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The Local Government Bill: Housing Finance Clauses

Bill 9 of 2002-03

The *Local Government Bill* was presented on 25 November 2002.

The Bill includes measures to abolish credit approvals and replace them with a new prudential borrowing system for local authorities. It also includes measures aimed at simplifying the housing finance system.

This paper deals only with those parts of the Bill that affect the area of local authority housing finance. Information on other aspects of the Bill can be found in the Research Paper entitled *The Local Government Bill*.

The Bill's provisions on housing finance will apply in England and Wales. Consequential amendments to the *Social Security Administration Act 1992* will also apply in Scotland.

Wendy Wilson

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Summary of main points

Chapter 1 of the Bill will introduce a new prudential borrowing regime for local authorities. Under this regime authorities will be responsible for taking decisions on how much they can afford to borrow and will, in theory, be able to take their own decisions with respect to their capital investment and capital programmes. Prudential borrowing will replace the current system of credit approvals under which central Government stipulates the amount and type of capital investment that each authority may fund from borrowing.

Prudential borrowing will apply across local authorities' services; it will not apply solely to housing capital finance. Detail on the Bill's provisions in relation to prudential borrowing (and the rationale behind its introduction) is provided in the Library Research Paper entitled *The Local Government Bill*. The capital finance section of this paper focuses on what impact the new system might have on authorities' ability to raise capital finance for housing investment.

Other housing finance measures in the Bill will:

- Remove the rules that require a proportion of capital receipts raised from the sale of housing assets to be set-aside for debt redemption. A new mechanism for “pooling” these receipts will be introduced. This pooling system will, controversially, apply to debt-free authorities.
- Facilitate the transfer of council housing to registered social landlords by enabling the Secretary of State or the National Assembly for Wales to repay the “overhanging debt” of an authority that might arise on the transfer of its stock (where the value of the stock is not sufficient to raise a receipt large enough to pay off the authority's attributable housing debt).
- Place a statutory duty on housing authorities to prepare a local housing strategy.
- Complete the transition to a resource accounting basis for Housing Revenue Accounts (HRAs) and fulfil the Government's commitment to remove the payment of Housing Benefit (Rent Rebates) for council tenants from authorities' HRAs.

The Bill's provisions on housing finance will apply in England and Wales. Consequential amendments to the *Social Security Administration Act 1992* will also apply in Scotland.

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I Introduction

The Local Government Bill's main purpose in relation to housing finance is to codify the new financial framework for local authority housing. This new framework began in April 2001 with the introduction of resource accounting;¹ the Bill's provisions will complete the transition to a resource accounting basis for Housing Revenue Accounts (HRAs) and will fulfil the Government's commitment to remove the payment of Housing Benefit (Rent Rebates) for council tenants from authorities' HRAs. In addition, it will simplify the capital control regime.

Commentators have questioned whether the more flexible financial arrangements introduced by the Bill will actually benefit housing authorities. It has been noted that many of the basic features of the current financial system, whereby income is largely determined by central government formulae, are retained. The systems under which capital and revenue resources are pooled nationally will remain in place and are actually strengthened. The Chartered Institute of Housing has concluded that:

The effect of the Bill on local housing authorities as a whole is financially neutral. Thus, for example, although the existing requirements to set-aside part of capital receipts against debt, and to cross-subsidise housing benefit payments from other tenants' rents, will be removed, "pooling" arrangements will ensure that any resources that would have been released form part of a national pot to be distributed by centrally-determined formulae.²

Changes to the capital finance system, including the treatment of capital receipts raised from the disposal of HRA assets, are contained in Chapter 1 of the Bill (Capital Finance etc). The provisions on "overhanging debt" are in Chapter 2 (Other Grants etc) while Part 7 of the Bill contains the Housing Revenue Account subsidy changes.

This paper first looks at the changes to the capital finance regime and the treatment of capital receipts before going on to look at overhanging debt and, finally, HRA subsidy.

II Capital finance

The current capital control system for local authorities is largely concerned with setting the scope and limits for financing capital expenditure by borrowing. Credit approvals lie at the heart of this system: before local authorities can borrow money, or enter into any

¹ Traditionally, local authorities recorded their financial transactions on a simple cash-flow basis –rather like a bank statement. Under resource accounting information is presented in a way that enables managers to make optimal decisions about the use of valuable and limited resources under their control. It involves consideration of the actual results of spending and investment decisions and requires managers and auditors to assess the actual outcomes of their decisions against planned outcomes.

² CIH memorandum submitted to the Transport, Local Government and the Regions Select Committee on the draft Bill (LGB03):
<http://www.publications.parliament.uk/pa/cm200102/cmselect/cmtlgr/981/981m04.htm>

long term financing arrangement that spreads the cost of a project over a number of years, a credit approval must be issued by Government.

In *Modernising Local Government Finance: A Green Paper*,³ the Department of Transport, Local Government and the Regions (DTLR) described the system's main strength as protecting those who use and pay for local services from local authorities running up unsustainable debt levels.⁴ However, the consultation paper went on to note that the credit approval system "seriously erodes local freedom and responsibility" because "it prevents local authorities from carrying out additional borrowing funded from their own resources, such as council tax or council house rents" and "has encouraged an artificial distinction between capital and current resources, sometimes preventing good value 'spend to save' schemes from going ahead."⁵

Modernising Local Government Finance and the White Paper that followed it, *Strong Local Leadership – Quality Public Services*,⁶ advocated the abolition of the existing system of credit approvals and its replacement with a local prudential regime under which individual authorities would be responsible for deciding how much they can afford to borrow in accordance with the prudential code.⁷

Chapter 1 of the *Local Government Bill* will introduce such a prudential borrowing regime. Detailed information on how this regime will operate is contained in the Library Research Paper entitled *The Local Government Bill*. It is the aim of this section of the paper to consider how this new regime might affect local authorities' ability to raise capital for housing investment.

A. Housing investment and the prudential regime

1. Housing investment: current options for local authorities

The Office of the Deputy Prime Minister (ODPM) has adopted a Public Service Agreement (PSA) target to deliver decent homes to all social sector tenants by 2010 and to reduce the number of social tenants living in non-decent homes by one third by April 2004. This is one of several floor targets announced in *A New Commitment to Neighbourhood Renewal: National Strategy Action Plan*⁸ which set out the Government's approach to tackling deprivation in England's poorest communities. Chapter 7 of the

³ DTLR, 19 September 2000: <http://www.local.detr.gov.uk/greenpap/>

⁴ *ibid*, paragraph 4.3

⁵ *ibid*

⁶ DTLR, 11 December 2001: <http://www.local-regions.odpm.gov.uk/sll/part1/index.htm>

⁷ This Code is being developed by the Chartered Institute of Public Finance and Accountancy (CIPFA).

⁸ Social Exclusion Unit, January 2001:

http://www.socialexclusionunit.gov.uk/publications/reports/html/action_plan/contents.htm

Housing Green Paper, *Quality and Choice: A decent home for all*,⁹ discussed how sufficient investment would be secured in order to deliver the Government's "decent homes"¹⁰ target. Reference was made to the fact that the 1996 English House Condition Survey had identified a £10 billion backlog of disrepair in the local authority housing sector alone.¹¹ The Chartered Institute of Housing (CIH) supports an estimate of £21-23 billion for outstanding work to British council housing.¹²

It was acknowledged in the Housing Green Paper that "public investment will not be enough to bring about the marked improvements in quality and management" that are sought. Four investment options are available to local authorities for stock refurbishment; under the first three of these options the housing stock remains in local authority ownership:

- Authorities can use their own resources and those made available through the new Major Repairs Allowance and the Single Capital Pot; or
- They can set up an Arm's Length Management Organisation; or
- They can pursue a Private Finance Initiative scheme; or
- They can transfer their housing stock to one or more registered social landlords.

Authorities are required to consider the relative merits of these options in the context of the Housing Revenue Account (HRA) business planning process.¹³ The views of tenants are seen as key to this process and it is acknowledged by the ODPM that "different options might be appropriate for different parts of the stock."¹⁴

To date, stock transfer has proved to be the main vehicle through which local authorities have sought to release funds to finance catch-up repairs on their stock.¹⁵ The registered social landlords (RSLs) that take over ownership of ex-local authority stock can raise finance outside the borrowing constraints to which authorities are currently subject. In

⁹ Department of Environment, Transport and the Regions (DETR), April 2000: <http://www.housing.odpm.gov.uk/information/consult/homes/green/>

¹⁰ Information on the definition of the "decent homes standard" is available on the Office of the Deputy Prime Minister's (ODPM) website at: <http://www.housing.odpm.gov.uk/information/dhg/definition/index.htm>

¹¹ Housing Green Paper, *Quality and Choice: A decent home for all*, paragraph 7.1: <http://www.housing.odpm.gov.uk/information/consult/homes/green/>

¹² *Housing Finance*, David Garnett, CIH 2000, p223

¹³ For more information on the options available to local authorities see Library standard note, *Council Stock: options for the future*, SN/SP/1531: <http://hcl1.hclibrary.parliament.uk/notes/sps/snsp-01531.pdf>

¹⁴ Housing Green Paper, *Quality and Choice: A decent home for all*, paragraph 1.4: <http://www.housing.odpm.gov.uk/information/consult/homes/green/>

¹⁵ For more information on stock transfers see Library standard note, *Large Scale Voluntary Housing Transfers*, SN/SP/1581: <http://hcl1.hclibrary.parliament.uk/notes/sps/snsp-01581.pdf>

addition to being able to borrow “prudentially” these landlords have a range of business freedoms which are not enjoyed by councils.

The Government published a *draft Local Government Bill* in June 2002¹⁶ which was subsequently scrutinised by the Transport, Local Government and the Regions Select Committee. The Chartered Institute of Housing’s (CIH) Memorandum on the draft Bill, which was submitted as evidence to the Committee, listed these RSL “business freedoms” as:

1. The ability to borrow “prudentially”;
2. The ability to borrow outside public sector controls;
3. The ability to borrow directly against the value of (and rental income stream from) the stock;
4. The ability to use their revenue stream more flexibly, notably to allow them to borrow against future rents to enable them to finance investment now;
5. Freedom from the liability of past debts;
6. Command of all the revenues relating to the stock (rents, Housing Benefit payments, etc) with no dependence on government revenue subsidy (except indirectly through Housing Benefit);
7. Project-specific grants for new house building (i.e. Social Housing Grant);
8. Much greater control of their own assets—in particular, the ability to replace stock which is in demand and which is sold to sitting tenants;
9. RSLs previously had more freedom to set rents and therefore to determine their future revenue streams but this difference has largely been nullified by the Government’s rent restructuring policy. However, they have greater freedom at the margin than local authorities.¹⁷

The failure of the Birmingham City Council stock transfer earlier this year¹⁸ (which would have been the largest stock transfer in England to date) led commentators to question whether sufficient investment to achieve the Decent Homes Standard would be forthcoming for those authorities who experience a negative transfer ballot, or for whom the stock transfer option is not financially viable.

According to a survey of local authorities conducted by Choice for Housing¹⁹ in 2001, 56% of councils had reached a decision on the future of their stock and, of those that had chosen a single option, 51% intended to keep their stock compared with 34% that cited

¹⁶ Published on 12 June 2002: <http://www.local-regions.odpm.gov.uk/consult/bill/index.htm>

¹⁷ CIH memorandum submitted to the Transport, Local Government and the Regions Select Committee on the draft Bill (LGB03) – on the internet at: <http://www.publications.parliament.uk/pa/cm200102/cmselect/cmtlgr/981/981m04.htm>

¹⁸ The transfer proposal was rejected by 66.8% of the tenants who voted on a turnout of 65.5% in April 2002.

¹⁹ An advisory service for council housing departments.

transfer as their chosen route for bringing in investment.²⁰ A number of local authorities would prefer to retain ownership of their housing stock but, as yet, cannot fulfil the criteria for the establishment of an Arm's Length Management Organisation (ALMO). Authorities that want to go down this route are first required to set up arrangements to separate out their strategic and management roles. This normally involves the establishment of a company. Initially they were also required to achieve an "excellent" (three-star) rating from the Housing Inspectorate for those services delivered by the arm's length body (obtained no more than one year before the ALMO application). However, as part of the 2002 Comprehensive Spending Review John Prescott announced a reduction in the criteria for arm's length investment from three to two stars.²¹

As part of the Comprehensive Spending Review 2000 it was announced that £160 million would be made available for ALMOs in 2002/03 and £300 million in 2003/04. These additional revenue resources are being channelled through the Housing Revenue Account (HRA) subsidy mechanism and are to be used to finance additional borrowing for investment in the stock.

The 2001 Local Government White Paper, *Strong Local Leadership – Quality Public Services*, included proposals to allow ALMOs to retain part of their rental income to fund investment. This was welcomed by housing bodies:

The Chartered Institute of Housing has welcomed the government's decision to allow Arms Length Companies (ALCs) to retain part of their rental income to fund investment. The change gives ALCs more financial autonomy and moves them closer to the status of Housing Associations while remaining in Local Authority ownership.

The White Paper proposes that ALCs will be able to take advantage of a special arrangement within the prudential borrowing regime and use this freedom to finance loans to carry out their business plans to achieve the Decent Homes standard.

Under the arrangements, the current £5000 per house allocation will be replaced by permission to keep sufficient rental income (or subsidy) to finance borrowing to complete the business plans. For example if the ALC needs £20m it would keep £2m income per year to finance that investment. The extra subsidy will be financed from the general uplift due to take place in local authority rents as a result of restructuring.

CIH Director of Policy John Perry said: "This answers one of CIH's key demands that Arms Length Companies be given greater spending potential and also more autonomy. It makes the arm's length option much more viable and attractive - with the important proviso that councils still have to meet the Best Value tests.

²⁰ 'Death of council homes greatly exaggerated', *Inside Housing*, 20 April 2001

²¹ A two star rating from the Inspectorate indicates "good" performance.

CIH will now be looking to extra funding being made available for the arms length initiative in the Spending Review 2002."²²

Eight successful authorities were awarded funds under the first ALMO bidding round while 13 submitted bids for the second round. These 13 authorities were provisionally allocated £355 million for the modernisation of their housing stock in May 2002.²³ The 2002 Comprehensive Spending Review saw the announcement of further increases in the investment available for housing up to 2005/06 (an additional £1.1 billion) but a precise breakdown of how the additional resources will be allocated is not expected until January 2003.²⁴

The other main option for refurbishing council housing is the Private Finance Initiative (PFI). It involves authorities entering into long-term service contracts with private sector providers under the PFI. Provided an authority can demonstrate an appropriate transfer of risk to the private sector, the investment made is not subject to public expenditure controls. Eight housing pathfinder schemes (covering 12,000 homes) were selected in 1999 to pilot PFI in housing. They are still at "various stages in the procurement process" but it is expected that some of them will sign contracts towards the end of 2002.²⁵ A further ten projects in England have been selected for ODPM support in a second round of Housing Revenue Account PFI (2002/03). As part of the July 2000 Comprehensive Spending Review it was announced that £760 million would be committed to the PFI in housing between 2001/02 – 2003/04. The Government has set a target of refurbishing 90,000 council homes under the PFI every year for 10 years.²⁶

Despite what is seen as a "growing role" for the PFI and ALMOs some commentators feel it is unlikely that local authorities' investment needs will be met without stock transfers. For example, Marlene Bailey, lead officer in the Calderdale stock transfer team, reportedly said:

We've got £112m of repairs and improvements to bring our properties up standard. Our rents were kept within guideline levels, and we had to make cuts in this financial year – thus resulting in the situation where this level of investment is required.

Our tenants do not want just bricks and mortar, but job creation and regeneration. The only way to get investment in was to go down the stock transfer route. If the

²² Chartered Institute of Housing Press Release, 12 December 2001

²³ DTLR Press Release, 0226/2002, 29 May 2002

²⁴ For more information see Library standard note, *Housing after the Spending Review 2002*, SN/SP/1915: <http://hcl1.hclibrary.parliament.uk/notes/sps/snsp-01915.pdf>

²⁵ ODPM Press Release 111/2002, 4 November 2002

²⁶ For more information on Housing PFI see Library standard note, *Council Stock: options for the future*, SN/SP/1531: <http://hcl1.hclibrary.parliament.uk/notes/sps/snsp-01531.pdf>

council had been able to borrow similar levels of money there wouldn't have been a move down this road.²⁷

Local housing authorities that are keen to retain their stock have long argued for a “level playing field” with RSLs, in terms of borrowing powers and their ability to raise capital finance. Much has been made of the opportunities that the prudential borrowing regime might offer in this regard.

2. Will prudential borrowing mean increased investment in council housing?

The prudential regime for local authority borrowing will replace the system of credit approvals, whereby central Government stipulates the amount and type of capital investment that each authority may fund from borrowing. The Chartered Institute of Public Finance and Accounting's (CIPFA) evidence to the Transport, Local Government and the Regions Select Committee described the new prudential system as:

Essentially in the new system local authorities are going to be responsible for taking decisions on how much they can afford to borrow and, therefore, taking their own decisions with respect to their capital investment and their capital programmes.²⁸

A written answer of 21 March 2001 gave a brief description of what the new system would involve:

Ms Armstrong: Consultees have overwhelmingly endorsed our proposals to abolish the present system of local authority capital controls and replace it with the prudential system described in the Green Paper. Legislation will be introduced as soon as parliamentary time allows. The new system will rely heavily on professional regulation and my Department has agreed to provide financial support to the Chartered Institute of Public Finance and Accountancy who will draft the necessary professional Code. Work on that and on other detailed development of the system will be taken forward immediately.

Under the new system local authorities will be free to invest in their communities without having to get permission each time from central Government. The consultation confirmed our view that the proposed safeguards in the system will ensure that authorities do not run up unsustainable levels of debt, and that the increased flexibility will allow them to deliver better value for money, including through partnership working.²⁹

²⁷ “What’s on the menu for LA stock?” *Housing Today*, 26 October 2000

²⁸ HC 981-I 2001-02, paragraph 7:

<http://www.publications.parliament.uk/pa/cm200102/cmselect/cmtlgr/981/981.pdf>

²⁹ HC Deb 21 March 2001 cc249-51W

Chapter 1 of the Bill will abolish the current system of credit approvals and introduce the new prudential system. Prudential borrowing will apply across local authorities' services; it will not apply solely to housing capital finance. Detail on the Bill's provisions in relation to prudential borrowing is provided in the Library Research Paper entitled *The Local Government Bill*. Background on the new system is also contained in Annex B to the Green Paper, *Modernising Local Government Finance*, which is available on the internet at: www.local.detr.gov.uk/greenpap/annexb.htm.

This section of the paper specifically considers how this new regime might affect local authorities' ability to raise capital for housing investment.

The Report of the Transport, Local Government and the Regions Select Committee on the *draft Local Government Bill* observed that two conditions are necessary for the meaningful operation of a prudential regime, namely:

- (i) powers; and
- (ii) resources (particularly revenue funding).³⁰

The Chartered Institute of Housing (CIH) and the Local Government Association (LGA) have pointed out that, although the introduction of a prudential borrowing regime is welcome, it will not create the desired "level playing field" with RSLs and is likely to have much more direct application in non-housing local authority business activities such as municipal markets, the remaining municipal bus companies, leisure centres and other facilities with locally-decided incomes:

The Bill will allow the Government to deliver the first of the eight freedoms listed above,³¹ but none of the others. In relation to item two, borrowing will remain within the main measure of government borrowing (Public Sector Net Borrowing—the replacement for the PSBR) even though councils will have more freedom. The Treasury will make estimates of the level of borrowing, as it does now, and as it will for (say) the proposed "foundation" hospitals within the NHS. No doubt it will act if local government greatly exceeds its estimates of new borrowing.

The draft Bill specifically rules out items three and four. It says nothing on the remaining items.³²

The Chartered Institute of Public Finance and Accounting's (CIPFA) evidence to the Transport, Local Government and the Regions Select Committee advised that:

³⁰ *ibid*

³¹ See page 10 of this paper.

³² CIH memorandum submitted to the Transport, Local Government and the Regions Select Committee on the draft Bill (LGB03) – on the internet at: <http://www.publications.parliament.uk/pa/cm200102/cmselect/cmtlgr/981/981m04.htm>

A freedom under the Prudential Code to manage your own shop in terms of capital investment is not a freedom if you have not got the revenue support behind it.³³

The key factor for local authorities in determining whether the prudential regime will lead to increased housing investment is the revenue subsidy system:

Council housing brings in revenue – rents – in the same way as the few remaining municipal bus companies bring in fares, markets make charges to stallholders and leisure centres earn entrance fees. But, unlike these other trading operations, the income from council housing is effectively decided not by the amount the customer pays but by the subsidy level the government determines. Government decides – within narrow margins – what each council can “earn” from its housing. In doing so, it has already assumed a certain level of borrowing. The government's “guideline” rents will sustain this amount of borrowing, and subsidy is withdrawn if rents are excessive.

There is some room for manoeuvre, but not much – nowhere near enough, for example, to cover the extra £600m that Sheffield needs to borrow to improve its stock. So, without a significant change in the subsidy system, the new prudential borrowing regime offers little extra to council housing.³⁴

The conventional wisdom is that the new regime will not lead to more council housing investment unless accompanied by substantial increases in HRA subsidy. The Government’s response to the Transport, Local Government and the Regions Select Committee Report on the *draft Local Government Bill* makes it clear that it does not envisage providing additional support for authorities that take advantage of the prudential regime:

The White Paper makes clear that the Government will continue to support the major part of local authorities’ capital investment. The prudential regime will then enable authorities to borrow for *additional* capital projects, provided that they can afford to service the debts without extra Government support. This will, in particular, facilitate capital schemes capable of generating sufficient revenue savings to meet the associated debt charges. The essence of the prudential regime is self-sufficiency and independence for local government. It would be totally self-defeating and conflict with the thrust of the Committee’s report if the regime depended upon yet more support from central government.³⁵

³³ HC 981-I 2001-02, paragraph 7:

<http://www.publications.parliament.uk/pa/cm200102/cmselect/cmtlgr/981/981.pdf>

³⁴ “Low politics, high stakes,” *Public Finance*, July 2002

http://www.publicfinance.co.uk/pf_new/search_details.ihtml?news_id=13637

³⁵ Cm 5638, November 2002, paragraph (c):

<http://www.local-regions.odpm.gov.uk/legislation/localgov-bill/pdf/cm5638.pdf>

Consequently, the CIH argues that stock transfer will continue to prove an attractive option for councils seeking to increase investment in their housing stock:

WILL THE BILL ASSIST COUNCILS WISHING TO RETAIN THEIR HOUSING STOCK?

The answer to this is also "no" except in certain circumstances. Some councils may find that, at the margin, they can borrow more than previously because they have sufficient "spare capacity" in their HRAs to sustain more debt, although such capacity is likely to be "squeezed out" by the progressive effects of rent restructuring (which will increase, not relax, central government control of HRAs).³⁶

The potential impact on councils that have established, or intend to establish, an ALMO is viewed as more significant because if these bodies meet the ODPM's requirements they will be allowed to retain more of their rental income (see page 11) and will, therefore, be in a better position to pay for the additional borrowing required to meet the Decent Homes Standard.

3. *The Way Forward for Housing Capital Finance*

The ODPM published a consultation paper entitled *The Way Forward for Housing Capital Finance* in August 2002. The paper's introduction referred to the proposals contained in the 2001 Local Government White Paper, the draft *Local Government Bill* and the results of the 2002 Spending Review. The purpose of the consultation exercise was explained as follows:

This consultation is about how that regime should be changed to ensure that the available resources are used to the best possible effect. The results of this consultation will be fed into the review of all policies that contribute to delivering the 2010 decent homes target. Final decisions by Ministers will reflect both this consultation and the results of that review.³⁷

Housing bodies have taken the opportunity offered by this "blue skies" consultation paper to set out their aspirations for the longer-term future of housing capital finance. Some of the responses have focused on ways in which more local authorities might be able to take advantage of the prudential borrowing regime that the *Local Government Bill* will introduce. One of the "radical" options in the paper aimed at providing HRA capital investment is debt restructuring, to allow councils to fund specified levels of investment

³⁶ CIH memorandum submitted to the Transport, Local Government and the Regions Select Committee on the draft Bill (LGB03) – on the internet at:

<http://www.publications.parliament.uk/pa/cm200102/cmselect/cmtlgr/981/981m04.htm>

³⁷ ODPM, August 2002:

<http://www.housing.odpm.gov.uk/information/consult/capitalfinance/pdf/wayforward.pdf>

without any housing element subsidy³⁸ (or the requirement to surrender housing element surpluses). Under this option councils would:

- retain the benefits of future rent increases (assumed to be in line with rent restructuring);
- neither receive housing element subsidy nor pay over surpluses; and undergo a debt restructuring. This would adjust the authority's housing debt so that, after meeting running costs, its depreciation and its debt service charges, it had sufficient surplus revenue to allow it to support prudential borrowing at the level it could otherwise have expected to fund under the HIP regime. In other words, the surplus revenue allowed for in the debt restructuring would replace the current central government support for capital investment. The local authority stock condition element of HIP would be discontinued.³⁹

This option has the CIH's support:

Of the options canvassed in the paper for supporting new investment and dealing with past debt, the CIH strongly favours what the ODPM has called the 'quasi-RSL' package, where debt restructuring would be carried out in such a way as to create headroom in HRAs to allow for future investment, in a similar way to what happens at stock transfer. This would have the great advantage of ending the current, highly complicated subsidy system and create much greater certainty for LAs. It would allow them two more of the business freedoms available to RSLs – the ability to borrow against future rent increases, and potentially fuller control of their own revenue resources (e.g. if they put up rents by £1, like HAs they would gain £1 in income.)⁴⁰

The CIH response goes on to outline various considerations that would have to be taken into account if this option is pursued. Debt restructuring is also favoured by the LGA:

Debt restructuring will provide local authorities with greater management freedom and allow them to use their rent increases (if in line with rent restructuring) although again the higher level of risk could lead to increased cost of borrowing. However, the associated benefits and freedoms, and the relaxation of central government control, largely outweigh the increased risk and would place housing authorities closer to a level playing field with RSLs. The LGA does not agree that this option should be reserved only for high performing authorities.

³⁸ Housing Revenue Account subsidy is currently made up of two elements. The housing element is the notional expenditure on the housing stock (mainly management and maintenance) less the notional income from the stock (mainly rent). This amount can be positive or negative.

³⁹ ODPM, *The Way Forward for Housing Capital Finance*, August 2002, paragraph 32:
<http://www.housing.odpm.gov.uk/information/consult/capitalfinance/pdf/wayforward.pdf>

⁴⁰ CIH response to *The Way Forward for Housing Capital Finance*, October 2002:
<http://www.cih.org/cgi-bin/display.pl?db=policies&id=367>

Local authorities are skilled in managing risk. Consideration needs to be given to how this would be applied in authorities that carry out partial stock transfers.⁴¹

Ultimately the CIH and other housing bodies favour a move away from Public Sector Net Borrowing (the replacement for the Public Sector Borrowing Requirement) to the General Government Financial Deficit (GGFD)⁴² as the main measure of public borrowing, and the establishment of “local housing corporations,” i.e. local housing companies wholly owned by local authorities. In most European countries borrowing by such bodies does not count against the GGFD:

The current consultation paper opens the opportunity to consider whether something like the ‘local housing corporation’ model might now be an appropriate long-term goal. The paper suggests that a performance test might be needed for councils which wanted the business freedoms it proposes, and that this test might be accession to ‘ALMO’ status (that is, having successfully set up and had accredited an arms length management organisation).⁴³

The CIH views ALMOs as a potential “stepping stone” to the development of local housing corporations or “local authority owned RSLs”:

The argument for developing the ALMO model in this way is here only presented in outline as a longer-term possibility. However, it is already clear that some of those involved in developing ALMOs are aware of their limitations, and want to look for ways in which they could improve the housing stock to higher than the decent homes standard, could remodel the stock, and could engage in the wider regeneration of their areas. We urge the ODPM, having opened a ‘blue skies’ discussion, to consider whether developments of this kind might have clear advantages as a further stage in the development of local authority housing once the initial restructuring which the consultation paper proposes, has taken place.⁴⁴

Consultation on *The Way Forward for Housing Capital Finance* closed on 18 October 2002.

⁴¹ The LGA’s response to *The Way Forward for Housing Capital Finance*, October 2002: http://www.lga.gov.uk/Documents/Briefing/Our_Work/social%20affairs/WayForwardOct02.pdf

⁴² i.e. the measure commonly used in Europe

⁴³ CIH response to *The Way Forward for Housing Capital Finance*, October 2002: <http://www.cih.org/cgi-bin/display.pl?db=policies&id=367>

⁴⁴ *ibid*

III Capital receipts

A. Background

Detailed background on the treatment of capital receipts under the current capital finance regime can be found in Library Research Paper 97/74, *The Local Government Finance (Supplementary Credit Approvals) Bill*.⁴⁵

Since 1 April 1990, under section 59 of the *Local Government and Housing Act 1989*, councils have been required to “set-aside” a percentage of the proceeds from the disposal of HRA assets (e.g. 75% of the income from “right to buy” sales and 50% from the sale of most other assets) to offset debt. Authorities with no long-term debt have not been affected by the set-aside rules; they have been allowed to spend their receipts as they wish.

The process of setting aside housing capital receipts acts as a redistributive mechanism to share out a proportion of the capital spending power that comes from the disposal of HRA assets between local authorities. The Government justifies the redistribution of capital receipts in the consultation paper, *The Way Forward for Housing Capital Finance*:

Most HRA assets have been funded in large part by central government subsidies and it is therefore reasonable that a substantial proportion of the proceeds of disposals should be recouped by central government and used to fund spending where the need is greatest.⁴⁶

The Way Forward for Housing Capital Finance also illustrates the size of the contribution that capital receipts make to housing capital investment:

In 2001-2 the provision for HIP [*Housing Investment Programme*]⁴⁷ was £770m and that for the ADP [*Approved Development Programme*]⁴⁸ was £810m, making a total of £1,580m. The proceeds of housing capital receipts set-aside were £1,248m (of which £976m came from Right to Buy receipts and £272m from transfer receipts). This means, in effect that the Exchequer added £332m (i.e. £1,580m less £1,248m) to the proceeds of set-aside.⁴⁹

On 14 November 2002 the ODPM announced proposals to allow local authorities to spend 100% of the capital receipts raised from the disposal of certain HRA assets. The additional finance will have to be spent on the provision of affordable housing or

⁴⁵ <http://hcl1.hclibrary.parliament.uk/rp97/rp97-074.pdf>

⁴⁶ ODPM, August 2002, paragraph 10:

<http://www.housing.odpm.gov.uk/information/consult/capitalfinance/pdf/wayforward.pdf>

⁴⁷ The capital programme for local authorities.

⁴⁸ The capital programme for RSLs.

⁴⁹ ODPM, August 2002, paragraph 21:

<http://www.housing.odpm.gov.uk/information/consult/capitalfinance/pdf/wayforward.pdf>

“replacement modern equivalent assets.”⁵⁰ The change, when introduced, will apply to the disposal of vacant HRA land, or surplus or inefficient HRA properties. Right to buy sales, receipts from voluntary transfers, large and small scale, will be excluded. It is thought that that these proposals could release up to £70 million each year for the provision of affordable housing.⁵¹

B. The Bill

Clauses 9 to 11 of the Bill contain measures relating to capital receipts. Capital receipts are defined in clause 9 broadly as now, i.e. as the proceeds of property sales. The existing definition will be amended slightly by clause 9 to provide that these sums will be treated as received when they become *payable* to the authority, rather than, as now, when they are *actually paid*. The Explanatory Notes to the Bill advise that, “this change is simply part of the general approach of bringing definitions in line with accounting practice and will have no practical implications.”⁵²

The Bill will remove the present rules requiring a proportion of housing receipts to be set aside for debt redemption. The Government outlined its reasons for amending the rules in the White Paper, *Strong Local Leadership – Quality Public Services*:

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

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

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

⁵⁰ ODPM press notice 121/2002, 14 November 2002

⁵¹ *ibid*

⁵² Bill 9-EN paragraph 24:

<http://www.publications.parliament.uk/pa/cm200203/cmbills/009/en/03009x--.htm>

- for authorities without HRA debt, a specified proportion of the HRA receipts will have to be paid into the pool.⁵³

Clause 11 of the Bill will give the Secretary of State power to make arrangements by regulation for the “pooling” of housing capital receipts across councils. There was concern that the White Paper had specifically referred to the pooling of housing receipts while the draft Bill referred to any capital receipt. The Government subsequently confirmed that the final version of the Bill would refer to only housing capital receipts; clause 11(3) of the Bill provides for this. The pooling mechanism, when established, will not apply retrospectively.⁵⁴

The treatment of amounts already set-aside under the current system will be specified in regulations made under clause 21. The Explanatory Notes to the Bill advise that the repeal of the set-aside rules will not, in itself, create access to any additional resources for authorities. Debt-free authorities with unused spending capacity of this kind will still be permitted to spend those sums when the new system is introduced.⁵⁵

Clause 10 of the Bill will apply the pooling mechanism to sales proceeds obtained both in cash and in non-monetary form, eg nomination rights.⁵⁶

C. Responses

1. The pooling mechanism

The Report of the Transport, Local Government and the Regions Select Committee on the *draft Local Government Bill* concluded that it contained insufficient information about the operation of any pooling system and redistributive mechanism that could be used, “meaning that it is not possible to comment on its fairness.”⁵⁷ The consultation paper, *The Way Forward for Housing Capital Finance*, was published after the Select Committee’s Report; chapter 2 of this paper asked for views on the operation of the proposed Housing Capital Receipts Pooling Regime.⁵⁸ This paper has provided more of an indication of how the Government intends capital receipts to be dealt with in future:

⁵³ DTLR, 11 December 2001, paragraphs 5.26-5.27:

<http://www.local-regions.odpm.gov.uk/sll/part1/index.htm>

⁵⁴ HC 981-I 2001-02, paragraph 16

<http://www.publications.parliament.uk/pa/cm200102/cmselect/cmtlgr/981/981.pdf>

⁵⁵ Bill 9-EN, paragraph 27:

<http://www.pulications.parliament.uk/pa/cm200203/cmbills/009/en/03009x--.htm>

⁵⁶ For example, if a local authority donates land to an RSL for housing development in return for nomination rights, it will be able to nominate households from its housing register when the development is finished.

⁵⁷ HC 981-I 2001-02, paragraph 18

<http://www.publications.parliament.uk/pa/cm200102/cmselect/cmtlgr/981/981.pdf>

⁵⁸ ODPM, August 2002:

<http://www.housing.odpm.gov.uk/information/consult/capitalfinance/pdf/wayforward.pdf>

- Right to buy receipts will be pooled to a similar extent (75%) as they are now;
- Pending the ODPM's review of policies contributing to the achievement of the Decent Homes Standard stock transfer receipts will be unaffected by pooling but will still be subject to the large scale voluntary transfer (LSVT) 'levy' – it is likely that this levy will be paid into the capital receipts pool;
- Other housing receipts from voluntary sales of HRA houses and land will not be pooled where they are to be recycled for housing purposes.

The Select Committee recommended that the approach to pooling housing receipts should differentiate between right to buy (RTB) and stock transfer receipts;⁵⁹ it appears that this has been taken on board. The CIH also supports this approach:

CIH endorses the proposal to maintain existing arrangements for stock transfer receipts, with the 'levy' being paid into the capital receipts 'pool'.⁶⁰

Other CIH comments on the pooling mechanism include:

- CIH accepts in principle that pooling is necessary for the time being, on the basis that 'transparency' is maintained in future years through the Spending Review and ODPM annual reports (i.e. regular publication of the figures disclosed in the current consultation paper);⁶¹
- CIH considers that the element of 'new money' should progressively increase, to counteract probable long-term decline in RTB and other receipts;
- CIH endorses the proposal that 'discretionary' receipts be retained locally and not pooled, where used for housing investment (which should be widely defined, and include housing-based regeneration);
- CIH considers that authorities should be able to retain an increasing proportion of RTB receipts, ie, that each year the proportion available locally should increase in tranches of (say) 5%;
- CIH considers that RTB receipts following transfer that are subject to sharing agreements should be excluded from pooling.⁶²

⁵⁹ HC 981-I 2001-02, paragraph 17

<http://www.publications.parliament.uk/pa/cm200102/cmselect/cmtlgr/981/981.pdf>

⁶⁰ CIH response to *The Way Forward for Housing Capital Finance*, October 2002:

<http://www.cih.org/cgi-bin/display.pl?db=policies&id=367>

⁶¹ See page 19 of this paper.

⁶² CIH's response to *The Way Forward for Housing Capital Finance*, October 2002: <http://www.cih.org/cgi-bin/display.pl?db=policies&id=367>

The Local Government Association (LGA) has raised the question of the revenue consequences of the pooling mechanism:

No mention is made in the consultation paper of the revenue consequences due to the loss of interest on payments made to the national pool. Subsidy will have to be increased to offset the loss if it is not to result in reduced services or a drain on the council tax.

The critical issue is that, if receipts are to be pooled for housing purposes, then any mechanism should be completely transparent to ensure that all the receipts are used for these purposes and not siphoned off in any way. Since with debt authorities will have their subsidy for capital charges reduced by their level of receipts anyway they may not necessarily need to pay the receipt direct into the pool. However, any subsidy adjustment should be on the basis of actual, not notional receipts, or authorities are placed at risk since RTB receipts are subject to fluctuation.⁶³

The Select Committee received evidence that the pooling mechanism could undermine the prudential regime as the knowledge or possibility that capital receipts would be pooled “could change the sale and investment decisions made by local authorities and would reduce the prudential limit for each authority.” The Committee recommended that the regulation making power to create a pooling mechanism (i.e. clause 10 in the draft Bill and clause 11 in the current Bill) should be removed.⁶⁴

The ODPM’s analysis of responses to the *draft Local Government Bill* reports that 134 respondents expressed concerns about capital receipts pooling. These concerns ranged from calls for more information to strong opposition. The analysis noted that there was some indication that more authorities might be supportive, or at least not directly opposed, once they felt clearer about how the system would operate.⁶⁵

Some of these issues are addressed in *The Way Forward for Housing Capital Finance*. It is the Department’s intention, after considering responses to that paper, to draft the regulations on the pooling mechanism and publish these with fuller details on the operation of the system.⁶⁶ The Government’s response to the Report of the Transport, Local Government and the Regions Select Committee on the draft Bill states that draft

⁶³ The LGA’s response to *The Way Forward for Housing Capital Finance*, October 2002: http://www.lga.gov.uk/Documents/Briefing/Our_Work/social%20affairs/WayForwardOct02.pdf

⁶⁴ HC 981-I 2001-02, paragraph 15
<http://pubs1.tso.parliament.uk/pa/cm200102/cmselect/cmtlgr/981/981.pdf>

⁶⁵ ODPM, *Draft Local Government Bill – Analysis of Consultation Responses*, November 2002: <http://www.local-regions.odpm.gov.uk/consult/bill/responses/>

⁶⁶ *ibid*

regulations on the pooling mechanism will be made available at the Committee Stage of the current Bill.⁶⁷

The Way Forward for Housing Capital Finance states that the new pooling mechanism will not be introduced before April 2004.⁶⁸

2. Pooling and debt-free authorities

The inclusion of debt-free authorities in the pooling process has caused consternation amongst those affected. South Cambridgeshire Council claimed that it could lose up to £9 million as a result of the provisions in the draft Bill and that a ten-year repairs project would be “severely curtailed.”⁶⁹ It was predicted that around 90 authorities in total could be adversely affected.⁷⁰

The LGA’s response to the draft Bill stated that “this is a highly controversial issue among local authorities.”⁷¹ In its response to *The Way Forward for Housing Capital Finance* the association has come out against the inclusion of debt-free authorities in the pooling process:

The LGA is opposed in principle to the pooling of housing capital receipts from debt-free authorities. In particular, authorities need more concrete information about the proposals in order that those that might be adversely affected are able to clarify their real loss when taking any gains from the abolition of the RTIA [receipts taken into account] mechanism into account. We would request the government to urgently provide exemplifications in order to aid authorities’ budget planning processes.⁷²

The CIH’s response to *The Way Forward for Housing Capital Finance* acknowledges the difficulty of excluding debt-free authorities from pooling but goes on to argue that their need for resources must be recognised in allocating from the resources “pool.”⁷³ When responding to the draft Bill the CIH said:

In relation to receipts in debt-free authorities, it is crucial that those in high demand areas which have worked towards being debt-free in order to have full

⁶⁷ Cm 5638, November 2002, paragraph (k): <http://www.local-regions.odpm.gov.uk/legislation/localgov-bill/pdf/cm5638.pdf>

⁶⁸ ODPM, August 2002, paragraph 22:
<http://www.housing.odpm.gov.uk/information/consult/capitalfinance/pdf/wayforward.pdf>

⁶⁹ “Cash redistribution plan sparks protest”, *Inside Housing*, 29 August 2002

⁷⁰ *ibid*

⁷¹ LGA’s response to the draft Bill, August 2002:
http://www.lga.gov.uk/Documents/Briefing/Our_Work/Westminster/LGWPSubmission4.pdf

⁷² The LGA’s response to *The Way Forward for Housing Capital Finance*, October 2002:
http://www.lga.gov.uk/Documents/Briefing/Our_Work/social%20affairs/WayForwardOct02.pdf

⁷³ CIH response to *The Way Forward for Housing Capital Finance*, October 2002:
<http://www.cih.org/cgi-bin/display.pl?db=policies&id=367>

access to their receipts are not heavily penalised by the redistribution mechanism.⁷⁴

The ODPM's analysis of responses to the draft Bill also found "strong 'in principle' opposition to clause 10" (now clause 11):

Many debt-free authorities saw clause 10 as contrary to the spirit of greater freedoms outlined elsewhere in the Bill, as they would no longer have full discretion to use local receipts to meet local needs. Authorities outlined how this would impact their ability to provide affordable housing meet to the decent homes target, and, in the case of Barking & Dagenham, to tackle deprivation issues. Respondents argued that achieving debt-free status had been encouraged by previous Government policies, and that they had worked hard by prudent management to achieve this. Others saw this as 'double taxation' on tenants as their rents had paid off debt, but now had to contribute to the national pool.⁷⁵

Authorities have welcomed a concession in the Bill that will allow them to spend receipts raised before the *Local Government Bill* comes into force.⁷⁶ Concern remains over the affect of pooling on future receipts raised.

3. Preserved right to buy receipts

The LGA has argued for the exclusion of "preserved" RTB receipts from any pooling arrangements:

Preserved Right-to-Buy (RTB) receipts should also be excluded - these are the receipts that arise in properties that have been transferred to a housing association or other similar body and where the tenant continues to have the same statutory RTB entitlement as when the council was a landlord. In most large scale voluntary transfers the use of those capital receipts, for improvements or provision of new housing, frequently make up part of the transfer agreement on which tenants voted. Future programmes may be dependent on these receipts and, if they are pooled, authorities could find themselves unable to meet the commitments that, at the time of transfer, they had made in good faith.⁷⁷

4. Non-monetary capital receipts

Both the CIH and LGA questioned the purpose of clause 9 of the draft Bill (clause 10 of the current Bill):

⁷⁴ CIH's response to the draft Bill, August 2002:

<http://www.cih.org/cgi-bin/display.pl?db=policies&id=349>

⁷⁵ ODPM, *Draft Local Government Bill – Analysis of Consultation Responses*, November 2002:

<http://www.local-regions.odpm.gov.uk/consult/bill/responses/>

⁷⁶ "Surprise right to buy concession in Local Government Bill," *Housing Today*, 28 November 2002

⁷⁷ LGA's response to the draft Bill, August 2002:

http://www.lga.gov.uk/Documents/Briefing/Our_Work/Westminster/LGWPSubmission4.pdf

Clause 9 refers to pooling the non-monetary benefits gained from housing sales e.g. nomination rights in large scale stock transfers. It is unclear what a compulsory pooling of nomination rights would achieve. The National Mobility Scheme already exists to enable authorities to do just that, voluntarily. The consequences of compulsory pooling of nomination rights will reduce the incentive for local councils to undertake large scale stock transfers and undermine authorities' ability to comply with their statutory duties towards the homeless and other people in housing need. The LGA questions the need, relevance or workability of such proposals.⁷⁸

Clause 9 of the Bill would allow the pooling of receipts to include those of a non-monetary value, such as nomination rights. This could theoretically result in an authority with low cash receipts but substantial nomination arrangements having to pay significant sums for them, which would be unfair. We see no purpose in pooling non-monetary receipts and call for this element of the Bill to be dropped.⁷⁹

IV Overhanging debt

The stated aim of clauses 40 and 41 of the Bill is to facilitate the transfer of council housing to registered social landlords (RSLs).

The explanatory notes to draft Bill explain the current approach to dealing with “overhanging debt” following a large scale transfer of local authority stock:

Where a local authority transfers the ownership of its social housing to a registered social landlord, it receives a capital receipt. At present, a part of such a receipt, specified by the Department, must be reserved, or set-aside, as provision for credit liabilities (effectively, to be used for repaying debts) under section 59 of the Local Government and Housing Act 1989 (‘the LGHA 1989’).

As a condition of consenting to the transfer, the Department requires authorities to use an amount of provision for credit liabilities equivalent to the reserved part of the housing transfer receipt to repay that part of its debt that is notionally attributable to the housing transferred.

It is usual for authorities’ debts to be with the Public Works Loan Board, although authorities may have other debts, e.g. with private banks.

Normally, the reserved part of the receipt from the disposal of the housing is greater than (and therefore notionally sufficient to repay) the attributable housing debt. In areas of poor housing conditions and low rent the obligation to improve

⁷⁸ LGA’s response to the draft Bill, August 2002, available online at: http://www.lga.gov.uk/Documents/Briefing/Our_Work/Westminster/LGWPSubmission4.pdf

⁷⁹ CIH’s response to the draft Bill, August 2002: <http://www.cih.org/cgi-bin/display.pl?db=policies&id=349>

the stock to a decent standard can depress the value of the housing stock and the capital receipt the local authority will receive.

Where the net capital receipt is less than the local authority's housing attributable debt, the Department will agree with the local authority that on the condition that the authority extinguishes debt with the Public Works Loan Commissioners ('PWLC') to the level of its net reserved capital receipt, the Department will make a payment to extinguish the remaining housing attributable debt. The Department's payment is dependent on the local authority's payment having been made. The Department's payment is known as an 'overhanging debt payment'.

The payments to the PWLC are currently made in reliance on the Appropriation Acts. So far there have been seven payments made in respect of housing transfers in Burnley, Coventry, Calderdale and Blackburn with Darwen, Redcar and Cleveland, St Helens and Knowsley.

The Appropriation Acts do not, however, provide an appropriate mechanism for continuing payments. No mechanism has been put in place or payments made in Wales to date.⁸⁰

Clause 40 will enable the Secretary of State or the National Assembly for Wales to repay (in whole or in part) PWLC debts of certain local authorities in England and Wales who have housing functions. The debts to be repaid could include the amount of "overhanging debt" by which the notional housing debt with the PWLC exceeds the reserved receipt from the housing transfer. The Explanatory Notes to the Bill state that clause 40 will have no added public expenditure or manpower implications in England as a more general power has hitherto been used to make these payments.⁸¹

Clause 41 will enable the Secretary of State and the National Assembly for Wales to make payments to local authorities who have transferred their stock to enable them to repay any non-PWLC overhanging debt.

A number of witnesses to the Transport, Local Government and the Regions Committee's scrutiny of the *draft Local Government Bill* expressed concerns about clauses 48 and 49 (clauses 40 and 41 of the current Bill), eg CIPFA said:

Points about transparency, equity and fairness can be made concerning the draft Bill's proposals for the Government to pay off "overhanging debt...From the perspective of the tenant who remains with the local authority, part of their rental payment services the historic housing debt rather than being applied to repairs, maintenance and improvements. The "playing field" is not level and taxpayers' money is being used in a discriminatory fashion. There is also a measure of

⁸⁰ Bill 9-EN, paragraphs 62-68:

<http://www.publications.parliament.uk/pa/cm200203/cmbills/009/en/03009x--.htm>

⁸¹ *ibid*, paragraph 69

“perverse incentive” in the proposal as it benefits authorities that have not maintained their housing stock in the past to a standard where the market value exceeds the historic debt.⁸²

The Select Committee concluded that clauses 48 and 49 (now clauses 40 and 41) would result in an uneven choice for tenants between remaining with the local authority and choosing the stock transfer route.⁸³ The Government’s response to the Committee rejects this proposition:

The Government does not accept that the effect of clauses 48 and 49 creates an uneven choice for tenants when it comes to deciding between remaining with the local authority or choosing the stock transfer route. Rather, it will ensure that tenants of all local authorities have the option of securing improved housing through large scale voluntary transfer if that is their choice.

Where a local authority owns housing stock the Government pays Housing Revenue Account subsidy in respect of the authority’s costs of servicing debt attributable to that housing stock. This enables local authorities to improve their housing assets with the expectation of receiving Government support towards any resulting attributable debt. When a local authority transfers its housing stock to a registered social landlord, normally the capital receipt from the transfer will be sufficient to repay the authority’s housing attributable debt, and no further Housing Revenue Account subsidy would be paid in respect of the debt. Where the receipt is insufficient to meet the debt in full, the local authority is left with a debt for assets it no longer owns. This is known as overhanging debt.

The purpose of clauses 48 and 49 is to provide a permanent legislative basis to enable the Government to pay off this overhanging debt, either in one simple payment direct to the Public Works Loans Commissioners (PWLC) – or to the local authority on condition that it is used to repay non-PWLC debt. Until now, payments to the PWLC by the Government have been made in reliance on the annual Appropriation Acts: it is not appropriate to rely on the Appropriation Act for continuing payments. (No payments have been made in respect of non-PWLC debt). Clauses 48 and 49 regularises the current practice for PWLC debts, and allow an extension to cover other debts.

The Government does not believe this distorts the decision making process in favour of large scale voluntary transfer (LSVT) because where the authority or its tenants do not choose to pursue an LSVT, the Government, through the Housing Revenue Account subsidy, will continue to ensure a local authority can meet the cost of servicing its housing attributable debt.⁸⁴

⁸² HC 981-I 2001-02, paragraph 31:

<http://www.publications.parliament.uk/pa/cm200102/cmselect/cmtlgr/981/981.pdf>

⁸³ HC 981-I 2001-02, paragraph 32:

<http://www.publications.parliament.uk/pa/cm200102/cmselect/cmtlgr/981/981.pdf>

⁸⁴ Cm 5638, November 2002, paragraph (r): <http://www.local-regions.odpm.gov.uk/legislation/localgov-bill/pdf/cm5638.pdf>

The ODPM's analysis of responses to the draft Bill notes that 13 respondents commented on these clauses and that they were "generally welcomed." Not all were in agreement however:

Nine of the respondents made particular comments. Plymouth City Council would like to see these provisions extended to meet overhanging debt payments on partial transfers. SIGOMA also wished to see them extended to partial transfers and to meeting the payment of early debt redemption penalties. Rotherham Metropolitan Borough Council and Manchester City Council both argued that these provisions would increase flexibility and would be necessary to enable those local authorities who would otherwise be left with residual housing debt, to pursue stock transfer, if it was their preferred investment option.

However, UNISON is not keen that there may be provision for meeting the payment of early debt redemption premia of PWLC or non-PWLC debt. It believes that if resources are available they should be used to increase the level of basic credit approvals or with the arrival of the prudential framework to finance the revenue stream needed to support additional investment. There was also concern from four respondents, the TUC, the Royal Borough of Kensington & Chelsea, Derby City Council and the GMB that these provisions might create an uneven playing field. The TUC were concerned that those authorities not transferring their housing stock would be penalised by having to continue servicing their housing debt. The Royal Borough of Kensington & Chelsea argued that it was unfair on those local authorities who are able to redeem their housing debt from the capital receipt received and who would then have to share the benefit beyond their boundaries through pooling.⁸⁵

V Housing strategies and revenue finance

A. Housing strategies, statements and HRA business plans

Clause 87 of the Bill was not included in the *draft Local Government Bill*.

At present there is no statutory duty on authorities to prepare a "local housing strategy." The Explanatory Notes to the Bill describe a local housing strategy as:

...the local housing authority's vision for housing in its area, its objectives and targets and policies on how it intends to manage and deliver its strategic housing role. It forms the overarching framework against which the authority considers and formulates other policies on more specific housing issues.⁸⁶

⁸⁵ ODPM, *Draft Local Government Bill – Analysis of Consultation Responses*, November 2002: <http://www.local-regions.odpm.gov.uk/consult/bill/responses/>

⁸⁶ Bill 9-EN, paragraph 206, <http://www.publications.parliament.uk/pa/cm200203/cmbills/009/en/03009x--.htm>

In England, local authorities prepare housing strategies in order to disseminate information to key service users, stakeholders and the Government Offices for the Regions. The Government Offices for the Regions use the information in the strategy documents when allocating basic credit approvals and other housing capital resources. In Wales, the Welsh Assembly has asked housing authorities to have local housing strategies in place by April 2004.

Clause 87 of the Bill will put the requirement to prepare local housing strategies on a statutory footing “to reflect the Government’s belief that an adequate strategy is essential to the delivery of local authorities’ housing functions.”⁸⁷ The Secretary of State in England and the National Assembly for Wales will have the power to require local housing authorities to have a strategy on certain specified matters relating to housing and will be able to impose requirements as to the ends that the strategy must achieve, the formulation of policy for the purposes of the strategy and the review of the strategy (clause 87(1)(b)). In practice it is expected that the requirements imposed will not differ from what authorities are currently asked to do on a non-statutory basis.⁸⁸

Local authorities are currently required to produce a number of plans, policies and strategies, for example, a Housing Revenue Account Business Plan relating to the management of their stock (for those authorities that still maintain a Housing Revenue Account, HRA), a Homelessness Strategy⁸⁹ and reports on home energy conservation measures.⁹⁰ It is accepted that there may be some overlap between these various documents and that appropriate linkages are not always made. Clause 87 will give an authority freedom to produce a single document to cover the various requirements, or to produce a number of documents “as best suits its local circumstances.”⁹¹

Clause 87 is supported by housing bodies:

CIH has warmly welcomed the legal requirement for councils in England and Wales to produce a local housing strategy included in the Local Government Bill published this week. CIH has been calling for a clear statutory basis for comprehensive local housing strategies to underpin councils' increasingly important strategic housing role.⁹²

The purpose of clause 88 is to make it clear that the Secretary of State or the National Assembly for Wales can, when imposing requirements as to the content of any document

⁸⁷ *ibid*, paragraph 208

⁸⁸ Bill 9-EN, paragraph 216:

<http://www.publications.parliament.uk/pa/cm200203/cmbills/009/en/03009x--.htm>

⁸⁹ Under the *Homelessness Act 2002*.

⁹⁰ Under the *Home Energy Conservation Act 1995*.

⁹¹ Bill 9-EN, paragraph 212:

<http://www.publications.parliament.uk/pa/cm200203/cmbills/009/en/03009x--.htm>

⁹² (204723) CIH Member Bulletin 27 November 2002

prepared for the purposes of clause 87, require the inclusion of material relating to property in the authority's Housing Revenue Account (HRA). This will be designated as the authority's Housing Revenue Account business plan. Local authority Housing Revenue Accounts are often referred to as "landlord" accounts. They are a record of the revenue expenditure and income relating to local housing authorities' own stock. The plan will set out how the authority manages its stock and performs its landlord role. The HRA business plan may be taken into account in the calculation of an authority's HRA subsidy entitlement (in accordance with clause 89).⁹³ Authorities that do not maintain an HRA (because they have disposed of their stock) will not be required to prepare an HRA business plan.

The LGA questioned the need for this clause in its response to the *draft Local Government Bill*:

This function is already being undertaken as part of resource accounting. A new statutory requirement is therefore both unnecessary and completely at odds with the White Paper commitment to reduce the number of plans local authorities are required to produce.⁹⁴

The provisions in clause 87 to allow authorities to produce a single document may have addressed the LGA's concerns.

Guidance will be issued to authorities on the requirements of clauses 87 and 88.⁹⁵

B. Housing Revenue Account subsidy

It has long been a source of dissatisfaction amongst local authorities and their tenants that the current HRA subsidy system (established in 1990) results in authorities, whose assumed income⁹⁶ exceeds their assumed expenditure⁹⁷ on the Housing Element of their HRAs, receiving reduced subsidy on the Rent Rebates (Housing Benefit) paid to their tenants. This system has been criticised because it results in the rent payments of "better off" tenants not in receipt of Rent Rebates helping to meet the cost of giving financial help to poorer tenants via Housing Benefit: this process has been labelled the "tenants' tax".⁹⁸

⁹³ In theory, Housing Revenue Account subsidy bridges any gap between the income and expenditure items on the HRA.

⁹⁴ LGA's response to the draft Bill, August 2002:

http://www.lga.gov.uk/Documents/Briefing/Our_Work/Westminster/LGWPSubmission4.pdf

⁹⁵ Bill 9-EN, paragraph 222:

<http://www.publications.parliament.uk/pa/cm200203/cmbills/009/en/03009x--.htm>

⁹⁶ From rents (net of rebates)

⁹⁷ On management and maintenance and loan charges

⁹⁸ Background information can be found in Library Research Paper 00/87, *Rent Rebates and Local Authority Housing Revenue Accounts*:

<http://www.parliament.uk/commons/lib/research/rp2000/rp00-087.pdf>

The Annual Report of the DETR in 2000 noted that the estimated gross cost of Rent Rebates in 2000/01 would be £4.2 billion. After taking into account Housing Element surpluses, the subsidy paid by the Government towards the cost of rent rebates amounted to £2.7 billion.⁹⁹ In other words, around £1.5 billion of Housing Element surpluses in the HRA was used to offset the cost of Rent Rebates.¹⁰⁰ The introduction of the Major Repairs Allowance to supplement other allowances for management and maintenance expenditure from April 2001 has reduced the level of rent surpluses from council rents used to offset the cost of Housing Benefit by around £1 billion.¹⁰¹ A minority of councils currently continue to contribute rental income towards the costs of Housing Benefit.

In 1999 the Government announced that it intended to introduce resource accounting into the HRA and that, as part of this process, Rent Rebates would be removed from the HRA. The Bill will achieve this. It will remove Rent Rebates from the HRA, and provide for them to be met by Rent Rebate subsidy payable under the *Social Security Administration Act 1992*.

Clause 89 will amend section 80 of the 1989 Act so that HRA subsidy may be calculated in such a manner as the Secretary of State or National Assembly for Wales may determine. Such a determination may provide for all or part of the amount to be calculated in accordance with formulae, or with reference to other factors, such as the authority's HRA business plan or the discharge of its housing functions. The Explanatory Notes to the Bill advise that this will provide "greater flexibility in calculating the amount of HRA subsidy payable to authorities":

It will, for example, allow the Secretary of State and the Assembly to target additional subsidy to authorities which provide better services to their tenants, perhaps by establishing arm's length housing management organisations.¹⁰²

Local authorities and their representative bodies have welcomed the removal of Rent Rebates from the HRA:

The LGA welcome the fact that legislation is finally being introduced to permit the removal of rent rebates from the HRA. It will also simplify the procedure for paying housing benefit subsidy to local authorities in England, since the responsibility is currently shared between ODPM and DWP and it will enable the National Assembly for Wales to exercise the powers in relation to Wales.¹⁰³

⁹⁹ Cm 4604, table 4g

¹⁰⁰ *ibid*

¹⁰¹ *Housing Finance Review*, Joseph Rowntree Foundation, 2001/2002

¹⁰² Bill 9-EN, paragraph 226:

<http://www.publications.parliament.uk/pa/cm200203/cmbills/009/en/03009x--.htm>

¹⁰³ LGA's response to the draft Bill, August 2002:

http://www.lga.gov.uk/Documents/Briefing/Our_Work/Westminster/LGWPSubmission4.pdf

The ODPM's analysis of consultation responses to the *draft Local Government Bill* found that "an overwhelming majority of the 102 respondents on Part 7 of the Bill supported the removal of rent rebates from the Housing Revenue Account and the creation of the new HRA housing benefit subsidy."¹⁰⁴ However, housing bodies are critical of the proposal to calculate subsidy on the basis of local authority performance:

The draft Bill proposes that the assessment of HRA subsidy be based in future not solely on national formulae but also on the Secretary of State's assessments of individual authorities' performance. We do not consider that this is justified. There is already an element of discretion within the capital regime, quite apart from the assessments that are made if a LA applies for additional subsidy (eg. for an ALMO). It should not be necessary to increase even further the degree of central control of HRAs, and the proposal runs counter to the spirit of the changes discussed in the paper *The Way Forward for Housing Capital Finance*. It will increase the uncertainty about their resources which LAs face, and comes on top of the centralisation inherent in the new rent regime. We call on the Government to drop sub clause 96 (2) (1A) (b) from the Bill.¹⁰⁵

Clause 96 enables the Secretary of State to distribute HRA subsidy in accordance with its assessment of the quality of the business plan rather than a formulaic assessment of the authority's need to spend. The LGA holds the view that resources should be distributed on the basis of need and not subjectively on whether or not an authority has produced a good plan.¹⁰⁶

Wolverhampton City Council gave evidence on the calculation of HRA subsidy to the Transport, Local Government and the Regions Select Committee during its examination of the *draft Local Government Bill*:

Part 7 of the draft Bill would allow the Secretary of State to adopt a highly subjective regime to determine each local authority's annual subsidy for council housing. It mixes the present formula approach with subjective assessments of Housing Revenue Account business plans and authorities' performances and 'assumptions as to any other matter'. Clearly this would give extremely wide powers to the Secretary of State with which to determine subsidy and the Government has determined for general fund services that plan based grant decisions are not appropriate, but for housing finance apparently a different approach is being taken.¹⁰⁷

¹⁰⁴ ODPM, *Draft Local Government Bill – Analysis of Consultation Responses*, November 2002: <http://www.local-regions.odpm.gov.uk/consult/bill/responses/>

¹⁰⁵ CIH's response to the draft Bill, August 2002: <http://www.cih.org/cgi-bin/display.pl?db=policies&id=349>

¹⁰⁶ LGA's response to the draft Bill, August 2002: http://www.lga.gov.uk/Documents/Briefing/Our_Work/Westminster/LGWPSubmission4.pdf

¹⁰⁷ HC 981-I 2001-02, paragraph 45: <http://www.publications.parliament.uk/pa/cm200102/cmselect/cmtlgr/981/981.pdf>

The Select Committee concluded that the Government should adopt a transparent approach to housing finance and, in particular, “that decisions should not be based on an assessment of business plans when such an approach has been rejected for local government finance more widely.”¹⁰⁸ The Government’s response to the Committee’s Report addresses this point:

The Government accepts that it is important that authorities know the basis on which any assessments will be made, and intends that the assessment criteria should be made available to them. It is important that the Government has maximum flexibility to distribute scarce housing resources, recognising both the relative needs of authorities and their success in meeting those needs. The clause will ensure that the Government is able, within the new local government finance regime, to target resources to greatest effect.¹⁰⁹

Clause 90 would insert a new section 80ZA into the 1989 Act. The Explanatory Notes to the Bill explain the purpose of this new section:

The new section 80ZA provides that where the calculation of HRA subsidy under sections 79 and 80 of the 1989 Act (as amended by clause 89) results in an overall negative amount, the authority concerned shall

- pay that amount to the Secretary of State or the Assembly; and
- charge the costs of doing so to its HRA. The costs will fall to be met from rental and other income in the HRA.¹¹⁰

The stated purpose of clause 90 is to:

...ensure that authorities which are able to generate surplus rental income, even though incurring management and maintenance etc expenditure comparable with other authorities, make a contribution towards meeting the costs incurred by authorities which cannot generate sufficient rent income to meet such costs.

This is effectively what happens under the present HRA subsidy arrangements, whereby the surplus is set off against that part of subsidy which is attributable to rent rebates. But the present arrangements are not consistent with the new financial framework for local authority housing (including resource accounting), and are not well understood. That is why rent rebates are being removed from the HRA. When that happens, the current redistributive mechanism will no longer be available.¹¹¹

¹⁰⁸ *ibid*

¹⁰⁹ Cm 5638, November 2002, paragraph (ee):

<http://www.local-regions.odpm.gov.uk/legislation/localgov-bill/pdf/cm5638.pdf>

¹¹⁰ Bill 9-EN, paragraph 229:

<http://www.publications.parliament.uk/pa/cm200203/cmbills/009/en/03009x--.htm>

¹¹¹ *ibid*, paragraphs 230-231

Background information on “negative subsidy” authorities can be found in Library Research Paper 00/87, *Rent Rebates and Local Authority Housing Revenue Accounts*.¹¹²

Currently, where an authority’s HRA subsidy entitlement is calculated to be a negative amount, section 80(2) of the 1989 Act provides that an equivalent positive amount to be transferred from the HRA to another revenue account of the authority, other than the Housing Repairs Account. In effect, rental income has been used to meet non-housing expenditure for some authorities in England. Section 80(2) will be repealed by this Bill.

A number of witnesses expressed concerns to the Select Committee’s examination of the *draft Local Government Bill* about the effect of clause 97 (clause 90 of the current Bill). Wolverhampton Council told the Committee that it pays around £10 million “surplus” on its HRA into its General Fund under the current system and was concerned that it would have to make similar payments to the Secretary of State under clause 97 (clause 90).

CIPFA’s written evidence to the Committee noted:

The proposal to redistribute excess rental income between local authorities raises questions of equity...Arguably, equity would dictate that rents should be reduced to match expenditure and that redistribution and equity should be achieved centrally through housing revenue account subsidy. The assumption behind these proposals seems to be that housing is a national service and that money from one area can be readily moved around the country.¹¹³

The CIH also expressed concern about clause 97 (now clause 90) on the grounds that authorities only have freedom to generate extra resources at the margin: in the CIH’s opinion most of this flexibility will be “squeezed out” by the Bill’s proposals.¹¹⁴

The Select Committee concluded that the Government should reconsider its proposals on negative HRA subsidy arrangements as under clause 97 (now clause 90) the “nearly poor” would be being asked to subsidise the rents of the other “nearly poor.”¹¹⁵ The Government has issued the following response to this point:

It is the case that under Clause 97, councils that are able to generate a surplus on their HRA after meeting reasonable management and maintenance costs will be required to pay that surplus into the Exchequer. Those surpluses, together with additional funding from the Exchequer, will provide the resources necessary to make good the deficits faced by other authorities. However, these are just accounting devices to ensure that the available resources to manage and maintain

¹¹² <http://www.parliament.uk/commons/lib/research/rp2000/rp00-087.pdf>

¹¹³ HC 981-I 2002-02, paragraph 46:

<http://www.publications.parliament.uk/pa/cm200102/cmselect/cmtlgr/981/981.pdf>

¹¹⁴ CIH’s response to the draft Bill, August 2002:

<http://www.cih.org/cgi-bin/display.pl?db=policies&id=349>

¹¹⁵ HC 981-I 2002-02, paragraph 47:

<http://www.publications.parliament.uk/pa/cm200102/cmselect/cmtlgr/981/981.pdf>

council housing are shared out fairly between authorities, on the basis that the same rules should apply to all. It is incorrect to suggest that in any practical sense tenants in surplus authorities are subsidising those in deficit authorities. The practical reality is that the vast majority of council tenants, including those in surplus authorities, are being substantially subsidised – rents remain well below market rates. This is not evident in the HRA subsidy system, as the accounting system used does not require any return on the capital employed.¹¹⁶

The ODPM's analysis of consultation responses to the *draft Local Government Bill* notes, on clause 97 (now clause 90):

A total of 18 authorities commented on clause 97, pooling of HRA negative amounts of subsidy. There was some opposition with one or two references to the "Daylight Robbery Campaign" and suggestions that negative amounts should be abated to zero. On the other hand the London borough of Tower Hamlets and Leeds City Council were in favour of pooling, and the London Government Information Unit welcomed the end of transfers of negative subsidy to the general fund.¹¹⁷

Clause 91 will insert a new section 87A into the 1989 Act to provide a mechanism in England and Wales for changes in the HRA to be made "to reflect new circumstances or to improve the financial arrangements for local authority housing."¹¹⁸ This is, in effect, an extended version of the existing power that enables Schedule 4 to the 1989 Act to be amended.

Schedule 6 to the Bill will make further provisions in relation to HRA subsidy:

- Paragraph 31 will introduce a transitional provision to provide flexibility in deciding how any overpaid HRA subsidy (paid in respect of rent rebates) is recovered. It will amend section 80A of the 1989 Act so that these overpayments can be recovered by withholding or reducing rent rebate subsidy payable under section 140A(2) of the *Social Security Administration Act 1992* (SSAA 1992) by the Secretary of State for Work and Pensions. The Secretary of State will be able to recover overpaid subsidy for HRA Rent Rebates even where the original subsidy was paid as part of HRA subsidy. This will be in addition to powers to recover overpaid HRA subsidy in respect of HRA rent rebates by withholding HRA subsidy payable in future in respect of, for example, management and maintenance.

¹¹⁶ Cm 5638, November 2002, paragraph (ff):

<http://www.local-regions.odpm.gov.uk/legislation/localgov-bill/pdf/cm5638.pdf>

¹¹⁷ ODPM, *Draft Local Government Bill – Analysis of Consultation Responses*, November 2002: <http://www.local-regions.odpm.gov.uk/consult/bill/responses/>

¹¹⁸ Bill 9-EN, paragraph 236:

<http://www.publications.parliament.uk/pa/cm200203/cmbills/009/en/03009x--.htm>

- Paragraph 33 will amend Schedule 4 to the 1989 Act to provide that the amount of Rent Rebates granted for the year to the tenants of HRA property will no longer be debited to the HRA.
- Sub-paragraph 5 of paragraph 33 will authorise the giving of directions requiring an authority to transfer an amount from its HRA to another revenue account, other than the Housing Repairs Account. This power will enable the continuation of the “rent rebate subsidy limitation” policy after Rent Rebates are removed from the HRA.¹¹⁹
- Paragraphs 34-39 of Schedule 6 will make “minor and consequential” amendments to the SSAA 1992. Because this Act extends to Scotland, these amendments will have effect in Scotland.

VI Local authority rents

Clause 92 will amend sub-section 24(3) of the *1985 Housing Act* to provide that it will only apply in Wales. It currently applies in England and Wales. Sub-section 24(3) requires authorities, when setting rents, to have regard to the principle that rents of houses of any class or description should bear broadly the same proportion to private sector rents as the rents of houses of any other class or description. This means that, for example, if an assured tenancy of a private sector house with a garden fetches a rent level of twice as high as a purpose built flat with the same number of rooms, the authority should “have regard” to the principle that their own houses with gardens should fetch twice as much rent as their purpose built flats with the same number of rooms.

The amendment is felt to be necessary as the requirements of section 24(3) might make it difficult for authorities to comply with the Government’s rent restructuring policy in the longer term.¹²⁰

Rent restructuring is not currently being implemented in Wales. Clause 92(2) will allow the National Assembly for Wales to make an order to repeal sub-section 24(3) in the future.

¹¹⁹ This policy applies where an authority chooses to increase its rents above a certain level. Authorities themselves are required to meet any additional benefit costs arising from such increases; they do not receive subsidy for them.

¹²⁰ For more information on rent restructuring see Library standard note, *Social housing: rent reform*, SN/SP/1090, <http://hcl1.hclibrary.parliament.uk/notes/sps/snsp-01090.pdf>

VII Glossary

Arm's length management organisations (ALMOs) – this involves a local authority setting up an arm's length company (under section 2 of the *Local Government Act 2000*) to which key housing services are delegated. The authority retains ownership of the stock but certain landlord functions, such as management and maintenance, are delegated.

Capital receipts – the sum raised from the sale of local authority owned assets.

Credit approval – this is an approval issued by Government that specifies the amount of capital expenditure that an authority can finance from borrowing.

Housing Revenue Account (HRA) – this is a statutory account maintained by all housing authorities to record all income and expenditure in relation to dwellings provided under the *1985 Housing Act*. Councils that transfer their entire housing stock are not required to maintain HRAs.)

Housing Revenue Account subsidy – a sum paid by Government to local housing authorities to make up any shortfall between income and expenditure on their HRAs. HRA subsidy may be a negative amount.

Large scale voluntary transfer (LSVT) – this is the sale of a local authority's housing stock to a registered social landlord. The sale of the stock in this way raises (if the value of the stock is higher than the authority's outstanding housing debt) a capital receipt.

LSVT levy - a levy is imposed by the Government on any balance remaining after the capital receipt raised by a transfer is applied to pay off an authority's housing debt. This levy was introduced in order to restrict the annual rate of growth in central Government's share of the costs of housing benefit and to control demand for private lending in any one year.

Overhanging debt – this arises where the net capital receipt from a LSVT is less than an authority's housing attributable debt.