



Communities and Governance

Council Housing Finance reform and stock transfer – some questions for local authority members, officers and tenants

Summary

- This bulletin considers the implications of council housing finance reform for stock transfer.
- It suggests that reform will make stock transfer very difficult to achieve.
- It explains why reform is unlikely to deliver the same investment as stock transfer.
- It asks how tenant-led transfers can be delivered after reform.
- It anticipates that low or no debt authorities, in particular, will be wary of accepting the Government's offer of voluntary reform.
- It asks what will happen if the Government implements reform for some authorities and leaves others with additional debt allocated to them.

Introduction

We are currently waiting for the Government's response to the outcome of its consultation exercise. As readers will be aware, the Government issued a consultation paper in July proposing a radical overhaul of the much-criticised system for council housing finance. There is a widespread acknowledgement that

reform is required and the principle of reform has been accepted by central and local politicians. There is however much debate still about the benefits to be derived from the reform and whether in fact the proposed remedy will achieve the desired results.

The problem is debt. There is a great deal of debt in the system and it is this debt which drives much of the illogicality in the system. Local authorities and their tenants see their rents being redistributed around the country not simply to meet housing need elsewhere but also to service debts incurred by those other local authorities many years ago. The proposed solution is (effectively) to reallocate that debt, leaving some local authorities with less debt and other authorities with (much) more debt. Heavily indebted authorities may regard this with equanimity but low or no debt authorities will be concerned.

The question for many authorities – especially those who are facing the prospect of incurring new debt in order to make a capital payment to CLG (for redistribution) – is whether 'two wrongs make a right'. It will be interesting to see how the debate unfolds over the coming weeks. The Government is likely to ask local authorities whether they are prepared to 'sign up' to reform on a voluntary basis in February next, with a view to completing the reform before the General Election (expected in May). Failing a voluntary

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agreement of this kind, reform will depend upon the introduction of legislation and the present Government at least has indicated that, though it is planning to introduce that legislation, it will not be possible to put enforced reform in place before 1 April 2012.

What about stock transfer?

As already indicated, there is keen interest in reform, to remove illogicality and to incentivise efficiency. Local housing authorities have long pressed for freedom to use their own resources (rents and receipts) as they see fit rather than be subject to a year-on-year 'determination' process.



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There is, however, no way of avoiding a debate also about stock transfer. Transfer has aroused strong feelings over the last 20 years but it has been a key and successful method for delivering investment in (former) Council housing stock. Transfer has delivered not just Decent Homes but also wider regeneration benefits.

The current Government is focusing on council housing finance reform as a way of showing support for local

authorities which have decided not to pursue stock transfer and do not want to be forced into transfer in the future.

The question arises whether council housing finance reform does in fact offer an alternative to stock transfer and also whether, in practice, the introduction of a reformed council housing finance system will make stock transfer very difficult or indeed impossible for any local authority to achieve in the future. An informed debate about the implications of council housing finance reform for stock transfer is essential, particularly when local authorities consider how to respond to the Government's offer of reform on a voluntary basis. Hence the questions which follow.

Will reform generate stock investment to match stock transfer?

It is a central feature of stock transfers that tenants 'work up' an investment programme for their homes which goes beyond the Decent Homes standard. The works offer reflects a detailed stock condition survey, a long period of consultation with tenants about the priorities they have for the investment in their homes and then the preparation of a locally tailored standard.

Council housing finance reform certainly promises to introduce a certain amount of additional investment. Local authorities' business plans will factor in an increase in the major repairs allowance of 24%, but this is a national increase and there will be variations from one local authority to another; and the 24% increase is substantially less than the 43% or indeed 60% widely anticipated before the reform proposals were made.

Authorities can also incorporate a 5% increase in management and maintenance allowances, but again this is a national increase with the prospect of significant local variations; and professional opinion is that a 10% increase is required.

Even more important than these increases is the amount of debt which will be (effectively) allocated to individual authorities (giving rise to capital payments by many and capital receipts for a few). There is approximately £17-18bn (actually £15bn or so) of debt in the system at present. There are, however, unnerving references in the consultation paper to backlogs of expenditure or investment whose funding is unclear. They fall into three categories: £1.4-£2.9bn of non-decent, catch-up work; £6bn of improvements or 'time expired elements'; and £5bn for disabled adaptations. There is a suggestion that at least the first two elements will be factored into

the initial financial settlements which will 'drive' the business plans.

Settlements at this level could prove very difficult for authorities to finance. The overall reform agenda has, so far, been driven on the assumption that the current surpluses within the system are sufficient to sustain the 'basic' £18bn of debt. The interest in reform might not have been so keen if professionals had been aware that the surpluses were to be used to sustain a substantially higher level of debt.

Although local authorities will need to evaluate carefully the Government's offer and evaluate the implications of their individual settlements, it will be very surprising if the investment available through settlements and the resulting business plans comes close to matching the stock investment traditionally available through stock transfer.



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Can stock transfer be promoted before Council housing finance reform?

The Government in the consultation paper (and the ministerial statement which preceded it) made clear that

it would not be providing more support for stock transfer than for stock retention. This was a controversial and somewhat obscure statement, not least because it ignored the fact that some stock transfers do not involve support at all.

On 16 December last the Minister for Housing allowed six proposals to proceed but said that, only subject to representations, he would require all other proposals to wait until he made the reform 'offer' in February.

It is important to appreciate that, despite this moratorium, stock transfer policy has not changed. The consultation paper and the ministerial statement relate to council housing finance reform and not stock transfer. The dilemma for authorities wishing to proceed with stock transfer – often in response to pressure from tenants – is how they can proceed in the face of such uncertainty. It may well be that there are no other authorities which are planning to issue offer documents before the forthcoming elections, let alone February. They may decide simply to work with their tenants and prepare a formal offer for distribution later in the year.

They will be conscious that there is a possibility that council housing finance reform will not happen at all. If a voluntary agreement on council housing finance reform is not concluded then reform will not happen before the General Election and it is a matter of speculation whether any new Government will promote the current reform proposals with vigour – or at all – in the face of opposition from some (positive value/negative subsidy) authorities. And of course there is a substantial period during which legislation needs to be prepared and passed. Is transfer simply to be put on hold for two or three years? The stock investment issues which transfer addresses will certainly not go away in the meantime.

What about stock transfer after reform?

If reform takes place, either on a voluntary or an enforced (i.e. legislated) basis, local housing authorities will have 30 year business plans. For reasons already discussed – chiefly relating to the allocation of (i.e. payment for) additional debt – these business plans could be very 'tight'. Many will also be based upon a good deal of new debt assumed by the local authority. Any stock transfer will require that all debt is repaid. Stock transfers currently 'work' on the basis that if there is so-called overhanging debt (i.e. debt which cannot be repaid from the receipt) the Government will write it off. That will not be available after reform. Local authorities will have to repay the debt themselves. The debt will be 'cheap' debt and though that relieves pressure on business plans it also makes it more difficult to repay the

debt through the transfer process, for obvious valuation reasons.

Can a local authority expect to be able to borrow to invest in its stock?

One of the main attractions of stock transfer is that the new landlord can escape from the strict controls over public sector borrowing. On the face of it, council housing finance reform could give similar freedoms to local authorities. It is, however, clear that the Government and specifically the Treasury are anxious to make sure that this does not take place. The consultation paper makes it clear that borrowing limits of some kind will apply and even if the (tight ?) business plans generate sufficient surplus income to service debt there will be controls – perhaps explicit controls – over a local authority's entitlement to borrow on what is called a 'prudential' basis.

There is also a reference to the possibility that the Government, at least in extreme circumstances, will re-open the debt settlement. This is not a basis on which local authority treasurers will feel confident to borrow money. They may be pleased that, at long last, council housing rents are their 'own' but, quite apart from the likelihood that they will need to be devoted for many years to meeting the unavoidable expenditure on council homes and services, any planned/future surpluses cannot safely be made available to support additional borrowing without more confidence than the initial settlement and the resulting business plans seem likely to generate.

And of course rents will continue to be subject to Government control. Recent experience shows that Government interventions are unpredictable. This makes borrowing against rents problematic.

Can a local authority release resources by out-performing its business plan?

We have already indicated that out-performance, at least in the early years, will be difficult to achieve. It will take some years before it will be clear whether initial business plans are at all 'generous'. It can be anticipated, particularly in the current funding climate, that the Government will wish to strike a hard bargain. The fact that the Government has chosen separately to deal with the so-called backlogs – amounting in total to as much as £15bn – suggests that the Government will not release its current control over the subsidy system lightly. On the other hand, even if out performance is achievable, there are likely to be ongoing controls – over

and above the prudential borrowing arrangements currently in place – to ensure that no financial embarrassment arises from local authorities seeking to use the income streams in future available to them.

The difficulty for local housing authorities is that out-performance is difficult to assess at the outset and it is this out-performance which is the 'prize' which council housing finance reform can deliver. By contrast, stock transfer delivers a predictable investment 'return' and any out performance is, so to speak, a bonus. In fact, out-performance is not unusual for stock transferees. It is certainly not regarded as a problem. Local authorities are rightly confident that stock transfer landlords will be committed to translating any out-performance into additional investment for homes or services. The Government through a one-off settlement delivering Council housing finance reform will not have the same



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confidence and indeed, given current public debt levels, might feel quite differently. If authorities can out-perform, then (arguably) CLG/Treasury will have failed to capture full value from the settlement(s).

Will Government consent to stock transfer still be needed?

The short answer is Yes. The freedom for local authorities arising from Council housing finance reform is freedom to 'run' the new 30 year business plan. It does not come with Government consent to transfer stock to a

new landlord. The current requirements will still be in place – not just to hold a ballot but also to meet Government requirements in relation to value for money and so forth. It is for this reason that, elsewhere, we are arguing that if Council housing finance reform takes place it should do so on the basis of a fully worked out self-financing agreement where such issues as consent to the stock transfer are addressed. Otherwise, the freedom which attracts local authorities to Council housing finance reform will be freedom simply to manage a (tight?) business plan; and the other options currently available to a local authority (and its tenants) – in particular stock transfer – will no longer be available or at any rate not available in a way which would be expected to be available to a truly autonomous local housing authority.



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Is there any special consideration given to tenant-led transfers?

The short answer is No. There are a number of tenant-led stock options currently under way and those local authorities are letting tenants tell members and officers what they expect, in relation to both their homes and their services. As far as the Government is concerned, such transfer proposals, attractive though they are, are treated formally in the same way as a conventional stock transfer proposal.

There are of course also provisions in the Housing and Regeneration Act 2008 (the 2008 Act) which anticipate tenants not just participating in and leading a stock options process but also proposing transfer itself. It is difficult to see how these can be given meaningful effect by a local authority after council housing finance reform, given that a tenant-led transfer can only proceed if the reallocated debt relating to the stock is repaid. We have already rehearsed the difficulties in repaying debt in a reformed Council housing finance system. It is to be hoped that the Government will explain how it will

support tenant-led transfer proposals. Otherwise this right for tenants will seem hollow.

Will partial/estate transfers still be possible?

There have been many partial/estate transfers over the last 20 years or so. The Government at one stage gave grant to support the business plans of stock transferees to help with the heavy expenditure involved in regenerating run-down estates. That grant is no longer available and estate transfers in the current pre-reform period will probably take place only if either or both of a registered social landlord/registered provider (RP) and the Homes and Communities Agency (HCA) can provide financial assistance. In the case of a RP this would involve making available reserves to support the business plan and in the case of the HCA this would require grant/investment funding of some kind. The Government's consultation paper indicates that regeneration projects of this kind are not to be funded through the 30 year business plans but from other sources.

Partial/estate transfers will only be possible in the future if either they are so viable in their own right that the attributable debt can be written off by the local authority itself (or still supported despite the loss of rental income) or if sufficient financial support is provided from external sources. The previous assistance from Government in the form of debt write-off will no longer be available. All this may make estate-based regeneration (much?) more difficult to deliver.

Will a ballot still be required?

Yes. There is no change proposed to the statutory regime and it is unlikely that after the general election a different party would seek to challenge this. Indeed the 2008 Act has made a ballot mandatory. This is not the place to describe the way in which, by custom and practice, local authorities and their tenants have built the necessary confidence and support but clearly that makes tenant-led transfer proposals all the more likely to be the ones which succeed. Hence the importance of the fact (as rehearsed above) that Council housing finance reform seems likely to provide no special favour to, or support for, tenant-led options.

What about 'positive value' local authorities which need no 'support'?

These authorities were surprisingly overlooked in the consultation paper/ministerial statement. At present a local authority whose transfer generates sufficient value

to repay that authority's debt (or involves no repayable debt) can proceed with transfer on its own account without any financial support from the Government. It needs, as a matter of prudence, to ensure that its consultation document complies with Government guidance but otherwise the local authority needs simply a consent from the Secretary of State before actual transfer can take place.

In this pre-reform period the Government can be expected to be looking closely at the impact that the 'departure' of such an authority would have on the system thereafter to be reformed. Compensation is no doubt in the Government's mind. Perhaps an increased levy? At present the levy is at 20% but that would be an obvious mechanism for the Government to use if it wanted to ensure that a departing positive value authority (paying heavily, it is presumed, into the system at present) can leave without leaving a 'hole'. Clearly this would be unpopular, not least because receipts are wholly committed to new build on the one hand and mitigating the corporate impact on the other; but perhaps this is the price to be paid for achieving transfer pre-reform?

After Council housing finance reform – certainly if implemented on a wholesale basis – this type of authority will be no more able to carry out a stock transfer than a previously indebted authority. It might not be too melodramatic to say that such an authority would then be 'locked into' the reform system. It is widely assumed that positive value authorities which are debt free and in negative subsidy are sceptical about the proposals for reform and this analysis indicates a reason why.

What about indebted housing authorities?

Currently a housing authority with housing debt (serviced through the HRA subsidy system) which wishes to carry out stock transfer can expect the Government to write off the attributable debt. This has been the practice for 20 years, but the Government is now evidently concerned about doing so. New considerations – political as well as financial perhaps - have found outward expression in the refusal to provide more support for transfer than for retention.

After reform, indebted local authorities will be in a better position than they are at the moment, in so far as they may have a lower debt to service. Nevertheless they will not be in any better position to transfer than their previously positive value, low debt counterparts. They will not be able to look to the Government to write off

their debt; they will have to deal with that themselves in ways already discussed.



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These authorities are quite as likely as other authorities – perhaps more so – to be interested in securing significant investment in their stock. There may be political or other reasons for being cautious about transfer, but the financial case for privately-funded investment is as powerful for these authorities as for positive value authorities.

What about a partially reformed system?

It has been assumed that if reform is to happen on a voluntary basis all affected authorities have to agree. It is however possible that the Government might decide to proceed even if some authorities (perhaps some low/no debt ones?) do not accept the debt allocated to them. In his 16 December announcement the Minister said that self-financing could be in place for 2011-12 'if it is **generally** accepted by local authorities'. The word 'generally' has been highlighted. It suggests that the Government is thinking of leaving some authorities in

their current position. This would in fact leave those authorities in some difficulty. They may not have 'signed up' because they want flexibility to carry out a transfer, if their tenants so desire; but post-reform the Government will have to decide whether to allow such an authority to do so without securing a whole or partial write off of the (new) debt notionally allocated to it.

The current Government might well be looking for write off; and though a new Government might not take the same approach it would still need to deal with the debt 'left behind' by the wholesale departures of authorities under the post-election reform 'offer'. Will it treat debt write off as all Governments until recently have done or will it be looking for compensation and if so will that compensation be affordable?

Conclusion

This bulletin suggests that, as the Council housing finance reform proposals are discussed, all affected local authorities will want also to consider the issue of stock transfer. Reform and transfer are intertwined. They encapsulate the debate about the benefits to be derived from Council housing finance reform. If Council housing finance reform does not or is not likely to deliver investment levels to match stock transfer then

questions will be asked about the benefits of proceeding, at least on a voluntary basis before the general election.

Authorities may decide that, given these and other uncertainties, it will be best to wait for the proposals to be developed further and for the implications to be given longer consideration and in particular to see whether, if there is a change of Government, the proposals are taken forward after the general election. And in the meantime those who have already been working on stock transfer proposals (but who were not one of the 'permitted' six) will presumably wish to continue to develop their plans to see how they compare with a post-reform scenario.

We look forward to watching the debate unfold and contributing to it.

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