“Borrowing to build” is no solution to the council housing shortage

Is lifting the “borrowing cap” for council Housing Revenue Accounts the solution for large scale new council house building?

Councils in England are building very few council homes. In the seven years from 2010-17 only 10,840 homes were built. This compares with 18,220 demolitions and 60,567 sold through Right to Buy (RTB). In the six years to 2016 council housing stock in England declined by 174,000. One suggested remedy for the shortage of council housing has been the proposal that councils should be allowed to “borrow to build”. The Local Government Association, Shadow Housing Minister John Healey, and others have recently repeated the call for the borrowing cap, set for each council in 2012, to either be eliminated or at least raised. John Healey suggested that this would enable councils to build “tens of thousands” of new council homes. What his evidence is for this we don't know.

It's our contention that only central government grant towards the cost of house building can provide the resources necessary to build new council housing on a scale sufficient to begin to tackle the housing shortage. Proposing that councils increase their debt takes no account of the financial crisis being faced by local authority Housing Revenue Accounts (HRAs).

“Self-financing”

In 2012 a new council housing finance system, 'self-financing', was introduced. The previous 'housing subsidy system' was centralised. Each year councils which continued to own their housing stock were given an 'allowance' by the Department of Communities & Local Government. What this meant in reality was that government decided how much of their rent income they could keep. The 'subsidy' could in fact be negative. In 2005 the Audit Commission report *Financing Council Housing* noted that 82% of housing authorities suffered from negative subsidy. In other words they received no subsidy and had to make an annual payment to the government from their rent income. The Audit Commission predicted that eventually *all* local authorities would suffer from negative subsidy. It was estimated by the Local Government Association that by 2022 tenants would be paying a subsidy to the government of £894 million. This situation was unsustainable. The New Labour government launched a review of council housing finance from which a new funding system called 'self-financing' was proposed. Since New Labour lost the 2010 General Election the system was introduced by the coalition government. 'Self-financing' was supposed to be a means of ensuring that councils had sufficient finance for the management, maintenance and renewal of their existing stock over the long-term. This was highly questionable to say the least. In any case no sooner had it been introduced than the coalition moved the goalposts.

Under the new system, what was deemed to be the national council housing debt was broken up and redistributed amongst stock-owning councils. Each council was given a certain level of debt and a debt limit for it's Housing Revenue Account. The 136 local authorities given additional debt had an extra £13 billion debt imposed on them. A minority, 33, had some debt relief of £5 billion. The councils with extra debt were given a 'loan/s'[1] by the government's Public Works Loan Board (PWLB) equal to the extra debt. Councils have to pay annual interest on it[2]. Nominally the 'loan' was for 30 years, though local authorities had discretion as to how much they paid off, and when, or if they paid it at all. From the point of view of the PWLB the longer the loan remains the more interest they take in. Some councils such as Swindon determined to pay a fixed sum each year, in Swindon's case £5 million[3]. Others, such as Bristol, decided not to repay any of the loan back because they they had insufficient money for the maintenance and renewal of their housing over the long term.

The debt each council was set comprised extra debt decided by the government and so-called historic debt of £18 billion left over from historic building programmes (much of it the product of 'creative accounting' by the Treasury). The "borrowing headroom", that is to say how much extra borrowing it was allowed to take on, is the difference between the debt and the debt limit. The borrowing capacity for all councils with HRAs was £2.856 billion in 2012.

Borrow to build?

The demand for eliminating or raising the borrowing cap might suggest that councils have used up all their borrowing capacity and are demanding more because they have none left. Yet that is far from the case. Whilst statistics for individual council borrowing are not readily available the government's COR4 data shows council HRA debt and "borrowing headroom". STCG has analysed this data for the financial year 2016/17. We have compared it with the 2012 'debt settlement'. We can see which authorities have increased their debt, implying extra borrowing, which councils have utilised their borrowing capacity, and by how much.

By 2017 their collective borrowing capacity had risen by £736 million; to £3.592 billion from £2.856 billion. This is an indication that councils have been very wary of taking on extra debt given the financial stresses they are under (of which more later).

There are 166 councils with an HRA. By 2017 just 49 of them had a lower borrowing capacity, suggesting they have borrowed more[4]. As you can see from the table below half of them have lowered their borrowing capacity by less than £5 million over 5 years. Only 13 councils had a £20 million or more decrease in their borrowing capacity.

Number of councils	Lower borrowing capacity
10	less than £1 million
15	£1 million to £4.999 million

1 Swindon actually took on 22 loans designed to equalise expenditure over the 30 years of their business plan.

2 The rate of interest was 3.26%. There was no money changing hands, of course. It was merely an accounting exercise between the Treasury and the PWLB, which is an agency of the Treasury.

3 Actually Swindon hasn't paid the money back to the PWLB. It has transferred it to the council's General Fund for reasons explained in the text.

4 Debt borrowing figures for council housing are unavailable. An FOI request to the DCLG elicited the response that they don't know since they do not differentiate between local authority debt overall and debt relating to HRAs.

4	£5 million to £9.999 million
7	£10 million to £19.999 million
13	£20 million and above

How much of their borrowing capacity have these councils used? Excluding those with a negligible borrowing capacity (e.g. £1,000) we find that of 44 councils only 12 have used 75% or more, 26 of them less than 50%.

Percentage of borrowing cap used

Less than 25%	25-49%	50-74%	75% plus
17	9	6	12

Bidding to borrow more

In response to calls for raising the borrowing limit, in April 2014 the government offered councils the opportunity to bid for the facility to borrow an extra £300 million overall. The offer was a flop. In the first round of bidding only £62 million extra borrowing capacity was granted. In a second round only £60 million was added, meaning that only £122 million was granted, less than half the available £300 million. This showed the reluctance of councils to take on more debt given their financial circumstances.

Paying back the debt?

There are 113 councils whose borrowing capacity has increased. This suggests that they have been paying off some of the original 'loan/s' from the PWLB or transferring it to the General Fund. If a council pays off part of the 'loan' then their borrowing capacity rises accordingly. However, the increase is marginal for many councils, with 43% having an increased their borrowing capacity by less than £5 million over 5 years.

Number of councils	Increased borrowing capacity
20	less than £1 million
29	£1 million to £4.999 £5 million
24	£5 million to £9.999 million
23	£10 million to £19.999 million
17	£20 million and above

In the case of Swindon Council it decided to pay off the original loan by £5 million a year, which means that the cap has risen by £25 million in the 5 completed financial years since the new system was introduced. Its “borrowing headroom” increased from £21 million to £46 million. Yet like many other councils it hasn't borrowed any more from the PWLB because it has insufficient funds to maintain and renew its existing housing over the course of its 30 year business plan. The fact that only 17 councils have seen their borrowing capacity increase by £20 million and above, suggests that very few are paying off the 'loan' consistently on an annual basis.

There are 59 councils whose debt has increased. However, the scale of borrowing must have been very small, with 32 increasing their debt by less than £5 million. Only 10 increased it by £20 million or more. Overall these 59 authorities increased their debt by £834 million. *Yet 4 authorities only were responsible for £420 million of it.*

Number of councils	Increased debt
14	less than £1 million
18	£1 million to £4.999 million
8	£5 million to £9.999 million
9	£10 million to £19.999 million
10	£20 million and above

There were 107 councils whose debt is lower than in 2012. However the debt of 44 of these fell by less than £5 million. Excluding the five which transferred their stock only 14 councils with an HRA have cut their debt by £20 million or more. It would appear that a small minority have consistently paid off debt each year or transferred it to the General Fund.

Number of councils	lower debt
17	less than £1 million
27	£1 million to £4.999 million
19	£5 million to £9.999 million
25	£10 million to £19.999 million
19	£20 million and above

The outstanding debt for all councils owning housing at the end of 2016-17 was £26.019 billion as compared to £26.933 billion in 2012. However, when you deduct £501 million which was debt write-off for five councils that transferred their stock to housing associations, after the introduction of 'self-financing', the remaining stock owning councils have only paid off roughly £413 million in the five completed years since 2012. More than two thirds of councils that have cut their debt have done so by less than 10%.

Percentage of debt cut

	<5%	5% < 10%	10% < 15%	15% < 20%	20% +
No of authorities	42	26	15	8	16

Does the fact that some councils are paying off their loan over 30 years mean that they have enough money to maintain and renew their existing stock? Not at all. The reason why

Swindon decided to 'pay off' their loan in equal annual instalments was essentially for the benefit of the General Fund rather than the HRA and its tenants. £5 million was paid into the General Fund because it served as a form of cheap borrowing. When the decision was made to do this it was cheaper for the General Fund to pay the annual interest for that part of the loan than to borrow money from the PWLB because the interest rates were higher than the 3.26% which was the rate for the £138.6 million 'loan' which was part of the 2012 'debt settlement'.

From this evidence it is clear that to imagine that extra borrowing will be snapped up by councils to build on a large scale is far-fetched. Even though borrowing interest rates are low, HRAs would have to service the extra debt on top of the £26 billion they already have.

HRA financial crisis

The reluctance of councils to increase their debt is understandable in the light of government policies which have blown a hole in their business plans. When the new system was introduced in 2012 they had to draw up 30 year business plans. Their projections were based on estimates of income and expenditure. Yet no sooner had the new system been introduced than the government implemented policies that undermined the financial projections of these business plans. These policies were:

- Changing the rent formula that councils had to operate from RPI + 0.5% + plus up to £2 a week extra, to CPI plus 1%;
- Increasing discounts for right to buy sales and cutting the qualifying period from 5 to 3 years, which led to a fourfold increase in sales and hence the loss of much more rent than was estimated in the business plan;
- Introducing a 4 year, 1% a year, rent cut.

As a result of these policies council HRAs are taking in far less income than projected in their 2012 business plans. As you can see from the Appendix below individual councils will collect hundreds of millions of pounds *less* in rent income than they planned for. The Association of Retained Council Housing estimated that councils would lose more than £2 billion as compared to their projected income if the rent formula of CPI + 1% had been left in place.[5] The cumulative impact over the remaining years of the 30 year business plan would be in the region of £30 billion less.

The result of this crisis is that councils are cutting back on planned spending, delaying the renewal of key components such as roofs, kitchens, bathrooms etc. Whilst these cut-backs are not necessarily a threat to life and limb they do mean that the standard of homes, and hence the living conditions of tenants, are likely to deteriorate. Councils are not renewing key components within their allotted life-span. Just to take the example of Swindon a housing stock survey proposed that an annual spending programme of £7 million on non-traditional (prefabricated) stock would be necessary for the next ten years in order to prolong the life of these properties. Yet for the next financial year spending on them is projected at £1.75 million. For the three years after that they are proposing to reduce spending on this work to zero in order to accommodate work on tower blocks.

5 The government was committed to a rent formula of CPI + 1% for ten years starting from 2015. yet within months of its implementation it was abandoned in favour of a 4 years annual rent cut of 1%.

The under-funding which Kensington & Chelsea Council's HRA faces can be gauged by its £87 million shortfall over five years on money needed for capital spending. In this case the financial shortfall was certainly a factor in the cheapskate work carried out on Grenfell Tower which led to the catastrophe (See**"Grenfell Tower: the deadly consequences of under-funding of council housing"** [6]). This shows how the funding crisis faced by HRAs *can have life-threatening consequences*.

The four year rent cut, combined with increased RTB sales is having a significant impact on rental income. Local Government Financial Statistics for England 2017 show that in 2016/17 council rent income fell by £124 million, or 1.7% compared to 2015/16. Overall income fell by £312 million or 3.5%. Debt and interest charges remain at around 25% of annual income, at £2.097 billion. To propose therefore, in the midst of this financial crisis, that councils take on more debt to build new homes, is absurd. As one Lead Member of a big authority posed recently, "Why would I take on extra debt when my revenue is decreasing?"

Without central government grant for new build, existing council tenants would carry the burden of new borrowing (it's their rent which is used to service the debt). New debt has to be serviced by declining revenue. Whilst the government is proposing to reintroduce the rent formula of CPI + 1% from 2019, for five years, it can in no way resolve the financial crisis. In the case of Swindon, for instance, an assumption was built into its 2012 business plan that CPI + 1% would be reintroduced, so it will have no impact on the level of loss of income as compared to its 2012 projections. If the formula is reintroduced then the extra rent (compared to the rent cut) is likely to be used to fund the backlog of work which has built up rather than building new homes.

The Islington example

Recently Islington Council wrote to the Secretary of State for Communities and Local Government asking him to raise their borrowing cap. Yet they have only used £10 million of their 'borrowing headroom', with the capacity still to borrow another £57 million.

A quick look at the situation in Islington shows the difficulties all stock owning authorities face in the absence of central government grant for new building. The council owned 25,245 properties at the end of the 2016-17 financial year. During that year it let only 1,250 properties. It has a waiting list of 18,000. It boasted to Mr Javid that it will deliver 2,000 new "affordable homes" from 2015-2019, though only 500 will be council homes, that is 100 a year. However, this is less than the number of homes they are losing under RTB. In the last four years they sold off 651.

The letter to Mr Javid says that with an extra £80 million HRA borrowing they would be able to increase the council housing output by an extra 160 units. Yet this extra borrowing would not enable them to even replace all the homes sold under RTB. This underlines the fact that increased borrowing cannot secure new building on anything like the scale required to address the housing shortage.

6 See **http://keepourcouncilhomes.wordpress.com/2017/06/21/grenfell-tower-the-deadly-consequences-of-under-funding-of-council-housing/**

Large scale building requires central government grant

There is currently no central government grant available for 'social housing' under the government's 2nd round of its Affordable Homes Programme. Recently, the Prime Minister, announced an extra £2 billion for “affordable housing”. The DCLG disingenuously announced that this *could* fund 25,000 council homes with “a typical grant” of £80,000 per property. Whilst they said that councils will be able to apply for grant from this funding for 'social rent' homes they will have to compete with housing associations and there is no prospect that this will all be for 'social rent' in any case. Even if it were, 5,000 homes per year, would be less than half the loss of homes under current RTB sales.

A large scale council house building programme would require serious money from government. With grant at £80,000 average, £4 billion a year would help fund 50,000 council homes a year, £8 billion would help to fund 100,000.

Unfortunately Labour's current policy is likely to be in the region of £60,000 a property, though its entire programme for “affordable housing” would be around £4 billion according to John Healey's office.[7] Given the fact that they are the only realistic alternative government, shifting their policy is the only practical means of opening up the prospect of a large scale council house building programme.

Conclusion

At the very time when they are under-funded as a result of the cost of servicing existing 'debt' and the impact of government policies on their rental income, increased borrowing by local authority HRAs is no solution to the council housing shortage. In 2012 the LGA and other organisations estimated that lifting the borrowing cap by £7 billion would enable councils to build an extra 12,000 a year for five years. This obviously didn't factor in changes in government policy since then which have undermined their finances. The 1% rent cut forced councils to scale back their building ambitions. For instance, Reading had to abandon its plans to build 1,000 homes over ten years because of the rent cut.

As we have seen from our analysis of the COR4 data council housing debt is a burden on local authorities. There is a strong case for cancelling the bogus debt which was imposed in 2012. In the consultation on the new system even the LGA called for debt cancellation. This is a policy STCG has been raising with Labour (see **“The case for cancelling council housing 'Debt'”**[8]). Whilst the current government will obviously not countenance such a policy, it does have power under the 2011 Localism Act to “reopen the (debt) settlement” if a local authority's income or costs significantly impacts on their finances. Government guidance on 'self-financing' actually gave the example of a change in national rent policy as one of the reasons why the debt settlement could be reopened. It would mean giving a 'payment' to councils, in effect adjusting the debt to take account of the loss of rent resulting from government policies.

In the case of Swindon, if the debt was adjusted to take account of lower income, it would mean in effect writing off the remaining debt[9]. This would no doubt apply to other

7 See correspondence with John Healey's office cited in **http://martinwicks.files.wordpress.com/2017/10/radicalpoa.pdf**

8 http://keepourcouncilhomes.wordpress.com/2016/11/20/the-case-for-cancelling-council-housing-debt/

9 The estimated loss of income over the course of the remainder of the 30 year business plan is more than £360

councils. For Swindon it would provide an extra £9 million a year because it no longer had to service debt and interest payments. This would stabilise the finances in terms of maintaining the stock but it wouldn't provide enough money for a large scale council house building programme. For that central government grant would be necessary, preferably at the level of £80,000 per unit.

Appendix

Here are some examples of the financial crisis faced by council HRAs:

- **Brighton.** The rent cut will reduce resources by £14.1 million over four years with a cumulative reduction in resources of £223 million over 30 years compared to previous business plan assumptions.
- **Bristol.** The council estimates that it can balance its budget up to year 16 of its business plan but from year 17 to 30 it will have a funding gap of £210 million for capital spending (i.e. for renewal of key housing components).
- **Hammersmith & Fulham**. £76 million of necessary major works was postponed as a result of the shortage of resources.
- **Kensington & Chelsea**. Such was the impact of government policies on their finances that over the next five years the HRA has £87 million less money than required for crucial capital spending. They have only £59 million available for £146.1 million of necessary work.
- **Lambeth.** The four year rent cut means a loss to the HRA of £80 million. A deficit of £190 million is forecast by the end of the HRA business plan.
- **Leicester**. The council's budget document for this financial year states that “The combined impact of rent reductions and reducing stock will result in £2.96 million less income in 2017/18 compared to the previous year, rising to £11.4 million a year in 2019/20. By 2019/10 annual income will be reduced by 14.2%.”
- **Leeds.** The council says in relation to the rent cut: “When compared to the level of resources assumed in the last approved Business Plan, the rent reduction policy equates to a loss of £283 million of rental income over a ten year period.”
- **Newham.** The rent cut will result in the loss of £33 million by 2020. Potential loss of rental income over 30 years of £488 million.
- **Newcastle.** The council estimates it will lose £593 million over the course of its 30 year business plan as a result of the cumulative impact of the four year rent cut.
- **Nottingham.** The council's capital investment programme will fall from £61 million in 2017/18 to £33 million in 2020/21 as a result of shrinking resources.
- **Reading.** As a result of the 4 year rent cut the HRA will lose an estimated £233 million over the life of the business plan. Their plan to build 1,000 homes over 30 years was no longer affordable.
- **Sheffield.** Capital expenditure will fall from £70 million a year in 2016/17 to £55 million in 2021/22. Because of the loss of income it will “extend life cycles”; that is components will not be renewed when they should be.
- Swindon. The council is estimated to take in £362 million less rent over the remainder of the business plan compared to its 2012 projections.

million. The current debt is £125 million.