



Council Housing Finance Reform – getting the Self Financing Agreement right

Summary

- This bulletin considers the agreement which will underpin the Council housing reform 'offer' about to be made by the Government to retention housing authorities.
- It explains why the agreement needs to be a detailed, balanced one if authorities are to have the confidence to take on the debt allocated to them.
- It suggests that authorities may therefore wish to take their time before accepting the offer (even in principle) and in particular evaluate any change in policy after the forthcoming Election.

avoid the need for legislation and not only enable the Government to commit to reform (before the Election?) but also bring forward the implementation from 1 April 2012.

It had, until recently, been assumed that all retention authorities would have to agree but it now appears that CLG might be ready and able to implement the reform on a partial basis. This would appear to involve those authorities who decline the offer being notionally (i.e. informally) allocated with the debt that they would have taken on had they agreed to reform. (This has significant implications for those authorities, not least if they wish to pursue a stock transfer because they (or a future Government) would have to deal with that debt in some which way.)

Introduction

This is the latest of a number of bulletins we have produced on the proposal to reform the Council Housing Finance system in England. If you would like to see our earlier bulletins please email idoollittle@trowers.com. The reform process has reached the point where we can shortly expect an offer to retention authorities from Communities and Local Government (CLG). If the offer is accepted (perhaps 'in principle' only?) this will

Reviewing the offer

All retention authorities will have studied the consultation paper issued in July last year in detail. They will have responded to the consultation paper or at the very least anticipated how they are likely to react to an offer of the kind outlined in the consultation paper. There were of course many gaps and uncertainties in the proposals and when the offer is made authorities will be looking for those gaps to be filled and uncertainties to be removed.

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With or without specialist assistance they will be looking at issues such as:

- the debt settlement – there has been much debate about the amount of debt that is to be redistributed. When reform was proposed it was assumed that the Government would be looking simply to redistribute the £17–18 billion notionally in the system, but it looks as if the Government is seeking to fund additional investment through the introduction of significant additional levels of debt. This will have obvious implications for affordability and authorities will be scrutinising the amount of debt they are being asked to take on for 30 years.
- increased allowances – the proposed 24% increase in the major repairs allowance and the 5% increase in the management and maintenance allowance were less than anticipated and generally thought to be needed; and the increases may well not be introduced at the same level for all authorities. How they are allocated locally and indeed how they are "weighted" (i.e. later rather than earlier in the business plan?) will need to be analysed carefully.
- transaction costs – it will be important for authorities to understand how the allocation of debt, and the payment of it, is to "work". The consultation paper indicated that the Government is aware that there could be significant transaction costs involved in repaying or assuming debt at a local rather than a national level. In a previous bulletin we explored the merits of the centralisation of debt but that no longer seems likely and many authorities would clearly prefer to control debt management themselves. There is however a price for doing so and the transaction costs will need to be reflected transparently and affordably in the debt settlement.
- the conversion of ALMO borrowing – there has been a good deal of debt assumed in order to pay for the Decent Homes programmes funded by ALMO authorities, and how that debt is converted will be of interest not only to those authorities which have ALMOs but also authorities which do not. The sums involved are very substantial.
- dependence on future grant funding – if, as appears, the Government intends to fund additional investment through a grant mechanism two possibilities arise. The first is the simple point that if this grant is converted straightaway into debt the initial debt settlement might simply be unaffordable

for local authorities. The second is that authorities have to bid for the grant and if that is the case they will want to know whether and to what extent there is certainty of securing that grant funding.



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- stock condition and standards – it looks as if the Government is proposing to agree business plans on the basis of actual rather than assumed stock condition. This will be welcome to those authorities that for whatever reason are not at Decent Homes or otherwise cannot sustain that standard; but it will be less welcome for those authorities which got to the Decent Homes standard in accordance with the approach "signed off" in July 2005. All authorities will need to concern themselves with the robustness of the data and indeed whether they need to secure a formal (warranted) survey. They need to be conscious of the fact that the business plan will commit them to a wider definition of Decent Homes (to include common parts and lifts) and they will also be concerned that there are

anticipated to be new eco requirements, which will not be a concern if future Governments acknowledge that additional funding will be required but will certainly be of concern if there is any pressure to delivery improved energy performance through business plan efficiencies.

How will the offer be accepted

It appears that the Government proposes to use the new power introduced in the section 313 of the Housing and Regeneration Act 2008 (which has become section 80B of the Local Government and Housing Act 1989) to take individual authorities' stock out of the subsidy system. (It is currently being used for Council new build.)

The important point to note is that, unusually, the agreement which results is a binding one. Local authorities can "hold" the Government to it. The question is how the Government is going to use to the power.



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It would clearly be attractive to CLG to keep the agreement very simple indeed, perhaps by confining the agreement to an acknowledgement by the local authority that it is not entitled to any subsidy (positive or negative) in return for the allocation of an agreed amount of debt.

Authorities, however, really need to have a good deal more in the self financing agreement than this. The following sections in this bulletin identify issues which, in our view, need to be addressed in the self financing agreement. The attraction of reform for at least some authorities will disappear if they are committed to 30 year business plans which are inflexible or unsustainable.

Access to grant funding

The so-called backlogs amount in total to some £15 billion. The "time expired elements" account for £6 billion; non-decency for £1.4 – 2.9 billion; and disabled adaptations to £5 billion. The first two elements at least are to be funded through the self financing arrangements in some way or other and if there is to be an application process then in evaluating the offer local authorities will need (as already indicated) an assurance as to their entitlement to grant. This assurance of grant funding, the process for applying for it and any relevant terms should be incorporated in the self financing agreement.

CLG reopening the debt settlement

The consultation paper (at paragraph 4.28) referred to the need for a mechanism to "re-open the debt settlement, following consultation, in the event of major policy changes on either long term rent policy or the standards that applied to social housing". The process for reopening the settlement and the precise circumstances in which it might occur need to be set out.

There is a risk that reform could become a one-sided arrangement, with local authorities taking on debt which they cannot in any circumstances "pass back" to the Government, while the Government can allocate more debt or otherwise revisit the terms of the original agreement merely "following consultation" if major policy changes dictate. If the self financing agreement is to be a meaningful one then more detail is required here and authorities can then decide whether there is sufficient reassurance for them to accept the offer or not.

Rent policy

It is axiomatic in the reform proposals that self financing authorities will still be subject to Government rent policy. The consultation paper, as just mentioned, anticipates the "need" to revisit the original settlement if long term rent policy is changed; but there is also the

simple and more immediate risk that the current (convergence) policy is implemented in a unpredictable or arbitrary fashion. Recent experiences arising from negative RPI and also the Government's desire to protect tenants from the impact of the recession make it clear that authorities are vulnerable to unexpected Government decisions.

The very late decision on rent increases last March was administratively and presentationally difficult but at least the costs were met, as we understand it, through the subsidy system. That protection would no longer be available.

Registered Social Landlords (**RSLs**) are of course subject to the same regime but there is a recognition in Government that they have to satisfy the requirements of funders and their business plans and, as a result, there is a negotiation which leads to a workable outcome. RSLs also have assets and reserves on which they can draw and this recourse may not be available to local authorities. There is therefore every reason to make sure that the required compliance with rent policy is properly spelt out in the self financing agreement, with appropriate levels of flexibility and protection for the local authorities.

Changes in law/policy

The analysis of rent policy highlights the issues here. There are three key risks. The first is that new statutory obligations arise which cannot be met through the self financing business plan. The consultation paper (at paragraph 3.28) makes it clear that requirements placed on landlords as a result of statutory obligations would be a matter for the landlord account but does not make it clear how such new (and expensive?) obligations would be funded. Perhaps CLG anticipates that if Parliament introduces new obligations then Parliament will fund them? Is this realistic?

Then there is the issue of regulation. The consultation paper at the same paragraph refers to new standards set by the Tenant Services Authority (**TSA**). All it offers in this respect is that the TSA will "take into account" the consequences for (inter alia) public expenditure.

Perhaps this is meant to signal that the TSA will not be arbitrary but though that will undoubtedly be the case the passage does not reassure local authorities that they will have the funds, through their self financing business plans, to meet such costs. Finally, what about major changes to housing benefit? Are authorities ready to take their chance on this? As much protection

and flexibility as possible need to be written into the self-financing agreement.

Ring-fencing income and expenditure

The consultation paper made clear that the Housing Revenue Account (**HRA**) ring-fence needs to be both strengthened and brought up to date and, if only to protect local authorities from being expected or indeed pressurised by central Government to meet non-HRA or otherwise unexpected expenditure through the business plan, the self financing agreement should spell out what the new ring-fence amounts to.

Indeed there is merit in making sure that both authorities and central Government are clear about the services – whether core or "core plus" – which need to be paid for out of the landlord account and which services are "non core" and to be met, if at all, from the general fund or other sources.



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Clarity in the self financing agreement is essential if there is to be avoided the risk that a financial settlement constructed on one basis proves to be inadequate

because that basis changes, through Governmental or other pressures, in the future.

Borrowing controls

A key potential attraction of self financing is the prospect that local authorities will be able to borrow against rental income. It may in fact prove to be the case that the "spare" rental income is very limited and that out-performance of the business plan takes many years to arrive or indeed is "lost" in absorbing additional Government or other pressures for expenditure on the stock. Nevertheless there is keen interest for authorities to be able to raise additional resources in this way. Previously borrowing of this kind - though theoretically available through the prudential borrowing system - was very limited indeed, chiefly because the year-on-year determination process gave council treasurers insufficient confidence that the debt could be serviced on a regular basis.

That uncertainty will be removed once the self financing business plans are put in place; but the Government has signalled in the consultation paper that it will not allow additional borrowing purely at the discretion of the local authorities.

At paragraph 4.35 CLG referred to the "need to ration or limit in some way any additional borrowing over what was implied by the notional initial business plan". It also implied that there were ongoing discussions with the Treasury about achieving fiscal neutrality once the self financing system was put in place. It will be interesting to see what CLG proposes in its offer to retention authorities. It might decide to rely upon the prudential code and the professionalism of council treasurers; but the Treasury might require a more explicit approach. The Chartered Institute of Housing has suggested a "peak debt" approach (adopted from stock transfer).

If the controls are unduly restrictive, authorities will question the benefits to be derived from self financing. The prize of borrowing against rental streams may be illusory. There is also the possibility that a local authority may need to borrow. A business plan might actually depend upon early borrowing. Borrowing controls are therefore a key issue and do need to be properly addressed in the self financing agreement.

Use of RTB receipts

The proposed retention of all RTB receipts - with the 75% previously pooled being available for reinvestment locally - has been widely welcomed. There is however

a signal in the consultation paper (paragraph 4.49) that the current definitions of affordable housing and regeneration will be revisited and if these are made more restrictive that will take away some of the benefit of retaining receipts. It is however important also to appreciate that a RTB receipt only arises when a property, and the income that goes with it, is lost. Compulsion to use that receipt for particular purposes might well be inappropriate; and there is also the technical point (addressed in stock transfer agreements) that the receipt might be less than the income foregone. Here too there are issues which need to be addressed in the self financing agreement



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Stock Transfer

Our previous bulletin addressed this sensitive issue. The conclusion of that bulletin was that following self financing stock transfer will be much more difficult to achieve than it is at present, even for positive value/no or low debt authorities which currently need no support (in the form of debt write-off) from central Government.

We have already suggested that **all** authorities will have debt allocated to them (formally or not) and, unless a

future Government were prepared to write off debt, stock transfer may not "work". The interest in stock transfers is unlikely to disappear simply because self financing is put in place.

Local authorities themselves will remain interested in offering their tenants investment standards which meet tenants' aspirations or otherwise exceed the Decent Homes standard. And tenants themselves may well initiate stock transfer proposals. They do so at the moment and there are new statutory rights for tenant-led stock disposals in the 2008 Act.

The self financing agreement therefore needs to set out the terms on which stock transfer can still take place in the future. The present Government has signalled that it will not support future transfers to any greater extent than they support retention authorities. This is widely interpreted to mean that transferring stock will be valued as if there were a simple Decent Homes offer. Will overhanging debt even at that level be written off by the Government when a transfer takes place? And what if a future Government is prepared to write-off debt on the previously conventional basis, i.e. writing off all the (allocated) housing debt for that authority?

Stock transfer will still require Government consent under self financing (as well as a ballot) and the terms on which that consent will be given need to be set out in the self financing agreement if local authorities are to appreciate the basis on which they can (or cannot) deliver what has hitherto being available through stock transfer when tenants have decided that substantially enhanced levels of investment are required for their properties.

Protection/risk management

Authorities will be very conscious of the possibility that a self financing business plan fails. It is one of the criticisms – but also one of the benefits - of the current system that authorities are assured that the costs of meeting their current housing debt will be met. Under self financing, interest rate and other risks will pass to the authorities themselves and central Government will have no further responsibility. There was certainly an attempt in the consultation document to address the issue of risk but the relevant section (see paragraphs 4.37 – 42) does not afford any real reassurance.

All it seems to anticipate is that there would be an entitlement for the TSA, under its new cross domain powers, to step in to deal with failure. That is not of course the scenario that concerns local authorities.

What happens if, for reasons outside their control, they are unable to service the debt or otherwise keep their business plans viable? There are plenty of external pressures and indeed (as already highlighted in this bulletin) Government interventions which could throw into disarray the most robust and the best managed business plans.

Should local authorities have the express right to sell voids in these circumstances, without needing to rely (as now) on the current (constrained) general consents? Unless there are clearer 'escape' mechanisms the only recourse will be to reduce the expenditure on works and services, and that is not the expected outcome of self financing.

Here is another instance of the need to deal with the "what if" scenarios at the outset in the form of express provisions in the self financing agreement. In particular, if asset management is deemed to be the appropriate way of dealing with risk and protecting the business plan, the Government will need to give its consent through the self financing agreement and not leave local authorities wondering if they will get the consent when they need it.



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Conclusion

No doubt other elements of the self financing "deal" will be identified by local authorities, either at a national or at a local level. It is possible that some of the points made in this bulletin will be of less importance to some authorities than others. It is nevertheless clear that the self financing agreements need to be "real" (i.e. both detailed and balanced) if authorities are to have the confidence to accept the offer – even if only in principle – in the relatively short space of time available before the Election.

It may be that some or many authorities will decide that it is better to let the debate unfold and for the points explored in this bulletin (and others) to be examined further before any new regime is put in place. Authorities may also decide that they will want to consult their tenants not only on the principles of the self financing regime but also on the details of the self financing agreement it proposes to sign. In any event, there is clearly a good deal of work to be done and

issues to consider before a self financing offer can be turned into a meaningful self financing agreement.

We hope this bulletin will contribute to the evaluation of the advantages and disadvantages of the offer and we are ready to continue to play a part in the debate and discussions which ensue.

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