's HRA to its General Fund because of fluctuations in HRA subsidy.
- The second option would provide 'a smooth reduction in the transfer that would be made over the period of the transitional measures'. This option would start from a 'base year' and calculate a year on year reduction in the transfer to the General Fund. This would give authorities certainty as to the amount of their transfer over the period of the transitional measures.

The annex to the consultation paper contains worked examples of how the two options would operate.

Local authorities and other interested parties had until 29 September 2000 to submit comments on these proposals.

D. Responses to the consultation on transitional measures

There is general support for phasing out payments from HRAs to General Funds but views vary on the timing of the transitional arrangements.

The 'negative subsidy' authorities have reportedly given the proposals a 'cautious welcome'.[37] Dacorum's Labour group leader, Keith White, has said that the proposals are 'workable' while Bracknell Forest's Leader, Paul Bettison, says the regime would be 'workable' but is of the opinion that it constitutes a 'wealth tax.'

The Chartered Institute of Housing (CIH) would like to see the phasing out of payments from HRAs to General Funds 'as quickly as possible' and is in favour of a shorter transitional period than the proposed 10 years.[38] The CIH suggests a fixed amount per year (between £200,000 and £500,000) by which negative subsidy authorities should reduce the subsidy to their General Funds from their HRAs. The CIH would like the DETR to produce a leaflet for distribution in affected authorities that explains the reasons behind any subsequent increases in Council Tax charges.[39]

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37 'Pot luck for 'negative' councils', *Inside Housing*, 25 August 2000

38 CIH response to *Resource Accounting in the Housing Revenue Account: Transitional Measures for Negative Subsidy Authorities*, September 2000

39 ibid