

TREASURY

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PART A

HOUSING POLICY

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24 MAR 1998

1987

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*LIMIT
cc (Alex Allen)*

10 DOWNING STREET
LONDON SW1A 2AA

From the Private Secretary

27 January 1987

I attach a paper by Peter Stredder of the Policy Unit here which the Prime Minister thought your Secretary of State would be interested to see.

The Prime Minister has asked that its circulation should be tightly restricted.

*PS/CST
cc Sir P Middleton
Mr FER Butler
Mr Anson
Mr Hawton*

David Norgrove

Robin Young, Esq.,
Department of the Environment.



*Norgrove
+ Young
27/1*

A NEW START FOR COUNCIL TENANTS

how many
~~on~~ (AM-UNION)
 Six 6 million
 and on the
 unemployment
 register

Objectives

Only 35% of council tenants are in work. 13% are unemployed and the rest are not in the labour force (eg pensioners, single mothers). Recent work on unemployment has highlighted the crucial importance of council estates in reinforcing dependence on the state and an anti-enterprise culture. We need to tackle this problem head on by breaking up the council house monopoly, devolving ownership to private sector trusts at estate level and whenever possible enabling tenants to become owner occupiers. Those who remain tenants should have the chance to become involved in running their estates, perhaps taking on repair or administration jobs themselves, giving them confidence, skills and pride that by their own abilities they can find jobs or set up new enterprises. This approach will equally bring housing benefits by breaking up the stock into manageable units, providing an opportunity to tackle union dominated and grossly inefficient working practices in some areas and depoliticising housing management.

Options

There are essentially two ways of proceeding. First, a 'case by case' approach would involve considering the position of individual estates. Tenants would be given the right to opt for transfer to private trusts and local authorities might be given a duty to work up schemes for each estate on a given timescale. In order to preserve equity between tenants who remained with the local authority and those who opted to transfer, the transferred estates would have to be sold at a market price - albeit one reflecting their tenanted status and the cost of outstanding repairs. At present rent levels, the worst estates could not be transferred without subsidy. So this strategy will

work best in conjunction with a policy of raising rents to economic levels.

This approach has its attractions. In particular, it can be presented as a natural evolution of existing housing policy. However it also has several flaws.

- it will be slow (perhaps 20% of the stock will be transferred to the private sector over the next 5 years, about the same impact as the right to buy has had since 1979);
- there will be ample opportunity for hostile local authorities obstruct its implementation just as they have obstructed 'right to buy';
- thus those tenants who most need to be given hope (those in Lambeth, Brent and Hackney) are least likely to benefit;
- the rent increases necessary to make this strategy work to best effect will be unpopular.

An end to council housing

Instead, we suggest that there should be a 'Big Bang' involving the transfer on a given day of each local authority's housing stock to a trust established in each area for the purpose. These trusts would be given the task of devolving management and ownership of the stock estate by estate to local control by a specified date. The Trusts would be required to give the maximum push to 'right to buy' and give those tenants with resources of their own the maximum opportunities to build up an equity stake in their dwelling. The outstanding debt on the stock would be written off but the new owners would be free to borrow to

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fund renovation. The remainder of this note sets out and considers this approach in more detail.

This proposal would give council tenants a new start writing off the mistakes of the past, giving them a stake and much greater say in the future and reducing substantially their dependency on the State. It is highly attractive because:

- it gives increased responsibility to those who become trustees (hopefully tenants' families by election or nomination);
- and to tenants generally because the fruits of any effort they make to maintain or improve the estate will flow directly back to them;
- creating an incentive for much greater efficiency in the day to day management and maintenance of the stock;
- providing more employment, training and the opportunity to cut costs by encouraging DIY, creating work on more major renovation and providing administrative experience;
- attacking the hopeless feeling that many in the poorest estates have of being trapped with no escape;
- making a serious assault on the most intractable crime sinks and the related problems of the isolation and loneliness of elderly and disabled;
- promoting community spirit;
- posing a fundamental challenge to the "welfare state philosophy" that "Nanny" Government knows best;

- encouraging tenants to exercise their right to buy (particularly in areas where Labour authorities have stifled applications) and offering the new ways of building up an equity stake in their house so that they can become owner-occupiers.

Legislation

In the first session of the next Parliament (in a major Housing Bill which would also deal with rent regulation) the Government should legislate for a new start for council tenants. On an appointed day all the housing stock in each local authority in England and Wales would be transferred to a housing trust established for the purpose in each area. The legislation would place a duty on the trustees to devolve management and ownership of their property on an estate by estate basis to local trusts by a specified date, subject to agreement by tenants. Those tenants who do not want such a transfer can opt to remain with the present Trust, which would then have a residual role, or to transfer to some other landlord such as one of the larger housing associations. Central government would assume responsibility for the outstanding loans relating to that stock. But new loans raised by the trusts, for example to fund renovation, would not be guaranteed by the Government. Local authorities would retain responsibility for other areas of housing policy such as the 'homeless' and home improvement grants. The cost to central Government of meeting the loan charges on the outstanding debt (£2.3 bn in 1984-85) would be roughly balanced by the savings in subsidy and reduced local authority requirement to borrow to fund refurbishment (£2.1 bn in 1984-85). Further details are at Annex A.

*What will
the Council
have to do?
Funding?*

Role of Initial Trusts

The trustees of each Trust would be appointed by the Secretary of State who would be required to include representatives of the tenants and of the local community. It is crucial that each trust has professional skills including legal skills to ensure that the trust deeds are adhered to and financial skills. We envisage that they might be similar in composition to the Boards of some of the larger housing associations, but with an element of tenant representation. The trust deeds would preserve the tenants' rights including the right to buy and requirement that rents be 'reasonable'. But rents would not be controlled, just as local authority rents at present are not controlled .

Transfer to Local Ownership and Control

The main function of these initial trusts would be to devolve control of the stock to estate level as quickly as possible. They are not intended as the long term way of running the stock since this would simply replace one monopoly landlord with another. But as noted above (and see below) they might have a residual role.

The deeds of each Trust would require it to break up the stock into the smallest viable management units (eg an estate or group of neighbouring streets) and give the tenants of each a choice of future ownership which would have to include a Trust set up specifically to run that estate with a wide measure of tenants' involvement and give those tenants with resources of their own the maximum opportunity to buy their homes or build up an equity stake. Tenants could be given other options such as those set out in Annex D. They would also require the successor bodies to bring their stock up to standard over a reasonable period and maintain it in satisfactory condition thereafter so that tenants could not simply opt for lower rents in the

expectation that a future government would be forced to subsidise the renovation of their housing. The Trusts would be required to have given tenants the opportunity to opt for and to complete the transfer of ownership of their stock by a specified date (say 3 years after the date at which one stock was transferred to them).

The initial trusts would also be responsible for appointing management and staff who initially would probably be some of the former local authority management and staff. Management would have an incentive to perform in the hope of keeping the managing contract once responsibility was devolved to local level. There would be a unique opportunity to break with restrictive working practice.

Allocations

An essential feature of these proposals is giving tenants more responsibility their housing. They are likely to use this in particular to take control of the allocation of new tenancies. This in itself will reinforce responsible behaviour since potential tenants will have to demonstrate that they will be acceptable neighbours. But it does pose problems:

- Local authorities will no longer have direct control over allocations but will still be responsible for housing homeless families.
- Tenants may discriminate on racial grounds between potential tenants.

In order to get over these difficulties we propose that the new trusts be required to publish an allocations policy, and have procedures for ensuring that it is adhered to. This policy would have to conform to race relations law. They would also have to allow the local authority nomination

rights over a proportion of vacancies arising for use by homeless families. But the trusts should retain as much discretion as possible over allocations because we think that tenants will favour families that are responsible and make good neighbours and that this peer group pressure is desirable.

In the longer term, the trusts and other private sector landlords will be free to build new rented housing. There should be scope within existing public expenditure totals to subsidise this to a limited extent because there will no longer be a need for public expenditure on new council housing. New private rented sector estates will also provide opportunities for better quality housing for existing tenants.

Financial Arrangements for the Initial Trusts

Because the outstanding debt on council housing will not be passed to the Trusts they will in aggregate have a surplus of income over current expenditure on management and maintenance. In 1984-85 this surplus was £1.3bn. We have examined the accounts of some local authorities and it seems likely that in most, but not all cases, council housing in each authority has a surplus of income over expenditure excluding debt charges (eg in Wandsworth there is a surplus of about £9 per house per week and in Barnet about £11 but in Hackney a deficit of £7 and Lambeth £5). Thus the trusts would in most cases be self-sufficient without Government grants and have a surplus which they might temporarily invest.

The stock inherited by the different trusts will vary widely in condition as well as rents. One option is to attempt to equalise the position of the trusts on the basis of some standard assumption about rent levels by requiring those whose stock is in relatively good condition to raise capital

to provide a 'dowry' to those whose stock was in poor condition. The aim would be to put each Trust in the position to charge the same rent to finance renovation of the stock to a given standard. Because the surplus of £1.3bn that the Trusts will have in aggregate is slightly more than sufficient to service index linked debt raised to finance the necessary refurbishment programme of £18.8 bn without raising rents, this 'equalisation' process could be effected and the renovation programme carried out without raising rents.

However, this process would be lengthy, would involve making subjective assessments of the cost involved and the rents that should be charged and would no doubt lead to dispute. Since almost all Trusts are initially more than financially viable, there is a lot to be said for the simpler approach with debt write-off but no equalisation. We expect that there will be three cases:

- low rents and poor stock will go together where councils have been unwilling to raise rents to keep the stock in good condition. Although they may need to raise rents to fund renovation, the resulting rent levels may be no higher than those in authorities that have not had to raise rents (eg Sunderland would have to raise rents from £12.40 to £15.60 a week, still lower than Birmingham at £17.00).
- In others, high repair costs will be associated with a large outstanding debt. Writing this off will tend to equalise rents (eg Barnet rents would rise but only from £22.70 to £25.50 a week).
- But in some areas, where tenants have been heavily subsidised by central and local government housing

is inefficiently managed and badly in need of renovation, rents may have to rise substantially (eg Hackney, Lambeth). Politically (and perhaps economically) there is a case for a transitional grant in these limited cases as part of a policy of 'writing off the mistakes of the past'. But the grant would be tapered to encourage the trusts in those areas to make rapid improvements in efficiency.

Despite the few examples in the last category a policy of no equalisation has a certain logic to it and it will be a much easier approach to explain to tenants than the alternative. We therefore favour it. Annex B contains some examples of the rent levels needed in particular authorities to fund running costs and the reported backlog of repairs reported in the DoE's 1985 survey. It takes no account of the scope for increased efficiency which must be substantial in authorities such as Hackney and Lambeth or the likely exaggeration of renovation costs.

Financial Arrangements for Local Trusts

But individual estates will face widely varying repair bills. As ownership is devolved to estate level rents will have to soar on estates in poor condition to fund renovation, and could be reduced on those in good condition unless some way is found to share the costs of refurbishment. The means of doing this is one of the most difficult aspects of this proposal since it will inevitably mean tenants on good estates meeting part of the cost of refurbishing poor estates. But if it is properly explained to tenants they will understand that it is fair. Tenants on good estates would otherwise receive an unwarranted bonus from the debt write-off and the equalisation would be no more than a continuation of the present system of rent pooling.

This process would start with the initial trusts making an assessment of the costs of bringing each estate up to a 'reasonable' standard. The precise scope of this exercise can be left to individual trusts to determine since it will affect their tenants alone. There then appear to be the following options:

- Those estates whose average cost is below that for the Trust as a whole will be required to raise private finance to provide a 'dowry' to those estates whose costs are above average. It could be left to local discretion to adjust the 'dowry' to reflect relative rent levels in the light of local circumstances (eg where a popular cottage estate had low rents but a high repair bill).
- The trust remains in being as a vehicle for raising private finance for renovating the stock to the 'reasonable' standard. Each trust could draw on the facility up to the amount required to bring their houses up to standard. Loan charges would be shared equally. This option would give less independence to the estate based trust than the first.
- There could be a differential debt write-off. The existing debt of estates with below average repair costs would not be fully written off. The reduction in public expenditure on debt charges would be used to finance a subsidy meeting part of the charges incurred on debt raised to fund repairs by estates with above average repair costs. This option would again give less independence to estate-based trusts and would involve continued public subsidy to some of them.

Public Expenditure

The note at Annex A contains a detailed assessment of the effect of the proposal on the various parties involved including the public sector. There would be an increase in public expenditure because central government would have to meet all the existing loan charge whereas at present they are largely met by tenants. But this increase would be almost completely offset within the public sector because local authorities would no longer have to incur capital expenditure on renovating the council house stock.

Cash Flows of Trusts

The effect of the proposal on tenants and the Trusts is more complex. We make a working assumption that rents are not reduced. The surplus of rental income over running costs is initially used to fund part of the increased renovation programme which we expect to take place. The balance is funded by borrowing. Existing rent levels should be sufficient to fund such a programme for many years though there would be a 'bulge' of debt as the backlog of renovation is cleared which will require rent increases in real terms amounting perhaps to a third spread over ten years (ie 50p per week at current prices per year), followed by a decline to a plateau about a sixth higher (£3 per week in current prices) than present rent levels. These rent increases are more modest than those since 1979 and should certainly be sustainable by tenants thus showing that the Trusts should be financially viable, on a non-profit making basis, in the long term.

The essence of this proposal is to allow a higher level of renovation expenditure to be funded by borrowing but to match this freedom by the discipline and opportunities of the market place. As such, there are no losers in the game

But how
do you
class land
surveys?
in LAB?
NB
needs to
win

in a cash flow sense (leaving on one side future rent increases); better quality housing for tenants is funded by investors who will gain a commercial return.

Effects on Assets: Gainers and Losers

However in a sense this proposal does involve a change in the assets and liabilities of the various parties involved. At present the taxpayer has a net liability because he has to subsidise council housing. Ratepayers have a modest asset because the small subsidy they provide is diminishing year by year in real terms whilst net rentals are at least keeping pace with inflation. Tenants have an asset represented by their right to a discount averaging 45% of the vacant possession price of the property. It is best to consider the effect of the transfer on assets and liabilities in two stages:

- the initial transfer
- the position once the stock has been renovated to an acceptable standard assuming it is and is not transferred to trusts.

Initially, taxpayers experience a substantial increase in net liabilities because they take on responsibility for the outstanding debt. The effect on ratepayers is broadly neutral because their loss of assets is matched by the loss of responsibility for servicing debt. There is no effect on tenants since the market value of their houses is unchanged. But the trusts gain substantial assets because they receive the houses but not the outstanding debt.

Renovating the stock does not affect the position of ratepayers or taxpayers if the stock remains in the public sector, since renovation costs are financed by new debt

serviced from increased rents. But if the stock is transferred to the trusts, their net assets decline since they take on new debt new debt but do not increase the value of their tenanted stock because the rental income which depresses its value is largely unchanged. Tenants gain because the market value of their houses improves.

Summary of Financial Position

Overall the proposal is broadly neutral on all parties in cash flow terms but it involves an increase in the net liabilities of the taxpayer, some increase in the net assets of the tenants and is broadly neutral for ratepayers and the new landlords.

Practicability

There are several practical objections that may be offered:

1. Tenants do not have the expertise to run their own housing.

This scheme does not require tenants to run their own housing, it gives them the option of doing so if they choose. But even then they would appoint professional managers to carry out day to day running of their housing.

2. Tenants may choose to neglect the condition of their houses, so forcing the Government eventually to reassume responsibility for renovation.

The trust deeds would require the initial Trusts to ensure that it and subsequent owners maintained tenanted stock in good condition.

3. Trustees might abuse their positions for political motives.

ms. Again, the Trust deeds would provide protection. It may be necessary to invent some sort of official 'policeman' to ensure that trustees are adhering to the trust deeds.

4. It would be difficult to raise finance on the scale or terms required to finance "dowries" and subsequent renovation work.

There is no net cost to whatever equalisation process is adopted. Renovation work will be carried out over a period of several years but annual expenditure will almost certainly be higher than the level of expenditure whilst in the public sector. The Trusts are intended to be firmly in the private sector and have no public sector guarantee. It will be for the Chancellor to take the demand for extra borrowing into account in determining fiscal and monetary policy and there is no guarantee that the private sector will be able to raise sufficient funds at acceptable interest rates. However, the Halifax have indicated (in the context of new building for letting under the assured tenancy scheme) that they might be willing to lend on index linked terms up to fifteen times net rental value provided rents were not regulated (which they would not be) and there is some evidence that the City could raise funds on appropriate terms, perhaps from overseas investors who are used to investing in rented property.

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5. The opposition could wreck the proposal by threatening to take the stock back into the public sector, to impose rent control or refuse to honour debts.

The opposition originally threatened to repeal "right to buy" but were later forced to support it. The inherent popular appeal of this proposal would eventually lead to a reversal of any similar threat. But the opposition are likely to be cautious about any statement likely to damage the viability of these trusts since it will clearly be to the disadvantage of the tenants on whose votes they depend.

EFFECT OF PROPOSALS ON CASH FLOWS OF TENANTS, RATEPAYERS,
TAXPAYERS AND TRUSTS

First Year After Transfer: Assumptions

The figures below show the effect, based on 1984-85, of transferring the council housing stock to private trusts. It shows in the first column cash flows assuming the stock remains in the public sector and in the second assuming that the stock had been transferred to a private Trust at the start of the financial year. It is also assumed that private sector trusts undertake a renovation programme twice as large as that in the public sector would have undertaken and fund it partly from the surplus of rents and partly from borrowing. Positive figures indicate receipts, negative ones expenditure.

<u>Taxpayers</u>	£ billion		Table 1
	Present	Proposed	Change
Subsidy	-0.4	Nil	+0.4
Debt charges subsidy	Nil	-2.2	-2.2
TOTAL	-0.4	-2.2	-1.8
FINANCED BY:	Taxation/ borrowing	Taxation/ borrowing	Taxation/ borrowing
<u>Ratepayers</u>	Present	Proposed	Change
Rents	+3.8	Nil	-3.8
Subsidy	+0.4	Nil	-0.4
Running Costs	-2.3	Nil	+2.3
Existing debt charges	-2.2	2.2	+2.2
New debt charges	-0.1	Nil	+0.1
Debt charges subsidy	Nil	2.2	+2.2
Capital Expenditure on Renovation	-1.2	Nil	+1.2
TOTAL	-1.6	Nil	+1.6
FINANCED BY:	0.4 rates 1.2 borrowing	Not Applicable	Reduced Borrowin

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Public Sector (Taxpayers & Ratepayers Together)

Total Taxpayers	-0.4	-2.2	-1.8
Total Ratepayers	-1.6	Nil	+1.6
TOTAL	-2.0	-2.2	-0.2
FINANCED BY:	Rates	Reduced	Increased
	Taxation	Rates/	taxation/
	Borrowing	Taxation/	reduced public
		Borrowing	expenditure

Tenants

Rents	-3.8	-3.8	Nil
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Trusts

Rents	Nil	+3.8	+3.8
Running Costs	Nil	-2.3	-2.3
New Debt Charges	Nil	-0.1	-0.1
Capital expenditure	Nil	-2.4	-2.4
TOTAL	Nil	-1.0	-1.0
FINANCED BY:	Not	Borrowing	Borrowing
	Applicable		

Comment

These figures show that in essence the proposal involves funding a higher level of housing renovation by higher private sector borrowing. The effect on public sector cash flow is broadly neutral though there might be a small amount of additional expenditure which could be funded, assuming a fixed PSBR by lower tax cuts on reductions in public expenditure elsewhere. In particular, this proposal involves an end to new council house building which at present costs £0.6 billion a year.

Steady State Position: Assumptions

As far as ratepayers are concerned, the financial position in later years differs little from that in year 1. The position of taxpayers depends on the precise profile of the outstanding debt charges and how the Chancellor of the day chooses to finance them. If he chooses to finance them by borrowing, there would be further interest charges to meet on this borrowing. We assume that a renovation programme of £18.8 bn is required to bring the stock up to standard and that in addition £1.2 billion needs to be spent to deal with newly arising problems. The £18.8 billion figure may well be an over-estimate since it relies solely on local authority figures, some of whom clearly have an incentive to exaggerate the position. The £1.2 billion is chosen as the level of expenditure incurred over the last few years which has, at most, been sufficient to stop the condition of the stock getting worse.

We assume that the new trusts undertake a programme to clear the backlog of renovation work with the following profile in real terms:

Table 2

	Year 1	Years 2 to 10	Year 11	Years 12 Onwards
Backlog	1.2	1.8	1.4	Nil
New problems	1.2	1.2	1.2	1.2
TOTAL	2.4	3.0	2.6	1.2

We assume that part of this programme is funded at existing rent levels but that the balance is funded by borrowing or index linked terms at a multiplier of 15. Rents are increased only to the extent necessary to ensure that borrowings in any year do not exceed capital expenditure.

The results of this analysis are in table 3.

Comment

Existing rent levels should be sufficient to fund the proposed renovation programme for a considerable period. Eventually rents will have to rise, perhaps by about 2½% a year in real terms to ensure that the trusts maintain on a sound financial footing and maintain their stock property. Eventually, as debt is retired, rents will no longer need to be increased and could start to decrease. Rents might peak (in about 2015) at about a third above their present level in real terms and then decline to a steady state (in about 2026) at about 16% above present levels.

No reliance should be placed on these figures in a precise sense. A simple analysis of this kind can take no account of many relevant factors such as the scope for reducing costs, charging requirements, right to buy sales or future financial conditions. Nevertheless it shows that this proposal is viable as a long term solution to the financing and maintenance of the council stock.

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ANNEX A - Table 3

	Year 2	Year 10	Year 11	Year 12	Year 25	Year 26	Year 27	Steady State
Rents	3.8	3.8	4.0	4.1	5.1	5.2	5.0	4.4
Running Costs	-2.3	-2.3	-2.3	-2.3	-2.3	-2.3	-2.3	-2.3
Loan Charges on Outstanding Debt	-0.1	-1.3	-1.5	-1.7	-2.7	-2.8	-2.8	-2.0
Loan Charges on New Debt	-0.1	-0.2	-0.2	-0.1	-0.1	-0.1	-0.1	-0.1
Renovation	-3.0	-3.0	-2.6	-1.2	-1.2	-1.2	-1.2	-1.2
Balance to be financed by borrowing	-1.7	-3.0	-2.6	-1.2	-1.2	-1.2	-1.2	-1.2
Total loans outstanding	-2.7	-22.0	-24.6	-25.8	-41.4	-41.6	-41.5	-30

- Assumptions:
- i. Borrowing for 25 years on index linked terms with repayments 1/15 amount borrowed (ie an index linked interest rate of about 4.39%).
 - ii. Borrowing limited to amount needed to fund renovation programmes.

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ANNEX E - Table 4

EFFECT OF PROPOSAL ON LOCAL AUTHORITY RENTS

	£ per week	£ per week	£	£ per week	£ per week
	Existing Rent	Management & Maintenance	Renovation - Total Cost Per Dwelling	Renovation - Loan Charges	New Rent
Hackney	12.50	19.60	12,139	15.60	35.20
Lambeth	15.20	20.60	14,111	18.10	38.70
Wandsworth	21.60	13.20	5,608	7.20	20.40
Westminster	22.30	20.80	6,083	7.80	28.60
Barnet	22.70	12.90	9,804	12.60	25.50
Bromley	18.50	12.50	1,128	1.40	13.90
Birmingham	15.60	8.40	6,670	8.60	17.00
Liverpool	15.20	7.20	4,425	5.40	12.60
Sunderland	12.40	6.60	7,050	9.10	15.60
Bristol	14.70	9.10	2,508	3.20	12.30
Nottingham	15.10	7.80	4,339	5.60	13.40
Tunbridge Wells	15.00	9.00	2,039	2.60	11.60
Tewkesbury	15.80	9.00	5,027	6.40	15.40

Note: These estimates look at rent levels in individual authorities assuming the outstanding renovation costs are met by borrowing on index linked terms at a multiplier of 15.

ANNEX C

TRANSFERS OF ASSETS AND LIABILITIES

Assumptions

The capital value of assets and liabilities is determined on the basis of a multiplier of 15 times (ie a discount note of about 7%) the income stream, where there is no ready market, since this is the basis used by the Halifax Building Society for valuing rented housing in real terms at unregulated rents. Conventional loans are valued by discounting loan charges at the same 7% rate assuming an inflation rate of 3% (which has been approximated by a multiplier of 10) index-linked loan on the basis of principal outstanding which increases in line with inflation. Assets with an open market valuation, such as owner occupied housing is valued on that basis.

Table 6 gives estimates of the assets and liabilities of the various parties involved immediately after the transfer of housing to the new trusts and twelve years later (ie once the backlog of renovation is supposed to have been tackled by the trusts) in two cases:

- a. that the transfers take place
- b. that the transfers do not take place.

In the second case two renovation options are considered:

- i. the public sector carries out the same renovation programme as the private trusts costing £33.2 bn.
- ii. the public sector renovation programme continues at its present level costing £14.4 bn.

In the second case, rents are assumed to rise to meet index linked loan charges in full amounting to 1/15 the capital cost.

ANNEX
C

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The renovation programme is assumed to increase the vacant possession market value of the stock by half the cost of renovation.

The key figures underlying the valuations are as follows:

	<u>Table 5</u>
	£ bn
Net rental: income before loan charges initially	1.5
Net rental: income before loan charges eventually	1.7
Case bi.	3.7
Case bii.	1.8
Central government subsidy case	0.4
Vacant possession market value of property initially	75
Vacant possession market value of property eventually	
Case a	91.6
Case bi.	91.6
Case b	82.2

Annex C - Table 6

£ billion	At Time of Transfer		Transfer	12 years later	
	Before	After		No Transfer Full Renovation	No Transfer Partial Renovation
TAXPAYERS					
<u>Liabilities</u>					
Subsidy	-6	Nil	Nil	-6	-6
Loan charges subsidy	<u>Nil</u>	<u>-23</u>	<u>-23</u>	<u>Nil</u>	<u>Nil</u>
TOTAL	-6	-23	-23	-6	-6
RATEPAYERS					
<u>Assets</u>					
Houses	23	Nil	Nil	56	27
Subsidy	6	Nil	Nil	6	6
Loan Charges subsidy	Nil	23	23	Nil	Nil
<u>Liabilities</u>					
Debt	<u>-23</u>	<u>-23</u>	<u>-23</u>	<u>-56</u>	<u>-37</u>
BALANCE	6	Nil	Nil	6	6
TENANTS					
<u>Assets</u>					
Right to Buy Discounts	34	34	41	41	37
TRUSTS					
<u>Assets</u>					
Houses	Nil	23	26	Nil	Nil
<u>Liabilities</u>					
Debt	<u>Nil</u>	<u>Nil</u>	<u>-25</u>	<u>Nil</u>	<u>Nil</u>
BALANCE	Nil	23	1	Nil	Nil
GRAND TOTAL	<u>34</u>	<u>34</u>	<u>45</u>	<u>41</u>	<u>37</u>

ALTERNATIVE FORMS OF TENURERenting

Rented housing can be owned by a variety of types of landlord. These can include:

- i. private companies or individuals;
- ii. subsidiaries of building societies;
- iii. housing associations;
- iv. housing co-operatives;
- v. trusts.

The main features distinguishing these options are:

- the extent to which they are profit making;
- the regulatory/legal framework within which they operate;
- the degree of tenant involvement.

Shared Ownership

Shared ownership allows tenants to rent a part and buy the other part of their house. The rented portion is essentially financed on the same basis as fully rented housing. The purchased portion would be financed by a mortgage, probably on conventional terms. Over a 10 year period, the costs for a tenant in a house costing £18,000 at a full rent of £18 a week purchasing 50% with housing prices growing at 8% a year might be:

CONFIDENTIAL

Initial Rent:	:	£9 per week
£9,000 mortgage over 25 years	:	£17 per week Net of tax relief
Value of house after 10 years	:	£19,400
Balance outstanding after 10 years	:	£7,200
EQUITY STAKE	:	£12,200

Fully Mutual Co-operatives

A fully mutual is a co-operative of which all tenants are members and all members tenants. The co-operative is entitled to mortgage interest relief whilst individual tenants are entitled to housing benefit. Tenants's rent is used to pay running costs plus repayments on a mortgage. Tenants can be given the option of converting to owner occupation at any stage by refinancing their portion of the mortgage. Typically this would be done when a tenant wished to move so that he captures equity growth in full by selling his house. The cooperative could have a right to repurchase so that the house could then be occupied by a new tenant on the same basis but at a higher rent.



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round to Tsy
Officials*

PRIME MINISTER

FUTURE ROLE FOR LOCAL AUTHORITIES

I promised to let you have a note describing how I see the problem of defining a future role for Local Government.

A. The Problem

Local Government has over time shifted from a primary concern with the provision of utilities like gas, electricity and water to the provision of labour intensive services like education, personal social services and housing. This shift has been accompanied by a huge upsurge in manpower allowing a growth of deeply entrenched trade union powers. Moreover local authorities now administer over one quarter (£31½ billion in England) of total public expenditure of which in England they raise £13½ billion locally, of which £6 billion is raised from business ratepayers and £7½ billion from other ratepayers. Of the amount raised from the domestic ratepayers only about one third on average of those eligible to vote pay full rates. There are significant variations around that average in different authorities.

The enormous spending power of local authorities combined with the very limited accountability to their local electorate and central government determination to restrain and if possible reverse the remorseless annual growth in local government expenditure has led to increasing conflict with central government. Though the Layfield Committee Report had much in it with which we disagreed, its central message was prophetic. It argued that local authorities had acquired powers of expenditure far greater than their effective financial responsibility and that it was necessary to bring these into line. If local authorities went on spending far more than they raised locally, central government would be forced to interfere increasingly in their activities. At the same time local government's incentives to spend prudently and efficiently would be undermined.

*Ridley
→ P.M.
28/1*



The years since Layfield have illustrated precisely that dilemma. We have chosen and have been forced to try and control local government spending. We have had some success but have paid a heavy price. We have markedly reduced the annual rate of real growth in local authority spending, and have made local government and the public aware of the enormous scope for efficiency savings. But we have not reduced the level of spending as much as we had hoped; we have had little effect on local authority manpower; we have alienated many of our supporters in local government, who would have preferred a quieter time; and the grant system has served to point up the defects of the present rating system only too clearly.

All this has led to a high level of tension between central and local government. This, and recent policy developments also raise the question of what should be the functions of local government in the future. Some of our major policies for the next Parliament will raise that question even more starkly. We are changing the role of local government in relation to transport away from their role as providers to 'enablers'. We are looking at the ways in which housing and education is provided.^x We are seeking to secure better value for money by introducing compulsory competitive tendering for an extensive range of services. But we have not looked at the cumulative effect of these policies on the future role of local government.

^x We are also transferring polytechnics away from Local Authorities

There is already a feeling in local government of a vacuum in Conservative circles about "where we are going" in local government. The Labour Party's policy which, though generally unpopular, impractical and internally contradictory, strikes a chord with councillors and not just Labour Councillors. They are proposing an extension of the present role of local authorities as providers; the retention (with amendments) of the present rating system; a removal of all central government controls and high levels of government grant. It is not difficult to ridicule this plan for the future. But we must find our own design for



the future which both voters and Conservatives in local government will support. It will be argued that we are removing more and more of their powers and present functions without giving anything worthwhile in return. I believe it is important for the Party to attract good people - businessmen and local leaders of society - into local government not only because it means better local government but because we rely on these people to work for us locally. Though the housing and education policies we are discussing are long term, the question of the future role of local government will be raised as soon as they become public and we will have to say something about our thoughts in the Manifesto.

B. Why do people become Councillors?

Our new prospectus for local authorities must be attractive to Conservative Councillors. It is useful to start by considering what attracts people into local government. Overwhelmingly the main reason seems to be a genuine desire to represent and serve the local communities in which they live. They may be spurred into local politics by a particular experience when, as residents or businessmen, they have come up against a local authority over a planning issue for example. Others go into local government because they hold strong political beliefs and enjoy political debate; they see local government as a way to influence the local and/or the national political debate. Some go into local government as a stepping stone to national politics; this is very valuable for us. There are also many who enjoy the power of patronage to be derived from control over the spending of large sums of public money. Finally there is an interest in the management of local services.

Of these factors the first two are undoubtedly the most important. Management and control of large budgets are not in themselves attractive to people who may spend the rest of their lives in management and look to local government for something



else. Nor do they have the time necessary. The representative function is still strong and healthy: the continuing popularity of service on parish councils is evidence that people are willing to perform the representative function without administering any services.

Many councillors, but particularly our opponents see Local Government as a political power base. The Met. Counties and the GLC attracted people who were given great power to influence the political debate but had little direct management responsibility. The GLC for example found it difficult to fill the Chairmanship of the Fire Services Committee because even though management was important and the budget was large there was little political content or local discretion. Recent years have seen an increase in complaints by local authority officers that elected Labour and Alliance councillors are interfering in the management of services. This happens I believe not because they are interested in management per se but because they are trying to achieve political objectives by other means.

How councillors see themselves is not of course the same thing as how people see local councillors and local government. Only at the lowest level of local government do people see Councillors as representatives; very few people know the name of their local councillor or have a clear idea of what function he is there to perform. Local government often seems remote and impersonal. The constant redrawing of boundaries to achieve administrative ends has tended to destroy the connection of local government with what people think of as "local communities". People feel that they can get more done locally by writing to their MP than by going to see their councillor. Another interesting point is what people perceive to be "local" as opposed to "national". If you asked someone to accept the proposition that he should accept entirely different standards and styles of education or housing or policing or fire prevention, simply because of some innate difference in the character of his area or local authority, he



would find that unreasonable. On the other hand there is a strong suspicion of centralisation and a strong feeling that there should be local democracy.

C. The future prospectus.

The consequences of our policies concerning the largest and most important local government services will be, over time, to remove the power of local authorities to provide services directly and to remove their power to control the market in those services. As much as possible will be returned to the market and delegated to those most directly interested in the service, both individuals and groups such as tenants or parents. The Transport Act effectively removes local authorities' role as direct providers (through PTEs and municipal bus companies). It also removes their ability to provide general subsidies to public transport and undermine the pricing mechanism. I have minuted you about a new housing policy which will aim over the long term to remove local authorities as direct providers of housing. It will also remove their powers to set rents which are unrelated to market rents, and will remove their powers to transfer resources between the housing revenue account and the rate fund revenue account. Our education policy should, over time, lead to the removal of most schools and polytechnics and their funding from local authorities altogether. The extension of contracting out whilst leaving the resource control of the services concerned in the hands of the local authorities will lead to much more provision of services by the private sector.

Over the last few decades, health, water, sewage, gas and electricity have also been removed from local authorities - so there is nothing new in this trend: but although local government will continue to have a role in enabling, managing and administering these services for some time to come, it is a very different role to the management of large and expensive services.



At the same time as these policies are working through over the life of the next Parliament and beyond, we shall be introducing the community charge and a new system of government grant to local authorities. This will provide better local accountability and our supporters hope that it will also mean less government intervention in the affairs of local government. In looking at the post-Green Paper world we have not really thought deeply about what "local discretion" there will be.

Our plans probably involve transferring three quarters of local authority spending from their direct control to that of others. We are therefore getting near the point where, apart from some sort of needs grant, authorities will be able to raise the bulk of their revenues through the community charge.

If we believe in the theory of accountability, we should, I would argue, accept that where local authorities raise money locally to pay for local services and everyone who votes contributes to the costs as well as enjoying the benefits, we will no longer need to control that spending. It can be argued that the choice of voters in these circumstances is the same as the choice they make in buying a washing machine or a car. So though local authorities will have less freedom to control or finance the big services, perhaps they should be given more freedom to spend on the truly local "parish pump" services; local environmental services, grants to local groups, arts, sport, leisure, pump priming finance for local businesses and so on. So long as most if not all of the money for this is raised locally on a broad tax base, there may be less need for us to control it.

We should also look at enhancing the representative role of local councillors. This is the most important role in the eyes of our councillors. Local authorities already spend a lot of time discussing matters for which they have no direct management responsibility. I am not referring here to the Labour councillors who waste time debating defence and foreign affairs.

✓
with all
the provisions

parish
analogy



Most authorities take a close interest in services like local health services, drainage, water and bus and train services. They are to some extent self appointed consumer 'watchdogs' and in this I think they can perform a valuable role. It might be worth considering whether with money raised locally, they might be given 'top-up' powers. For example where British Gas is not prepared to lay gas mains, they might be given powers to negotiate a price with them. Or if there is a local demand for a particular health service facility above the basic standard of provision, they might be able to pay for it from the community charge. They could even use this power to "top up" schools which have opted out. This is precisely what they do with bus services now.

What would local authorities make of this role and what would they do with these powers? Some will argue that left-wing local authorities will abuse these powers to attack the Government, to fund extreme causes, to make more of a nuisance of themselves on national issues and so on. But if they are truly accountable to their voters then either they will not behave in that way if they wish to remain in office or if they do then we have to assume that their activities reflect the choice of the local community as to how their money should be spent. It requires courage to accept this proposition. But if we do not, I do not think that the future we offer the good as well as the bad in local government is an attractive one. I also think that taking away the big spending power base of local authorities, will make being a councillor much less attractive to ambitious left-wing councillors.

The policies we are pursuing also raise questions about the structure of local government. I am not proposing that anything should be said now about that, because from past experience, changing the structure of local government has not been popular. But we should realise that in removing so much power from local authorities over the major services, we are going to be drawn - willy nilly - into structural change. In particular, there will



be a big question mark over the future of county councils. We are already in the process of removing their planning powers. They have little political influence at all over the fire or police services, and less over transport (except as providers of local roads and subsidy for uneconomic bus services). We are effectively looking to remove education as well. This will leave them like the GLC and the Met. Counties as a tier of government with too little to do - and we do not want two tiers of representation. There will continue to be important functions to be done at a county or wider regional level (like allocation of funds to police, fire services and so on). But they could be done by lead authorities or by joint boards of smaller authorities, or by a diversity of arrangements.

If we were to move to unitary authorities for local government services, what shape should these authorities take? I feel there is a need to achieve a closer identity between local authorities and the communities they serve so that local councillors are seen as the first port of call by local people to represent their interests. This may eventually mean some redrawing of boundaries to reflect areas more recognisable as having a "community of interest". I also believe that it would be better to have single member wards with fewer councillors overall. We might also consider a system of elected mayors. The elected mayor can provide a figurehead representing both an embodiment of the local community and local pride and be the leader of the local authority. We have in any case to think about this whole area in the context of the Widdicombe report.

Finally planning is properly a local authority function. It provides one of the major attractions to Conservatives in local government as it gives a real power to improve local events. I would not propose to remove planning powers from them. It is the present function which most clearly fits the representation role described above.



Conclusion

To sum up, I think we can make an attractive future role for local authorities as representatives of the community, providing a number of minor and relatively inexpensive services, and possibly 'top-up' powers, but acting mainly as enablers, and regulators in the interests of their local communities. They would pay for these services mainly from the money they raised through the community charge from all local residents. I even think such a role may be more attractive to good local Tories, and less attractive to power hungry left-wing activists.

A handwritten signature in black ink, appearing to be 'NR' with a flourish.

NR

28 January 1987

COPY NO 1 OF 1



Alex - no copies?

PRIME MINISTER

1. This is the housing policy paper which I have told you I was preparing. I am also sending a copy to the Chancellor of the Exchequer, but to no-one else.

Political Objectives

2. Council housing is one of the main bastions of the dependency culture fostered by municipal councils. By keeping rents unrealistically low they have created client groups among local residents. By building huge estates maintained by direct labour organisations they have created client groups among the local workforce. When we have taken steps to make it difficult for them to sustain low rents or inefficient working practices by borrowing or by subsidy from the rates, they have cut costs by allowing a backlog of disrepair to build up - which they have blamed on national policies to restrain capital spending. We cannot afford to allow this to continue.

3. Our main political objectives are four: to reduce dependency by breaking up the monolithic council estates and by getting as many of these homes as possible transferred to alternative ownership; to continue to increase owner occupation (by up to 1 million more homes in the next 5 years); to revive the private rented sector in order to create a market in rented housing, to assist mobility of labour and to restore freedom of choice to those who prefer to rent; and to achieve all these three objectives at reduced cost to the public sector, taking account of both current and capital costs.

4. I would express these four political objectives in rather different form for inclusion in the Manifesto. I would put our policy like this:



"We have given council and housing association tenants the right to buy their homes. Over 1 million have now exercised that right. During the next five years we expect another million more to become home owners. We will continue tax relief arrangements that make it easy for people to buy their homes.

But we must help those people who feel trapped as tenants in the monolithic and soulless council estates. We must improve the quality of housing and secure the right to rent for those who will continue to find it more advantageous to rent or who cannot afford to buy. They should have the right to choose whether to rent from the Council, a Housing Association, or a private landlord. Indeed, council tenants should have the right to choose to have their homes owned by a Trust or a co-operative which they control, or another landlord if they are unhappy with the choice and quality of housing offered by their Local Authority landlord.

? ?
We want to attract private investment into rented property again. We shall restructure housing benefit so that everyone can afford to pay the rent necessary for a reasonable house or flat, while landlords can receive an adequate return on their investment to enable them to maintain the property at a good standard. We shall tighten up on safeguards against harassment and exploitation.

This policy will enable us to tackle the neglect by some local authorities of their housing stock, and to bring shortages of rented accommodation to an end."

Financial Mechanisms

5. The policy seeks to provide a means of implementing these objectives. The key point is that - unless we provide some subsidy to the rented sector analogous to mortgage interest tax relief,

I thought Ridley was against this ??

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true?*



which I discuss in paragraph 17 below - rents need to be increased by some 75-100%. This is necessary to enable local authorities to maintain and replace their stock properly and to make it possible for private landlords to secure an adequate return on their investment.

what assumptions?

6. For the private rented sector the main step that is needed to increase rents to more economic levels is to repeal the present Rent Act controls. I envisage that in the first instance we should only remove the controls on new lettings. For existing tenancies we should provide for a gradual increase to economic levels over a transition period of, say, 5 years, with perhaps rather longer in London.

7. For local authorities we could prescribe rent increases by statute. But that is a controversial route which led us to the Clay Cross imbroglio in the 1970s. I think we shall do better to subject them to financial pressures that will impel them to increase rents, without actually determining the rents themselves centrally.

8. A possible way of achieving this is set out in Annex A. Essentially it involves ring-fencing each authority's current and capital expenditure on housing in a single account; forbidding subsidies from (or to) the rates; and requiring each authority to meet the cost of housing benefit for its tenants from this account. Such an account would normally be in deficit for each authority, and would, therefore, have to be balanced by external finance which we should control. This external support - it would be analogous to the "needs grant" in the new local government finance system - would replace the present Exchequer subsidies for housing, Exchequer support for housing benefit, the housing element of the rate support grant, and capital allocations and borrowing by authorities for housing. In addition to providing us with a lever for ensuring the rents and maintenance costs are kept at economically sensible levels, such an arrangement would lead to



Exchequer savings by compelling authorities to utilise receipts from housing sales in areas where there is little or no need for further investment in council housing to meet the costs of housing benefit in the area.

9. The effects of increasing rents to economic levels under the new arrangements would be to encourage many more people to buy their council houses. It would also make it economic for private investors to buy council houses and continue to let them to tenants who, with the help of housing benefit if necessary, would pay rents which provided an adequate return on the investment. If this were combined with a "right to change one's landlord" if a majority of tenants so wished, we could see quite large scale transfers of council housing to ownership by Housing Associations, tenant co-operatives or trusts, and private landlords (including Building Societies in a new role).

Implications for Housing Benefit

10. At the end of the transition to higher rents there will be few in rented accommodation who do not need benefit. There will be an unsubsidised top end of the rental market, mainly in London; but most who can afford to will buy (with the help of tax relief) rather than pay economic rents. It will be necessary to remodel housing benefit so that public and private sector landlords cannot exploit the system by driving rents or standards of provision to excessive levels at the expense of the Exchequer. We shall need to set a maximum level for benefit in each area for a range of types of dwelling so as to avoid this. The areas to be used for this purpose would need careful consideration. In setting their boundaries we should need to take account of differences in property values both between different parts of the country and, at a more local level, between more and less desirable parts of a town.

*Annally
noted*

ghostly admin implications.



11. The level of the benefit ceiling in each area would be a critical instrument of housing policy since it would ultimately be the main determinant of rents. For this reason, and because Exchequer support for housing benefit would form an integral part of the support arrangements for local authorities' unified housing accounts, it might be sensible for housing benefit policy to revert to DOE. Whether or not this is done, I think we should take a close look at the rules to see whether, in the longer term, we can find a way of ensuring that households pay at least some part of the cost of their housing from their own pockets. I am concerned that if we do not, there is simply no incentive for the poorest tenants to take any interest in whether their housing is provided at reasonable cost.

Public Expenditure Effects

12. A balance sheet of all these moves is enclosed, showing likely public and tax expenditure over a 15 year period (Annex B). To do these calculations, we have had to make some assumptions about the rate of public sector capital expenditure. Solely for this purpose we have assumed that the "£19bn backlog" (I do not accept the figure, and it is only used as an illustration) will be eliminated by the end of the century. Whatever figure is used it will not affect the balance sheet - merely the total of public expenditure for each scenario. We have also assumed that over the same period enough new housing will be built by the private or public sectors to meet present forecasts of household formation.

13. The figures show that, although with the new policies housing benefit costs more, there is a large inflow of additional capital receipts, some increased rent from public housing and less need for new public sector capital investment than if we were to continue as at present. By reducing the numbers in the public sector and getting the maximum private sector contribution towards housing investment as well as by increasing the income from rents, we can save a great deal of what will otherwise inevitably be a



very big public expenditure bill over the next 15 years. On the assumptions we have made the total result of the policy might be a saving of £23bn by 2001, by comparison with continuing with existing policies, though different combinations of assumptions may alter the figure to some extent.

The Next Steps

14. Policies which increase rents and which deprive local authorities of a part of their empire are bound to be controversial. Nevertheless, I believe the arrangements outlined above rest on the bedrock of a growing consensus about the future of rented housing. First, it is accepted by most shades of political opinion that the huge council estates should be broken up in the interests of greater diversity and choice for tenants. Second, there is increasing recognition that it makes sense to get private investment back into rented housing because total reliance on the public sector is economically damaging and does not produce the best results for tenants. Third, there is a growing awareness that financial systems that conceal the true cost of building and maintaining housing can only be damaging in the long term. For all these reasons I would judge that if we are successful in establishing these new policies they will not be easy to reverse.

15. There is, of course, a great deal more work to be done to develop all this. As with the local government finance studies we shall need to develop the policy instruments and analyse their effects in detail. We shall need to look at the effects on household payments and housing supply in different parts of the country and within representative urban areas, to estimate gainers and losers, and to explore transitional arrangements. Before we embark on all this I should, however, like to be clear with you and Nigel that we are on the right track, and that we should be thinking in terms of preparing the policies and the major legislation that will be needed for introduction as soon as we can get it ready - and at the latest in 1988/89.



16. One final point. The arrangements I have described above get much closer to economic realities than the present housing system. Rents are related to the true value of properties. The help that tenants are getting is clearly visible as housing benefit and is not hidden away in the form of artificially depressed rents. But we shall still be some way away from a true market system because owner occupiers will continue to get help in the form of MITR. This will make the cost of owner occupation lower than that of renting, with the consequence, discussed above, that the remainder of those who can afford to will buy their homes, and the overwhelming majority of tenants who remain will be on housing benefit. Thus our arrangements for housing benefit will be the dominant factor in determining rents. That in turn will mean that we shall not be able to count on market pressures on rents to determine the pattern of supply of rented housing, but will have to continue to rely heavily on administrative measures.

17. The problem arises because of the imbalance between the costs of renting and the costs of buying. One way of correcting this would of course be to abolish MITR. Another would be to make a roughly equivalent subsidy available to landlords. This option is shown in Annex B in the "30% assistance" column. On the assumptions we have used, it is actually cheaper in public expenditure terms than the "full economic rents" option because private investors would find it more attractive to put money into rented accommodation, so that public sector provision need not be so great. It might be useful for us to talk over the implications of this at an early stage.

A handwritten signature in dark ink, appearing to be the initials "NR" with a stylized flourish extending to the right.

NR

28 January 1986



ANNEX A

UNIFIED HOUSING ACCOUNTS FOR LOCAL AUTHORITIES

1. A unified housing account (UHA) would include all receipts and payments, current and capital, relating to a local authority's role as landlord, but would be ring-fenced from the remainder of the authority's finances.

2. The major categories of receipts would be:

gross rents received
capital receipts
interest from investing receipts or granting mortgages on properties sold

The major categories of payments would be:

housing benefit for the authority's tenants
capital payments
loan charges on past borrowing and any new borrowing management and maintenance.

3. For almost all, possibly all, housing authorities such an account would be in deficit. The authority would no longer be allowed to make contributions from the rate fund. The assessed deficit on the UHA would be the authority's external financing requirement (EFR) for housing, and would be met by grant from DOE, possibly in combination with borrowing approvals. This new grant would replace exchequer subsidies for housing and housing benefit and the relevant element in block grant. Public expenditure on local authority housing would be redefined as the total EFRs for all authorities.

4. The EFR for each authority each year would be calculated by DOE on the assumption that rents, capital receipts and management



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and maintenance expenditure would all be at the desired level. The amount of grant (plus any borrowing approvals) would then be:

(the lower of actual or assessed payments) minus
(the higher of actual or assessed receipts).

5. This would provide a powerful financial instrument for raising rents, because the level of rent income assumed in calculating the EFR could be raised progressively until it represents an adequate return on capital value, and local authorities would have only very limited room for manoeuvre. The UHA would also prevent a situation arising in which heavy central government expenditure on housing benefit would exist side by side with large surpluses on local authorities' housing accounts (because of high rents), and some authorities would have large stocks of capital receipts (because of increased sales) but little or no requirement for further capital expenditure. The UHA would allow rent income and capital receipts to be utilised to meet the cost of housing benefit, so that exchequer help could be concentrated on those authorities with the largest deficits even on this basis, in other words those with the greatest need for capital expenditure and the lowest incomes among tenants.

ESTIMATE OF THE "BALANCE SHEET" FOR ALTERNATIVE POLICIES ON RENTS AND SUBSIDIES

(£ million at 1986/87 prices)

What happens in individual transitional years?

	1986/87 Est. Out-turn (a)	Cumulative 1986/87 to 2000/01			"Steady State" Year(2000/01)				
		Basic Case	Full Economic Rents	30 Percent Assistance	Basic Case	Full Economic Rents	30 Percent Assistance		
<u>Local Authorities</u>									
(1) Exchequer subsidy and RFC	1,044	32,100	-16,800	-2,700	+2536	3,600	-5300	-2,000	-500
(2) Housing benefit	1,855	29,700	61,200	48,000	+345	2,200	+3600	5,800	4,200
(3) Gross capital expenditure (HRA)	1,927	47,900	41,900	38,500	-227	1,700	-300	1,400	1,400
(4) Capital receipts	-1,515	-10,800	-19,600	-18,100	+1315	-200	-100	-300	-300
Sub-total (rounded)	3,300	98,900	65,900	65,790	+4000	7,300	-2400	4,900	4,800
<u>Housing Associations</u>									
(5) Capital, etc	820	12,300	5,000	5,000	-	820	-820	nil	nil
(6) Housing benefit for HA tenants	220	4,800	11,700	10,200	+180	400	+800	1,200	900
Sub-total (rounded)	1,050	17,100	16,700	15,200	+150	1,200	0	1,200	900
<u>Private rented sector</u>									
(7) Housing benefit	290	4,200	11,000	10,500	+10	300	+800	1,100	1,050
(8) 30 percent subsidies (a)	...	...	...	3,300	...	...	...	...	200
(9) Tax on rental income (b)	-250	-3,000	-4,900	-4,500	+100	-150	-250	-400	-350
Sub-total (rounded)	50	1,200	6,100	9,300	+100	150	+650	700	900
(10) Owner-occupiers' tax relief	4,050	76,400	80,900	79,800	+1200	5,250	+600	5,850	5,700
(11) Private sector renovation and clearance	590	8,850	9,850	9,850	+10	600	+150	750	750
(12) Administration	150	2,250	2,250	2,250	-	150	-	150	150
(13) <u>Housing PSBR</u>	9,200	204,700	181,700	182,000		14,650		13,550	13,200
					+5450		-1100		

Notes: (a) Includes grant paid on improvements
 (b) Shown negative, because it is a deduction from expenditure

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ESTIMATE OF THE BALANCE SHEET FOR ALTERNATIVE POLICIES ON RENTS
AND SUBSIDIES ASSUMPTIONS USED

New Building

The increase in the number of households was estimated from future changes in the adult population and allowance made for the increase in owner-occupation by Right to Buy and in other ways. Although with the increase in owner-occupation the total rented housing stock will fall, new building will be needed to offset in part the sales for owner-occupation. In the "basic case" all the new building is done by local authorities apart from a continuation of the present rate of building by Housing Associations. In the "full economic rent" case, new building for rent by the private sector replaces building by local authorities over a 10 year period. In the "30 percent assistance" case aided building for rent by the private sector replaces local authority building over a five year period.

Renovation

Expenditure sufficient to eliminate the estimated amount of dis-repair by the end of the period (2000/01) is allowed. Expenditure is about £2½ billion higher in the "basic case" than the other cases as there are fewer sales to private owners who do the work at their own expense (apart from grants).

Rents

In the "basic case" public sector rents rise in line with prices only, and so remain at their present level of about £16.50 a week at 1986/87 value of money. In the "full economic rents" and "30 percent assistance" cases, the transition to the new level of rents takes place in five annual steps. When these are complete, rents would average about £29 a week at 1986/87 value of money, in the "30 percent assistance" case; £37 a week in the "full economic rents" case. A similar transition is assumed for the private sector and housing associations, except that new lettings can be at market rents straight away.

Housing Benefit

The calculations are in terms of the scheme as it will be from 1988, with increases in rent met 100% at the margin. Restructuring would be needed; but only marginal savings would be possible if rents were to be sustained at levels sufficient to give the private rented sector an adequate incentive to invest.

Grants

The higher figures shown in the "full economic rents" and "30 percent assistance" cases are due to aid to Right to Buy purchasers with the cost of renovating former local authority stock.

HAWTIN
→ CHIEF
29/1

FROM: M V HAWTIN
DATE: 29 January 1987

I am putting this forward now so that you can have an immediate assessment.

- 1. MR F E R BUTLER
- 2. CHANCELLOR

I have held a discussion with those concerned and will put forward my own thoughts on Monday. I think it

cc Mr Anson
Miss Peirson
Mr Scholar
Mr Instone
Mr Pirie
Miss Noble

Copies attached for:

Chief Secretary
Sir P Middleton
Mr Cropper
Mr Tyrie

would be worth having a meeting before the Prime Minister's meeting at which we could talk through the effects of these proposals.

FERB
30.1.

Thanks. We
clearly need a
note on FERB
into Gussm's.

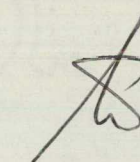
HOUSING POLICY

I understand from Mr Allan that the Chancellor had a word with Mr Ridley in the margins of Cabinet today about the handling of the latter's personal note to the Prime Minister on housing policy. As a result, Mr Norgrove is to set up a meeting to discuss this next Thursday.

2. These arrangements mean that the immediate note from the Chancellor to the Prime Minister, commissioned in Mr Allan's minute of today's date, is no longer required. But the Chancellor and the Chief Secretary will wish to see as soon as possible our preliminary analysis of Mr Ridley's ideas, so that there is time for a Treasury discussion and, if necessary, the Chancellor to minute the Prime Minister before next Thursday's meeting.

3. I attach a note, prepared in consultation with ST, which describes the main features of Mr Ridley's proposals and discusses the main issues which appear to arise on them. This takes account of an initial discussion with DOE which we had yesterday, as a result of which they have undertaken to send us further material explaining the projections underlying the figures in the Balance Sheet attached to Mr Ridley's note.

4. The Chancellor will wish to take an early view on how the highly sensitive issues of mortgage tax relief and equivalent subsidies to landlords should be handled. Apart from this, it is clear that Mr Ridley's ideas require a good deal of further detailed work, particularly on the implications for housing benefit arrangements, and for the structure of local authority housing finance and local authority financial controls more generally, including questions of public expenditure classification. The Prime Minister's meeting next week will need to take a view on how such work should be organised. One way forward would be to ask a small group of Officials in Treasury, No. 10 Policy Unit and DOE (including political advisers) to prepare a further report to the same group of Ministers in a short time. In view of the importance of the housing benefit aspects, there is also the question of how soon DHSS should be brought in to the discussions.



M V HAWTIN

CONFIDENTIALHOUSING POLICY - PRELIMINARY ASSESSMENT OF MR RIDLEY'S PROPOSALSOutline of Mr Ridley's Proposals

1. Mr Ridley describes his essential objectives as:-

(a) to break up council estates and to transfer as many as possible of them into alternative ownership;

(b) to increase owner occupation by up to 1 million more homes in the next 5 years, through a mixture of council house sales and meeting new demand;

(c) to revive the private rented sector;

(d) to reduce the public sector costs of housing.

2. Mr Ridley's principal proposed means of achieving these objectives are as follows.

3. First, he proposes to establish a new financial structure for local authority housing. His main proposal (set out in Annex A of his minute) is to create a single account for each local authority, including both capital and revenue expenditure and receipts (including housing benefit). His main aim in doing this is to make council rents move to more economic levels. This in turn would provide more funds for the maintenance of council estates without having to increase public expenditure in the way that has happened in past years (though this depends on definitional changes - see below); it would also provide a greater incentive for council tenants not in receipt of housing benefit to provide their own homes, because they would be paying higher rents. In order to maintain financial disciplines on local authorities, Mr Ridley would prevent local authorities subsidising their housing account from their general rate fund; instead the Government would prescribe the level of external finance available for each local housing authority. (The external finance limit

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would include housing benefit subsidy as well as any borrowing and other grants; housing subsidy - now paid by DOE - as such would end.)

4. Second, Mr Ridley proposes to deregulate private sector rents. He proposes that regulation of new lettings should be removed as soon as legislation is passed, with deregulation for existing tenancies phased in over perhaps 5 years, or possibly rather longer in London.

5. Third, he recognises that expenditure on housing benefit and the number of people receiving it would need to rise under these proposals, to cope with the implied higher rents. (Expenditure on housing benefit would roughly treble.) The essence of his proposal is to let rents rise, underpinned by housing benefit, to economic levels. He recognises that there is a problem that both local authorities and private landlords could simply raise rents above economic levels and recover them completely through housing benefit under the arrangements due to come into effect anyway after 1988. He proposes to deal with this by setting a maximum level of benefit in each area for different types of home. In addition he proposes that the cost of benefit for local authority tenants should be included within the local authority housing account described above, and that local authorities would accordingly be constrained in how much benefit they could pay through Government control of their external finance. He also suggests that DOE might take back responsibility for housing benefit, which was surrendered to DHSS a few years ago, on the grounds that it should be seen essentially as an instrument of housing policy, especially as it is a critical determinant for Government in its attitude towards rent levels.

Assessment

6. It is first worth noting what Mr Ridley is not proposing. Some aspects of housing policy he assumes will continue, or else has reached no clear view on whether arrangements should be changed. This applies in particular to:-

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(a) Mortgage interest tax relief. His proposed wording for the Manifesto (paragraph 4) implies this will continue, as do his summary figures (see paragraph 11 below). However he recognises that this will continue to provide an economic bias in favour of home ownership relative to private sector lettings. In paragraph 17 he hints that one way of dealing with this might be to abolish mortgage interest tax relief. But he suggests an alternative might be to provide an equivalent amount of assistance through subsidies to landlords. (He does not elaborate on how these subsidies would be given, though we assume he may be thinking of tax reliefs.) He does not appear to have made up his mind whether he wishes to press for this if mortgage interest tax relief remains. It would of course be considerably cheaper if mortgage interest tax relief were scaled down, which would reduce the scope for arguments about additional reliefs for landlords.

(b) Security of tenure. Mr Ridley does not mention removing restrictions in current legislation which inhibit landlords from removing tenants. He may feel that if private sector rents can rise to economic levels landlords will have no particular wish to change tenants. But arguably that is an unrealistic assumption, since landlords may simply be deterred from letting by the risk of obtaining bad tenants.

(c) Reversing decline of private rented sector. We understand Mr Ridley is not assuming that his proposals for deregulation of rents will do any more than reduce the rate of decline of the private rented sector; he does not appear to expect the decline to be reversed even if tax reliefs are given to landlords.

(d) Right to buy discounts. Mr Ridley is assuming these will remain at their present fairly high level, though it could be argued that if local authority rents are allowed to rise to economic levels, that in itself will provide an adequate incentive for tenants to buy without the extra cost of the discounts. Nor is he

This seems to be an important omission.

CONFIDENTIAL

proposing any changes in the method of valuation of council property, which it has been suggested inhibit the sale of flats in the worst estates.

(e) Council house estates. It is not immediately clear what his proposals do to achieve his objective of breaking up council estates and transferring ownership. The concept in Annex A of his paper is for a single housing account for each authority. But behind this he appears to envisage the possibility of separate mini-accounts for each estate, so that these might more easily be transferable to private sector management. But the idea is not clearly developed. To be viable the privatised units would virtually all require continuing subsidy through housing benefit to meet the necessary economic levels of rent. (Nearly all those remaining in local authority housing would, under his proposals, be in housing benefit.)

7. Apart from the points above the other major issues raised by Mr Ridley's proposals which would require further examination in depth, are as follows:-

8. First, housing benefit. A fundamental consideration in Mr Ridley's proposal is that because rents need to go up, expenditure on housing benefit and the numbers of people receiving it must go up as well. There is no real escape from this, so long as it is assumed that poor people cannot be expected to pay more than a certain amount on their rents. If this is assumed, then an almost inevitable corollary of economic rents is more expenditure on housing benefit, though, on Mr Ridley's figures more than offset by PSBR savings elsewhere. There is no real point in pursuing Mr Ridley's main proposals unless Ministers accept the consequences for increased housing benefit.

9. However in some ways Mr Ridley has exaggerated the degree of structural change that would be needed compared with what DHSS are already planning. For example they are already consulting local authorities about the need to set ceilings on levels of

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housing benefit subsidy to local authorities (to prevent exploitation under the post-1988 system already planned). Mr Ridley seems to assume it will be necessary to control not only the levels of subsidy to local authorities but also the actual level of benefit they can pay, which may be unnecessary. He also seems unclear on whether what is proposed is a complete ceiling on benefit above a certain level or a tapering amount of subsidy above that level. It therefore seems unnecessary for the Manifesto to propose "restructuring" of housing benefit; the changes he wants to achieve could probably be described more modestly. Nor would his proposals necessarily require policy responsibility for housing benefit to be transferred from DHSS to DOE, though we would not necessarily rule this out.

10. Third, local authority housing accounts. We can give Mr Ridley's proposals a guarded welcome here, since they are in some ways similar to proposals we were developing ourselves earlier this year. But there are still major issues to be resolved, for example the form of external finance (eg grants or loans); how local authorities' existing accumulated receipts would be dealt with; how far further receipts can be relied on to reduce the need for Government assistance, and whether there is any timing problem; the extent to which there would be a real risk of financial limits, once set, being breached (especially given their dependence on demand-led housing benefit expenditure); and perhaps above all how the proposals would fit in with any wider proposals for reforming local authority financial controls. Further thought would, of course, need to be given to the public expenditure classification implications: on present definitions Mr Ridley's proposals imply an increase in public expenditure (as opposed to the PSBR) - mainly because local authority rents do not now count as negative public expenditure.

11. Fourth, costs. Annex B of Mr Ridley's minute shows the assumed PSBR costs. His figures suggest that his proposals (with or without new reliefs to landlords) would cost about £20 billion less over the next 13 years compared with carrying on existing policies. However given the sensitivities to changes in assumptions, this difference is not perhaps very large. The

CONFIDENTIAL

balance would of course be very different if some change was made to mortgage tax relief, given that this accounts for well over one-third of public housing expenditure. The figures also assume that the so-called £19 billion "backlog" of council house maintenance is eliminated by the end of the century, though this is not central to the proposals. The costs of all the options could be reduced if it is assumed that this "backlog" of council maintenance is not eliminated; but this will not make much difference to the relative costs of the options.

PERSONAL AND CONFIDENTIAL

FROM: F. E. R. BUTLER
2nd February, 1987.

CHANCELLOR

c.c. Chief Secretary
Sir P. Middleton
Mr. Anson
Miss Peirson
Mr. Scholar
Mr. Hawtin
Mr. Instone
Mr. Pirie
Miss Noble
Mr. Cropper
Mr. Tyrie

HOUSING POLICY

I put forward on Friday Mr. Hawtin's note attaching a preliminary assessment of Mr. Ridley's housing proposals. I said that I would put forward my own comments, having had a discussion with those involved in the Treasury.

2. The fiscal effects of housing policy are a function of:-

- (i) Expenditure on capital investment and maintenance of public housing;
- (ii) subsidies to housing accounts, which arise when rents are insufficient to service the above;
- (iii) housing benefit for poor tenants;
- (iv) tax reliefs for purchase or renting.

These are offset by capital proceeds from sales of public sector houses.

3. Leaving aside Mr. Ridley's suggestion of a subsidy for rents (on which more below), my main comment on his

Butler
→ C/E
2/2

other proposals is that they concentrate on reducing subsidies to housing accounts - (ii) above - by putting pressure on local authorities to raise rents. (It is welcome from a narrow public expenditure point of view that by bringing all the flows into a single housing account he identifies the "public expenditure trap" by which higher rent revenue at present increases public expenditure because of the housing benefit associated with it and offers the possibility of removing it by redefinition.)

4. The favourable fiscal effects of Mr. Ridley's proposals come predominantly from their consequences for tenants above the much increased housing benefit levels who

- (a) pay higher rents substituting for subsidies to housing revenue accounts;
- (b) consequently have a bigger incentive to buy their council property, thus producing capital receipts for the Exchequer.

There is some benefit from private landlords meeting housing needs which the public sector would have had to provide for, but it is small.

5. The downside of Mr. Ridley's proposals is:-

- (a) They do not do much to reduce public sector capital expenditure on housing. Capital expenditure on the backlog of maintenance will not be greatly reduced from what it otherwise would have been - because the properties on which it is necessary are mostly not those which would be sold off - and the contribution of private landlords to meeting housing need is still not great;
- (b) housing benefit goes steeply up while rents are rising to economic levels and, because recipients of it can be indifferent to the level of their

PERSONAL AND CONFIDENTIAL

rents, there is increased scope for local authorities and private landlords to take the government for a ride after that point has been reached. Mr. Ridley envisages two defences to this first, a ceiling on benefit related to the market rate for property in each area and second, in the case of local authorities, pressure on the external finance (which would include the central government's contribution to housing benefit) so that they have an interest in keeping housing benefit down. The main point about such downward pressure - apart from the fact that it is not clear in detail how it would work - is that it is easier said than done, as DHSS's recent attempt to get local authorities to finance a higher proportion of housing benefit has shown.

*How to
Mr. Ridley's
proposals?*

6. Mr. Ridley skirts cautiously around mortgage interest relief, as is understandable in a minute to the Prime Minister. He observes that mortgage interest relief distorts the system in favour of owner occupation and pushes up rents and consequently housing benefit. I suspect that his proposal for "30 per cent assistance" to renting is a way of highlighting the anomaly caused by mortgage interest relief rather than a whole-hearted proposal. It would of course remove the distortion caused by mortgage interest relief by extending Exchequer subsidy to housing as a whole; but by the same token it would remove some of the stimulus to council house sales.

7. My conclusion on Mr. Ridley's proposals are as follows:-

- (i) So far as they go, they go in the right direction and it is particularly welcome that they offer the prospect of removing the "public expenditure trap" involved in raising local authority rents.

PERSONAL AND CONFIDENTIAL

- (ii) They do not address a major area of fiscal cost - namely maintenance of the vast estates. The note by the No.10 Policy Unit is addressed to this issue. We are giving you a separate analysis of that, but the proposals for a "big bang" and local management of these estates seem to me wildly unrealistic. It should be possible to make more gradual progress - but still more significant than Mr. Ridley proposes - towards substituting private sector management and provision for public expenditure in these estates.
- (iii) The upward pressure on housing benefit is a major area of vulnerability in Mr. Ridley's proposals, and further analysis is needed, preferably bringing in DHSS sooner rather than later, on DOE's ideas for protecting the Exchequer from this;
- (iv) The proposal for 30 per cent assistance to private landlords introduces an absurd degree of fiscal support for housing and is probably intended to highlight the distortion caused by mortgage tax relief. It would, of course, remove some of the stimulus to owner occupation provided by the present bias in favour of mortgages.

F.E.R.B.

F. E. R. BUTLER



10 DOWNING STREET
LONDON SW1A 2AA

CH/EXCHEQUE	
REC.	03 FEB 1987
ACTION	PS/CST
COPIES TO	SIR P. MIDDLETON MR F. B. BUTLER MR ANSON MR HASTIN MR INSTONE MR PIRIE MISS NOBLE MR TYRIE

From the Private Secretary

2 February 1987

HOUSING POLICY

The Prime Minister wishes to hold an early meeting to discuss your Secretary of State's paper on housing policy. Her first reaction was, as Mr. Ridley knows, to question whether the proposals would in practice lead to a substantial transfer of housing out of the control of local authorities. She was also concerned about the effect of much higher rents in increasing the numbers receiving housing benefit and the cost of that.

The Prime Minister would be grateful if Mr. Ridley could circulate before the meeting a note to discuss these two points.

I am sending a copy of this letter to Alex Allan (HM Treasury).

Ch
FOR 5 PM meeting

AA

(DAVID NORGROVE)

Norgrove
→ Young
2/2

Robin Young, Esq.,
Department of the Environment.

PERSONAL AND CONFIDENTIAL

FROM: F. E. R. BUTLER
5th February, 1987.

CHANCELLOR OF THE EXCHEQUER

- c.c. Chief Secretary
- Sir Peter Middleton
- Mr. Anson
- Mr. Scholar
- Miss Peirson
- Mr. Instone
- Miss Noble
- Mr. Tyrie
- Mr. Cropper

Ch
This seems broadly OK
- a few suggestions
AA
Thanks
OK

HOUSING POLICY

As agreed at your meeting on Tuesday evening, I attach a draft of a minute which you might send to the Prime Minister in advance of her meeting on 10th February. It draws on contributions from Mr. Hawtin and others.

BUTLER
→ CH/EX
5/2

F.E.R.B.

F. E. R. BUTLER

PERSONAL AND CONFIDENTIAL

DRAFT MINUTE FROM THE CHANCELLOR TO THE PRIME MINISTER

HOUSING POLICY

Nick's thought

I would like to offer some comments on Nicholas Ridley's paper on housing policy before our meeting on 10th February.

2. I strongly support his general objectives - breaking up council estates and transferring ownership away from local authorities; increasing owner occupation; reviving the private rented sector; and reducing public sector costs.

3. I also support Nicholas' ^{general} approach. In examining his proposals and carrying the work further, I think we need to concentrate on the two subjects picked up in your private secretary's letter of 2nd February -

(i) How we limit and control the effects of his proposals on housing benefit;

(ii) how we get private management into the large public estates: this is not addressed in Nicholas' proposals, but is the subject of the paper from the Policy Unit. This is where the greatest scope for saving public expenditure lies, since housing authorities have to spend so heavily on maintenance.

Thank I know he attaches importance to it; it is also

Explains

Other aspects which I suggest we must tackle are:-

(iii) other measures to break up public supply of housing;

(iv) further measures to revive the private rented sector: I am opposed to the "30 per cent

but I have to say that strongly

doing this via tax relief

assistance"] to private landlords, which would extend the subsidisation of housing to a ridiculous extent;

Overall

(v) the effect on job mobility of north/south differences in property values.

I amplify these points in the following paragraphs.

(i) Limiting and controlling the effects on housing benefit

4. Nicholas proposes a new financial mechanism to put pressure on local authorities to raise rents to economic levels, thus reducing Exchequer subsidies to local authority housing accounts. This is welcome. But the effect would be, according to the figures attached to his minute, that housing benefit will almost treble from the present level of about £3½ billion for the UK.

5. There is also a danger that, because housing benefit recipients can be indifferent to their rents, local authorities and private landlords may go above economic rents and - in effect - simply collect the money from the government. Nicholas envisages controlling this through regional ceilings on rent qualifying for housing benefit and through pressure on local authorities' external finance.

6. We need to be very sure that this would work, and more generally that we have machinery to keep housing benefit under control: otherwise the consequences for the Exchequer could be catastrophic. ~~If the general level of rents rise, people will need to get used to devoting a larger proportion of their household expenditure to housing.~~

We need also to consider whether we should continue to meet 100% of housing costs of those receiving benefit, or delete - as we shall be doing for

(ii) Getting private management into the large estates

7. The paper by the No. 10 Policy Unit suggests a "big bang" approach. I see its attractions; but I am sceptical

rates and the community charge - we should set the benefit level at a lower proportion.

about its practicability. It would be a massive undertaking to be tackled ^{all at once} ~~at one time~~, in the face of opposition from many housing authorities; and there is likely to be a severe social problem in persuading council tenants - a high proportion of whom ^{as the Policy Unit paper points out} are pensioners, single parent families or unemployed - to act responsibly as members of Trusts. ~~I see~~ ^{There is also} a real risk that the Trusts will be taken over by left wing activists, who would be even worse than local authorities.

8. My feeling is that a gradualist approach is the more realistic option. The paper by the Policy Unit makes a valuable suggestion in pointing out that some - I recognise not all - estates would be viable if their capital debt ^{write} ~~was~~ removed. I would be interested in Nicholas' comments on the scope for using this means to get estates into the ownership and management of the private sector, either in the form of housing associations or some other body. ^{ing} Write off ~~of~~ debt would ~~of course~~ reduce the upward pressure on rents and hence make it harder for the rest of the private rented sector to compete. ^{But it is well worth}

^{The arguments are not easy:}
^{Pursuing}

(iii) Other measures to break up public supply of housing

9. I think that we ^{also} must look at other ideas for breaking up the big estates. ^{Some} Examples ^{of them} ~~which occur to me~~ are:-

- (a) Greater incentives for occupiers of local authority flats to buy: for example I understand that valuations very often do not realistically reflect the low market value of such properties. ^{Official}
- (b) Penalties on local authorities who do not re-let property quickly enough, including the removal of such property from local authority control.
- (c) Reducing the categories of homeless which local authorities are under a duty to house; at present this is open to abuse.

PERSONAL AND CONFIDENTIAL

(iv) Further measures to revive the rented sector

10. ~~I understand that~~ Nicholas' proposals would not reverse the decline in the private rented sector, only reduce it. They do not say anything about landlords' rights of recovery of their property, ~~and I am convinced that this remains one of the important obstacles to private letting.~~ ^(the security of tenure problem) Deregulation of new lettings, on tenure as well as rents, would seem to be an essential first step.

(v) The effect on job mobility of the gap in north-south property values

11. Many people will not take jobs in the north, because they are afraid that they will not be able to afford to buy if they return south. This problem would be eased if they could hold on to their houses in the south and let them while they were away. This in turn would be eased if the anxieties about letting were removed, and there may also be capital gains tax complications which I would be willing to look at ways of easing.

Next Steps

12. I agree with Nicholas that we should aim to legislate as soon as possible in the next Parliament. There are a large number of issues to be addressed in detail, with which the Treasury will need to be associated, and the DHSS should be brought into the work on housing benefit. I suggest we should agree at our meeting how this further work should be handled.

13. I am copying this minute to Nicholas Ridley.

N.L.



CH/EXCHEQUER	
REC.	06 FEB 1987
ACTION	MR INSTONE
COPIES TO	MR FER BRUER

6/2

RIDLEY
P.M.
6/2

PERSONAL AND CONFIDENTIAL

PRIME MINISTER

HOUSING POLICY

1. Your Private Secretary's letter of 2 February asked for further advice before our meeting on the pace of transfers of housing out of the control of local authorities, and possibilities for limiting the housing benefit costs of higher rents.

The pace of change

2. Although my previous note dealt primarily with the overall financial framework, there is implicit in it a speedy shift of housing out of the hands of local authorities. There are three powerful factors which lead to this effect:

- increased sales under the right to buy provisions as rapidly rising rents narrow the gap between the costs of renting and buying (we estimate an additional half million sales a year or more within a few years of the introduction of the new arrangements);
- a much bigger contribution from the private sector - including in particular housing associations wholly funded by private finance - towards new investment in rented housing as the new rents provide an economic rate of return (we have illustrated the rate of new building for rent by the private sector rising from zero at present to about 35,000 a year by the mid nineties with a corresponding fall in the public sector);
- competition from private sector landlords who will be able to offer better housing at as low or lower rents, so encouraging local authority tenants to seek transfers to new landlords in increasing numbers.

3. Taking all these factors together the present stock of 4.5m local authority dwellings could be reduced to 2-3m by the early 1990s, with the major part of the reduction in the urban area where unsatisfactory conditions are most likely to impel tenants to transfer to other landlords. (The remaining local authority stock would increasingly provide for special need groups such as the elderly and disabled.)

4. In order to facilitate the transfer of estates to other landlords during the transition to the new arrangements we shall need to enable tenants to opt for a change of landlord, and to reinforce the advantages to tenants of moving out of the local



PERSONAL AND CONFIDENTIAL

authority sector. There is undoubtedly a large backlog of disrepair in local authority housing. Rising rents will make a contribution towards this, but a large part of it will still have to be met by public funds. The more we channel them through housing associations rather than local authorities, the more attractive it will be for local authority tenants to opt to transfer so as to have their dwellings improved rapidly. One way of achieving this is described at Annex A. The tenants would have the choice of moving to a housing association at the same rent level and with the benefit of the property being put into a good condition sooner rather than later.

5. If we wished to give additional impetus to the pace of transfer we could give housing association or other private landlords a right to take over a particular estate or block. For private landlords, I think this right would probably need to continue to be made subject to the consent of a majority of tenants, as at present. If the landlords were housing associations, this right could be without the consent of the tenants.

6. Finally, we could consider obliging local authorities to dispose of housing. This amounts to putting the authorities' housing functions into commission. We are considering the possibilities of action on these lines in connection with certain London authorities. But there are formidable operational and financial difficulties in undertaking this on any very large scale. Annex B attached discusses the difficulties of the approach suggested by Mr. Stredder which would entail the transfer of all local authority stock on a vesting date. The problems could be reduced by singling out a smaller group of authorities, but we should still be faced with an operation far greater in scale and politically much more contentious than the abolition of the metropolitan counties and the GLC. For example, even if we confined such a scheme to councils with over 20,000 houses, we should have to deal with 55 individual authorities, and over 2 million houses. I think we should keep this kind of action in reserve for the worst authorities which have shown themselves to be incapable of managing their affairs.

7. All of these actions taken together will certainly lead to very substantial movement out of the local authority sector. Indeed the practical constraint on the speed of change is likely to be our willingness to release resources for repairs to houses transferred to the private sector (though under the proposals in Annex A the improvement work would make no call on public expenditure, it would reduce the annual saving to the PSBR from the new arrangements by mopping up some of the gain to the Exchequer from the higher levels of receipts).



PERSONAL AND CONFIDENTIAL

8. Over and above this extra pressure for transfer during the transition, there would be continuing pressures for the foreseeable future because we should have introduced a real element of competition into rented housing. Rents would depend on the capital value of the dwelling and the costs of management and maintenance. There is no way that Liverpool, for example, with its inflated and incompetent direct labour organisation, could compete with landlords backed by private finance and with a businesslike approach to management costs. Liverpool council tenants would see their neighbours paying much lower rents for much better maintained housing. And they would have the right to opt to change their landlord.

Housing benefit costs

9. The higher housing benefit costs are a consequence of the rising rents under the new regime. I fear that they cannot be avoided. The only option is to keep rents down. But on that basis we incur substantially higher public expenditure costs for two main reasons. First, we forego the £700m or so that would be contributed through higher rents by tenants who are not reliant on housing benefit. Second, since the artificially depressed rents could not support private investment, the whole cost of investment in rented housing would continue to be borne by the public sector. If rents do not rise, we can forget about massive transfers away from the local authority sector. That is the path we are travelling down at the moment, and it is ruinously expensive. I think that it is essential that we revive private initiative in the rented housing market by remunerating investment properly.

10. In fact, the higher housing benefit costs are only part of a wider calculation. The overall figures (£ million at 1986/87 prices) would be:

	<u>Cumulative</u> <u>total to</u> <u>2001</u>	<u>Annual</u> <u>amount</u> <u>thereafter</u>
Increase in Housing Benefit	45,200	5,200
Additional tax relief for owner-occupiers	4,500	600
<u>Total additional PSBR cost</u>	<u>49,700</u>	<u>5,800</u>
Savings in housing subsidies	48,900	5,600
Extra capital receipts from sales	8,800	100
Capital expenditure transferred to private sector	13,300	1,100
<u>Total PSBR savings</u>	<u>71,000</u>	<u>6,800</u>
<u>Total savings exceed additional cost by:</u>	<u>21,300</u>	<u>1,000</u>



PERSONAL AND CONFIDENTIAL

11. That said, I am very well aware of the dangers of excessive reliance on benefit in terms of fostering dependency and exacerbating the "poverty trap". There is no easy answer to this. Because people's housing circumstances are very different, it would be prohibitively expensive to pursue the "universal housing allowance" route. The only alternative, which I think we must consider squarely, is to oblige all tenants, however poor, to meet some proportion of the cost of their housing from their own pockets. We might consider some general uprating of benefits at an averaged level to reduce the impact; but as I said in my previous note, this seems to me to be the only way in which low-income tenants can be encouraged to take an interest in the cost of their housing.

12. I am copying this minute to Nigel Lawson.

As you also suggested

Rhys-Jones

PP NR

6 February 1987

(Approved in draft by the Secretary of State and signed in his absence.)



PERSONAL AND CONFIDENTIAL

ANNEX A

FINANCIAL CONSEQUENCES OF TRANSFERS OF LOCAL AUTHORITY STOCK

1. During the transition period, rents for local authority tenants might be set to rise by five equal stages from present levels to an "economic level" reflecting an appropriate commercial rate of return on the capital value of the property in an average state of repair.
2. The same rent regime could apply if the property were transferred out of the ownership of the authority.
3. Tenants could be given a right to require their authority to dispose of their estate to a willing purchaser (normally a housing association backed by private finance).
4. The disposal price would reflect the discounted future rent stream minus the estimated cost of putting the property into good repair. The purchaser would be able to afford to undertake any repairs and improvements immediately provided that the financial institutions have sufficient confidence in the stability of the new regime to lend on reasonable terms.
5. Since the purchase price would take account of the higher rents available it would be larger than under the present rent regime and there would be a substantial increase in the capital receipts of the authority*. These would however be compensated for by reductions in the "housing needs grant" so that the benefits would flow to the Exchequer.
6. The rate of improvement of the remaining local authority stock would depend on the resources made available for this purpose through the "housing needs grant", which would be under central Government control.

*The implications of the rising capital value of public sector housing associated with higher rents will also need to be considered in connection with the discount levels offered under the right-to-buy scheme.

ANNEX
A



A NEW START FOR COUNCIL TENANTS
SOME NOTES ON MR STREDDER'S PAPER

The Proposal

1. The essence of the proposal is that local authorities' housing stocks should be transferred to independent trusts free of debt, with loan charges now falling on local authorities' housing revenue accounts transferred to the Exchequer (ie national taxation). The excess of rents plus other income (heating charges, rents for garages and hard-standings, shops on housing estates, and possibly sales interest) exceeds expenditure on general and special supervision and management and repair and maintenance charged to revenue by a margin sufficient to finance some capital expenditure either directly out of revenue or by meeting the loan charged on indexed debt. Where more capital expenditure was needed than this, rents would be raised to service indexed debt incurred to finance the expenditure. The amount of debt to be transferred would be about £25 billion, with interest of £2.7 billion in 1986/87.

Commentary

2. The proposal has some attractive features:

- (i) it would secure the immediate transfer of local authority housing to new bodies which would have a direct concern with decentralising and diversifying the stock into smaller units with maximum tenant involvement.
- (ii) all capital expenditure that is required on the stock, whether for new build or for renovation, would be financed by the private sector and would no longer be public expenditure. This is achieved with comparatively modest increases in rents by having the Exchequer take over the servicing of existing loan debt. This means that the



whole of the rental income, net of running and management and maintenance costs, is available to service the new capital needed, so that capital can be raised privately.

(iii) Because all outstanding debt is written off, no further subsidies would be needed.

3. There are, however, some serious problems in the proposal as formulated - economic, political and administrative.

Economic Problems

4. (i) All local authority housing would effectively be given away to the new private sector trusts. All future RTB proceeds, and all prospect of sales proceeds on whole estates when rents are higher, would be foregone by the public sector. These could be very substantial sums - we estimate some £25 billion.

(ii) Rents would not be increased to economic levels. This means that tenants of former local authority housing would continue in effect to receive a subsidy represented by the initial gift of the housing to the Trusts. Because of this the operation of the rest of the rented market would be seriously distorted. It would be very difficult to attract new investment into the rented sector because of the subsidised competition from the Trusts. Hence overall there would probably be less total investment in rented housing, and less diversity and competition among its suppliers.

(iii) Pooling of rented income within trusts would be very difficult to achieve, once they began to be broken up into smaller units, as Mr Stredder's paper acknowledges.

(iv) The Trusts with the worst repair problems could offer only limited security for loans and might not be able to borrow on the terms outlined by Mr Stredder (or on any terms at all). Rents would vary very substantially between authorities for similar properties of similar value.



Political Problems

5. (i) Major confrontation with the whole of local government in taking away one of their major services. The ADC authorities might resist even more strongly than the metropolitan because housing is their most important service. For some of them it could raise questions about their continuing viability as separate authorities.

(ii) Central Government accountability for the Trusts. If they are appointed by the Secretary of State, he will have to assume direct Parliamentary accountability for all the problems of shortages, disrepair, mismanagement etc in the whole local authority housing stock as well as for any local problems the Trusts might face in allocating tenancies, collecting rent arrears, etc.

Administrative Problems

6. (i) Finding sufficient people to be on the Boards of the local trusts.

(ii) Identifying all the present staff in Housing, Treasurer's and central departments of local authorities dealing with housing, and working out arrangements for transferring some or all of them to the new bodies.

(iii) Disentangling rent collection, rate collection and administration of housing benefit (rent and rate rebates) for council tenants. The administrative costs of separating these out and establishing separate rent collection arrangements for the new Trusts are likely to be substantial.

(iv) Working out arrangements for linking the housing maintenance work at present carried out by authorities Direct Labour Organisations.

PERSONAL AND CONFIDENTIAL

FROM: D R INSTONE
DATE: 9 February 1987

1. MR HAWTIN (*discontinued in draft*)
2. CHANCELLOR OF THE EXCHEQUER

cc Chief Secretary
Sir P Middleton
Mr F E R Butler
Mr Anson
Miss Peirson
Mr Scholar
Miss Noble Mr Pirie
Mr Tyrie
Mr Cropper
Mrs Holmans
Mr Legg

[Mr. G. Summers]

HOUSING POLICY: BRIEF FOR PRIME MINISTER'S MEETING ON 10 FEBRUARY

For the meeting you have:-

- (a) Mr Ridley's original proposals;
- (b) the No.10 Policy Unit proposals (Mr Norgrove's minute of 27 January);
- (c) your own comments (your minute of 6 February);
- (d) Mr Ridley's reply (in his minute of 6 February) to the Prime Minister's questions on whether his proposals:-
 - (i) would lead to a fast enough transfer away from local authorities; and
 - (ii) have adverse effects on housing benefit.

The costings in paragraph 10 of his minute are broadly consistent with the fuller table of costings - copy attached - presented with his earlier minute.

OBJECTIVES

2. At this stage it is unlikely you will be able to take many firm decisions of substance; so the main issue to settle is likely

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to be the handling of further work. But there are some areas where you may be able to reach broad agreement, where there is little difference of principle.

3. So you might try to secure conclusions from the meeting on the following lines:-

(i) The aim should be to work up proposals for legislation as soon as possible after the Election (Mr Ridley suggests the 1988-89 Session, which is probably the earliest realistic time).

(ii) The attractiveness of many of the proposals depends critically on their practicability and the costings: a small group of officials from DOE, No.10 and Treasury should produce an agreed report on these aspects for a further discussion between the same group of Ministers in (say) one-two months time. (The Prime Minister will no doubt want to consider whether or not to bring in DHSS (as you suggested). At some stage the Scottish and Welsh Secretaries will need to be involved: all Mr Ridley's figures relate to England only.)

(iii) On the substance, essential components of any package should be:-

- (a) deregulation of the private rented sector;
- (b) a range of measures to facilitate the transfer of local authority estates into alternative ownership.

THE ISSUES

4. You might suggest that your discussion should distinguish between:-

- (i) the underlying aims of housing policy;

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have with
note in
1987-88*

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(ii) what to do about the public sector - and local authority estates in particular;

(iii) what to do about the private sector, especially the private rented sector.

(i) The Underlying Aims of Housing Policy

5. You might suggest that the criteria against which any housing policy should be tested are:-

(a) More efficient use of resources. That means eliminating subsidies as far as politically practicable, except where these are designed to protect the poor, and allowing the housing market to work better. So Mr Ridley is right in principle to press for economic rents and an end to housing subsidy. But it casts doubt on his proposals for "30% assistance" to landlords. (NB his figures illustrating this option assume this assistance is given to private sector and local authority landlords.)

(b) Minimising the effects on the PSBR. That also points to reducing subsidies, and preventing the extension of tax reliefs.

(c) Ensuring a minimum acceptable standard of housing for those who cannot otherwise afford it - without encouraging growth of the "benefit culture".

(d) Encouraging incentives and mobility. That means reviving the private rented sector, but ensuring that any extension of housing benefit from higher rents does not dampen incentives to work. Adverse distributional effects (ie too many losers) should be avoided.

(ii) The Public Sector: Local Authority Estates

6. Points to make are:-

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(a) Do Mr Ridley's proposals imply a fast enough run down of local authority estates? If they do, are they achievable? His estimate that they would allow the number of households in local authority housing to come down as low as 2-3 million in England by the early 1990s looks rather optimistic - though we have not had time to test the figures in detail.

(b) The Policy Unit proposals for a "big bang" may be impracticable, because most tenants will take little interest in management and could be exploited by unscrupulous trusts (though the Policy Unit think that suitable trust deeds could prevent this). The proposed writing-off of debt is attractive in principle. But it needs to be looked at very carefully: there are macro-economic effects from the transfer of debt burden to the Exchequer and Mr Ridley thinks it could give the new owners an unfair advantage over other landlords, whose rents would have to cover their interest charges. But it would be sensible for officials to explore the Policy Unit proposals further, without ruling them out at this stage.

(c) Mr Ridley ~~is~~ has a new proposal (Annex A of his minute of 6 February) allowing local authority tenants to opt for a change of landlord. It is unclear how much practical difference this would make, since it may be hard to find willing buyers (though allowing tenants the option of establishing their own trusts might be a solution in some areas). But again officials should explore this further.

(d) The other measures to break up public housing set out in paragraph 8 of your minute ((i) more realistic valuations, (ii) removal of unlet property, (iii) reducing "homeless" categories) should also be further explored.

(e) The housing benefit consequences are crucial. There are two problems: the levels would rise with

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economic rents; and it may be difficult to control rents charged to beneficiaries and prevent them from rising above economic rents. Two ways of tackling this are implicit in Mr Ridley's paper: (i) through subsidy systems; (ii) by making everyone pay part of their rent. Essential that these issues are further explored. We need to consider at what stage DHSS should be brought in.

(f) Mr Ridley's costings assume that in all cases the alleged "£19 billion backlog" of renovation of local authority housing is tackled. This makes Mr Ridley's proposals seem more cost-effective than his "do nothing" option. But we need to compare with the real base case of existing spending levels. In these terms clearance of the backlog costs over £2 billion a year more in public expenditure. Essential officials consider implications of this, including scope for more private funding (without breaching "Ryrie rules").

NB (g) Mr Ridley's costings are based on large increases in rent levels. These are above those required to achieve a 5% real rate of return on housing assets (ie "economic rents") (except under his "30% assistance to landlords" case). So he is begging the question of what "economic rents" are. This needs to be looked at.

(iii) Private Rented Sector

7. Points to make here are:-

(a) Mr Ridley's proposals still do not reverse the decline. Although he suggests new building for rent would rise from zero to 35,000 a year, that would be probably more than offset by other rented stock coming off the market (eg sold for owner-occupation).

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(b) Early action on deregulation of both rents (subject to housing benefit consequences) and security of tenure seems essential. Action on tenure could be confined to new lettings. Do not favour Mr Ridley's option of 30% assistance to landlords (public or private ones). On Mr Ridley's figures it makes little difference to supply of private rented accommodation anyway. Agree no case at any rate for extending mortgage tax relief.

(c) Officials' paper should therefore include more detailed options for private rented sector.

D R I

D R INSTONE

ESTIMATE OF THE "BALANCE SHEET" FOR ALTERNATIVE POLICIES ON RENTS AND SUBSIDIES

(£ million at 1986/87 prices)

	1986/87 Est. Out-turn	Cumulative 1986/87 to 2000/01			"Steady State" Year(2000/01)		
		Basic Case	Full Economic Rents	30 Percent Assistance	Basic Case	Full Economic Rents	30 Percent Assistance
<u>Local Authorities</u>							
(1) Exchequer subsidy and RFC	1,044	32,100	-16,800	-2,700	3,600	-2,000	-500
(2) Housing benefit	1,855	29,700	61,200	48,000	2,200	5,800	4,200
(3) Gross capital expenditure (HRA)	1,927	47,900	41,900	38,500	1,700	1,400	1,400
(4) Capital receipts	-1,515	-10,800	-19,600	-18,100	-200	-300	-300
<u>Sub-total (rounded)</u>	<u>3,300</u>	<u>98,900</u>	<u>65,900</u>	<u>65,790</u>	<u>7,300</u>	<u>4,900</u>	<u>4,800</u>
<u>Housing Associations</u>							
(5) Capital, etc	820	12,300	5,000	5,000	820	nil	nil
(6) Housing benefit for HA tenants	220	4,800	11,700	10,200	400	1,200	900
<u>Sub-total (rounded)</u>	<u>1,050</u>	<u>17,100</u>	<u>16,700</u>	<u>15,200</u>	<u>1,200</u>	<u>1,200</u>	<u>900</u>
<u>Private rented sector</u>							
(7) Housing benefit	290	4,200	11,000	10,500	300	1,100	1,050
(8) 30 percent subsidies (a)	...	...	...	3,300	...	...	200
(9) Tax on rental income (b)	-250	-3,000	-4,900	-4,500	-150	-400	-350
<u>Sub-total (rounded)</u>	<u>50</u>	<u>1,200</u>	<u>6,100</u>	<u>9,300</u>	<u>150</u>	<u>700</u>	<u>900</u>
10) Owner-occupiers' tax relief	4,050	76,400	80,900	79,800	5,250	5,850	5,700
11) Private sector renovation and clearance	590	8,850	9,850	9,850	600	750	750
12) Administration	150	2,250	2,250	2,250	150	150	150
13) <u>Housing PSBR</u>	<u>9,200</u>	<u>204,700</u>	<u>181,700</u>	<u>182,000</u>	<u>14,650</u>	<u>13,550</u>	<u>13,200</u>

Notes: (a) Includes grant paid on improvements

(b) Shown negative, because it is a deduction from expenditure



10 DOWNING STREET
LONDON SW1A 2AA

From the Private Secretary

CH/EXCHEQUER	
REC.	18 FEB 1987 ✓ 18/2
ACTION	MR INSTONE
COPIES TO	MR FER BUTLER
	MR DJ L MOORE
	MRS M BROWN

EXTRACT ONLY

17 February 1987

Dear Robin,

1. Alex
2. R P

HOUSING POLICY

The Prime Minister yesterday discussed Housing Policy with your Secretary of State and the Chancellor of the Exchequer. Mr Peter Stredder, No 10 Policy Unit, was also present.

The papers before the meeting were your Secretary of State's minutes of 28 January and 6 February, the Chancellor of the Exchequer's minute (undated) and the paper by the Policy Unit attached to my letter to you of 27 January.

The Prime Minister noted that there were potentially three major Bills which would fall to the lot of the Department of the Environment in the first Session of the new Parliament: Abolition of Rates, Housing Reform and Water Privatisation. Abolition of Rates should be the top priority. Housing Reform was also a very high priority. The Chancellor pointed to the importance of water privatisation, both for its role in wider share ownership and for its role in generating privatisation proceeds. Mr Ridley suggested that water privatisation would probably be delayed in any case through the need to create a proper controlling authority for land drainage and related matters. A Bill to create the necessary vires and to deal with water metering would however be needed in the first Session. The Chancellor noted that a single Bill was under consideration which would create the necessary vires for the privatisations envisaged in the next Parliament.

The Prime Minister said the objective should be to move as many council estates as possible out of public sector control. However, it did not seem feasible to try to achieve this through the "Big Bang" approach advocated by the Policy Unit. Such an approach would be deeply disturbing to council tenants and it seemed unlikely that enough people would come forward to run the proposed housing trusts competently.

The meeting agreed the following points after discussion.

- (i) Higher rents would provide extra resources for renovation and repair, give housing associations and other private landlords an incentive to take over council housing and provide an incentive to tenants to buy their own homes. The consequences for

NO 10
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17/2

housing benefit would, however, need the most careful consideration. The result of higher rents and higher payments of housing benefit would be to make more people dependent on the State though on the other hand tenants were already dependent on low cost public sector housing. There was a very strong case for all tenants to be required to pay some proportion of their rent.

- (ii) The arrangements for housing benefit should be further studied to reduce the scope for rents to be pushed up simply on the basis that central Government would foot the bill; one possibility would be for rent officers to specify maximum rents in a particular area according to the size and character of the accommodation, rather than on the basis of each individual property.
- (iii) The effects of the proposals on public expenditure and public borrowing should be discussed further between the Department of the Environment and the Treasury.
- (iv) Possible mechanisms for taking housing out of local authority control which were worthy of further study included the following:
- allowing tenants the right to opt for transfer to private landlords;
 - allowing housing associations the right to take over local authority housing (tenants would in this case have no right to refuse);
 - the creation of Urban Development Corporations with a housing role, as permitted under existing legislation;
 - ensuring the transfer of housing as part of the process of putting a bankrupt authority back on its feet, along the lines discussed by MISC 109;
 - the compulsory transfer of local authority housing which had been empty for more than a specified period;
 - requiring every existing vacant property, and every property as it became vacant, to be offered for sale to council tenants.
- (v) It would be sensible for the housing reforms to be directed to the worst areas in the first instance.

Bringing the meeting to a close, the Prime Minister said that for the reforms to succeed, they must offer the prospect of demolition of poor quality estates, and tower blocks in particular, and their replacement by attractive low rise housing. The next step in discussion should be the

preparation of a further paper by a working group of officials under Department of the Environment Chairmanship, to include the Treasury, Department of Health and Social Security and the No 10 Policy Unit. The Prime Minister invited Mr Ridley to discuss his proposals as soon as possible with Mr Fowler. The aim should be a further meeting, to include Mr Fowler, within ten days if possible.

I am copying this letter to Alex Allan (HM Treasury).

Yms,
David .

D R NORGROVE

R.U. Young, Esq.
Department of the Environment



10 DOWNING STREET
LONDON SW1A 2AA

From the Private Secretary

CH/EXCHEQUER	
REC.	18 FEB 1987
ACTION	MR INSTONE
COPIES TO	MR FER BUTLER

✓ 15/2

17 February 1987

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17/2

Dear Sir,

HOUSING POLICY

I should add to my record of yesterday's meeting on housing policy a further point, namely that the scale of any continuing local authority involvement in construction of new housing needs to be further considered. Your Secretary of State suggested that in due course new building by local authorities would be confined to particular needs, for example, sheltered housing.

I am copying this letter to Alex Allan (HM Treasury).

*Yours,
David*

David Norgrove

Robin Young Esq
Department of the Environment

pmp

2 MARSHAM STREET
LONDON SW1P 3EB
01-212 3434

My ref:

Your ref:



Geoffrey Podger Esq
Private Secretary to
The Rt Hon Norman Fowler MP
Department of Health and Social Security
Alexander Flemming House
Elephant and Castle
LONDON
SE1

CH/EXCHEQUE	
REC.	19 FEB 1987 1/2
ACTION	MR INSTONE 18 February 1987
COPIES TO	MR PETER BUTLER

Dear Geoffrey,

HOUSING POLICY

As discussed on the telephone earlier today, I enclose a full set of the correspondence between my Secretary of State and No 10 about housing policy. You will see, in particular, David Norgrove's letter of 17 February which records the decision to invite your Secretary of State to join in these discussions.

Our officials are, I think, already in touch, with a view to preparing the paper which we are asked to put together in the course of next week. Meanwhile my Secretary of State would very much like to meet yours, without officials, to discuss this subject generally. Perhaps we could arrange something around a vote early next week. We will be in touch about that.

I am copying this letter, without the enclosures, to David Norgrove (No 10) and Alex Allan (Treasury).

Yours sincerely,
Robin Young.

R U YOUNG
Private Secretary

PS. My Secretary of State asked me to stress the confidentiality of these discussions in particular, and the need to copy the papers to a minimum number of people.

DOE copy no 1 of 2



CH/EXCHEQU	
REC.	27 FEB 1987
ACTION	MR INSTONE
COPIES TO	MR FER BUTLER

27/2
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 PM
 27/2

Prime Minister

HOUSING POLICY

I have had a brief talk with Norman Fowler about the housing benefit implications of my proposals. Officials have also met and produced the attached report.

The housing benefit consequences of my proposals are critically important, both because of the increased cost of benefit in a world of higher rents, and because of the potential risk of making recipients more dependent on benefit than at present.

On costs the note by officials shows that with the present system of housing benefit, increasing rents to full economic levels (6-7% rate of return) could take the benefit bill in England from £2.4bn to nearly £8bn. It might be possible to reduce this significantly by 3 main measures:

- (i) holding rent levels to, say, a 4-5% return;
- (ii) requiring all tenants, even those on benefit, to pay some part of their rent themselves;
- (iii) placing a ceiling on benefit levels in different areas of the country, thus encouraging benefit recipients to live in the most economic housing in their areas.

Holding rent levels to give only a 4-5% rate of return might reduce the total benefit bill by some £2bn. Rents at this level would be competitive with the costs of owner occupation; whereas at 6-7% it would pay households to buy rather than rent. But a 4-5% rate of return would not by itself be sufficient to attract private investment into rented housing; and we should have to assist new investment, either with the kind of 30% grant we are currently pioneering for housing association and private



landlords, or through a tax concession for the rented sector similar to mortgage tax relief for the owner-occupied sector. Overall the total public sector cost will be much the same either way as the balance sheet I sent you with my first minute showed.

The other two possibilities have not yet been fully costed, but might save up to perhaps £½bn.

Even with these modifications the total cost of housing benefit in a higher rent world will clearly be substantially higher than at present. But as my earlier paper showed it should be possible to achieve clear net savings by eliminating "bricks and mortar" housing subsidies, substantially reducing public and capital expenditure on housing as private investment takes over, and stimulating further capital receipts as we privatise the stock. The preliminary calculations I circulated indicated a potential cumulative public expenditure saving of £21bn up to the end of the century, and £1bn a year thereafter.

These figures will of course need to be tested further with a variety of different assumptions. But there are undoubtedly substantial savings to be made by moving to a free private market for rented housing, with personal subsidies to individuals who need help with the rent, in place of the present system of public provision of rented housing provided at artificially low rents even for those who can afford to pay more.

On dependency there is no getting away from the fact that most benefit recipients (over half of whom are old) are dependent on the State to meet their costs of living and housing costs. They cannot be anything else while they have little or no other source of income.

But the form of their dependency can be importantly changed. At present artificially low rents in the public and private sectors trap tenants in unsatisfactory housing that is not kept up properly, leaving them little or no choice to obtain anything



better. What we want to achieve by our changes is to ensure that the recipients of support have the maximum incentive to behave responsibly with the support that is given them. That means ensuring:

(i) that they pay the full price for goods and services rather than artificially subsidised ones, so that they recognise the true costs and the value of the help they are getting; and

(ii) that so far as possible support comes as a single addition to their income, leaving them free to work out in a responsible way how much they want to spend on food, clothes, housing, fuel etc, rather than giving them separate help with all their separate needs, thus removing all real freedom of choice and responsibility.

My proposal on moving rents to economic levels obviously meets the first of these points for housing costs. On the second I think the best we can do is to ensure that every household pays some of its rent.

If we can agree on these general principles at our meeting next week we should then, I suggest, commission officials to work up in more detail the various aspects of the proposals they set out in their report. If we want to legislate this autumn, as I believe we should, there will be a very tight timetable for taking decisions and preparing instructions.

I think we must ask officials to do the necessary detailed work to enable us to decide the main principles of the new regime by Easter, and to fill in the details by June.

I am copying this minute to Nigel Lawson and Norman Fowler.

R. J.

PP N R

CONFIDENTIAL

HOUSING POLICY

PRELIMINARY REPORT BY WORKING GROUP OF OFFICIALS

1. In his minute of 28 January the Secretary of State for the Environment put forward proposals for major reforms of the rented sector of the housing market. The three main purposes were:

(i) to maintain the impetus towards home ownership for those who want and can afford it;

(ii) to provide conditions in which private investment could again take place in the rented sector, and so arrest the decline of the past 60 years;

(iii) to break up excessive concentration of rented housing in the hands of local authorities, and bring about more diversity and competition in the supply of rented housing, and more choice and involvement for tenants.

2. The Secretary of State proposed that rents in both public and private sectors should rise substantially. In the private sector, market rents are needed to remunerate investment: if rents do not rise the private sector will not invest. An equivalent increase in public sector rents is needed to stimulate right to buy sales, to facilitate transfers of local authority housing to private landlords and to prevent local authorities influencing tenant choice by undercutting the private sector. If rents are to rise, housing benefit expenditure must also increase.

3. Following the Prime Minister's initial meeting on these proposals on 16 February a working group of officials of the Departments principally concerned were asked to prepare a quick further report, covering:

(i) The implications of the Secretary of State's proposals for housing benefit, and possible methods for dealing with them.

(ii) The work programme that would now need to be undertaken by officials of the relevant Departments to develop the Secretary of State's proposals further.

Housing Benefit

4. At present there are 6.5m tenants in England. 40% of these pay their full rent themselves; 25% receive some help with their rent from Housing Benefit; 33% have the whole of their rent met by benefits. The total cost of rent support through benefits in 1986/87 in England is £2365m.

(For further figures see Annex A).

5. Under the Secretary of State's proposals rents would on average rise substantially in real terms within the range 50-100% (in some areas the increases could fall well outside this range, and this needs further work). This would encourage even more households to choose owner-occupation in preference to renting (eg 0.5 million additional RTB sales by the end of the century), so that the total number of tenants could be expected to decline further to about 5½m by 2001. But within that total a higher proportion (perhaps up to 90%) would have to rely wholly or partly on housing benefit because rents would be higher, and because the transfer to owner-occupation would occur mainly among those households who do not at present receive housing benefit. The upshot of these two changes is that the number of tenants receiving housing benefit would increase compared with the present number, and the costs would be substantially higher because of the higher rents. So there would be increasing dependence within the rented sector on housing benefit but less on other forms of subsidy which would have been eliminated; Annex A exemplifies the position in England in 2001 on the basis of a 6-7% rate of return for landlords and on the basis of a 4-5% rate of return.

Reducing the Total Costs of Housing Benefit, and Reducing Dependency

6. It would be possible to reduce the benefit costs, and dependency, to some extent by modifying various parameters of the housing benefit system. In particular all tenants might be required to bear some part of their housing costs themselves, and maxima might be set for the benefit payable in different parts of the country. Such limitations would reduce costs and would also give housing benefit recipients an incentive to economise in their housing and to be less dependent. Setting limits on the level of rent admissible for benefit by area would also serve the important purpose of preventing excessive rents being charged by private landlords to housing benefit tenants at the expense of the Exchequer. (This is similar to the aim of various modifications to the housing subsidy system at present under consideration by DHSS). Such limits would apply only for the purpose of benefit entitlement - they would not be a statutory limit on the rent which a landlord could charge. They could be set, possibly by rent officers, at levels sufficient to give landlords a reasonable return on their investment. In a system of this kind great care would need to be taken in the choice of areas to avoid disincentives to mobility. A preliminary note on some of the possibilities here, and further issues that would need to be explored in further work is at Annex B. We cannot in advance of this work quantify how far they might enable the total benefit bill to be reduced, but it is difficult to see that it would be feasible to reduce it by more than a maximum of £½bn or so.

7. It is clear however that whatever modifications of this kind are introduced they cannot alter the basic point that higher rents must mean higher housing benefit costs. The offsetting savings come in other areas of housing expenditure, principally:

(i) eliminating the present Exchequer and rate fund subsidies to local authority revenue accounts;

(ii) generating revenue surpluses on public sector housing over and above what might be made available for the outstanding repairs expenditure.

(iii) major reductions in public capital expenditure on new build as private sector investment takes over;

(iv) increased capital receipts as additional sales of individual public sector dwellings and of whole blocks and estates are encouraged by higher rents.

8. On the Secretary of State's initial exemplifications the net result of these savings more than outweighed the increased cost of benefit and showed a net cumulative advantage to the public sector of £21bn up to the end of the century and £1bn a year thereafter, as compared with existing policies. Essentially we should be completing the switch from the pre 1979 indiscriminate support through "bricks and mortar" subsidies and public capital expenditure, to a system of "personal" subsidy through housing benefit which would ensure that help goes only to those who need it. It will, however, be necessary to do a good deal of further work to test the robustness of the figures on a variety of alternative assumptions. Extension of the exemplifications to Scotland and Wales will also be necessary, and will not necessarily produce strictly pro rate results because of the different pattern of tenure and rent levels, particularly in Scotland. The transitional period will also need close study.

9. We have assumed that investors in rented housing will require a return of about 6-7%, in addition to capital growth. These figures are based on commercial advice, but need to be investigated more fully. Three main possibilities have so far been identified in the papers, and would be worth exploring further:

- (i) letting without any subsidy from the public sector;
- (ii) letting with the assistance of a subsidy, thus allowing the required return to be obtained at a lower rent level. For illustration, a grant of 30% (by analogy with mortgage interest tax relief) is used. This kind of grant is already being pioneered for housing associations and private landlords;
- (iii) letting in the private sector as in (i) or (ii) above; but with lower rents charged in the public sector

Work Programme

10. The main elements of a work programme on other aspects of the policy are:

- (i) The means of diversifying local authority estates - how to give tenants a workable and useful right to change landlords, how to overcome local authority opposition, how to produce an effective method for intervention by the Secretary of State in the worst authorities (Note at C)
- (ii) Interaction between rent levels, rates of return and subsidy in the rented sector.
- (iii) The means of securing rent increases in local authority housing, including the concept of the unified housing account put forward by the Secretary of State, and whether we should aim to establish higher rents before major transfers of local authority stock to other owners so as to secure higher proceeds for the public sector.
- (iv) Interactions with other aspects of local authority finance including capital controls, and changes of function.
- (v) Deregulation of the private rented sector.
- (vi) Reshaping of the role of housing associations.
- (vii) Implications for housing and other social security benefits, and proposals for dealing with them.
- (viii) Wider economic effects of proposals, including RPI implications;
- (ix) Gainers and losers among individuals and among local authorities, and transitional arrangements.

(x) Effects on housing market in the south east.

Presentation of the Proposals

11. Presentation of proposals on these lines would be of crucial importance. Substantial increases in rents will not be popular, even if housing benefit covers most of the burden for the poorest. And some tenants may be suspicious of the benefits of transferring local authority estates to other owners, at least until a number of successful transfers have proved their worth.

12. In order to make the package saleable there would need to be strong emphasis on its positive features. In particular it might be desirable to offer:

(i) The prospect of securing much earlier action on outstanding repairs, and replacement of the worst housing and tower blocks much earlier than otherwise would be achieved by bringing in private capital to supplement and eventually replace public capital expenditure. It would be particularly important to demonstrate tangible results on these lines at an early stage in some of the difficult urban areas as rents begin to move upwards, and diversification proceeds. This would need, however, to take account of public expenditure constraints.

(ii) The prospect of tenants securing much more control over their own estates and blocks through management and ownership being broken down to small co-operative trusts or participative housing associations.

Timetable

13. In order to prepare a Bill on this subject for introduction this autumn, decisions on the main features of the legislation would be needed by Easter.

HOUSING BENEFIT AT PRESENT

The following table shows the number of tenants in England in the different sectors, the proportion receiving housing benefit, and the cost of benefit in 1986/87.

	Nos of tenants (millions)	Nos and % paying full rent themselves	Nos and % receiving partial support from HB	Nos and % whose rent is met wholly by HB	Cost of HB (£m)
Local authority and new town tenants	4.3	1.49 (35%)	1.24 (29%)	1.57 (37%)	1855
Private sector and housing association tenants	2.2	1.2 (55%)	0.4 (18%)	0.6 (27%)	510
Total	6.5	2.69 (41%)	1.64 (25%)	2.17 (33%)	2365

ANNEX A: HOUSING
BENEFIT AT PRESENT
(TABLES)

HOUSING BENEFIT IN 2000/01

The following table shows the same information for England in the year 2000/1 as the assumptions underlying the Secretary of State for the Environment's proposals and assuming a 4 - 5% rate of return in all parts of the rented sector.

	Nos of Tenants (millions)	Nos and % paying full rent themselves	Nos and % receiving partial support from HB	Nos and % whose rent is met wholly by HB	Cost of HB (£m)
Local authority and new town tenants	3.44	0.25 (7%)	1.09 (32%)	2.10 (61%)	4150
Private sector and housing association tenants	2.07	0.52 (25%)	0.54 (26%)	1.01 (49%)	2100
Total	5.51	0.77 (14%)	1.63 (30%)	3.11 (56%)	6250

HOUSING BENEFIT IN 2000/01

The following table shows the same information for England in the year 2000/1 as the assumptions underlying the Secretary of State for the Environment's proposals and assuming a 6 - 7% rate of return in all parts of the rented sector.

	Nos of tenants (millions)	Nos and % paying full rent themselves	Nos and % receiving partial support from HB	Nos and % whose rent is met wholly by HB	Cost of HB (£M)
Local authority and new town tenants	3.37	0.086 (3%)	1.15 (34%)	2.135 (63%)	5650
Private sector and housing association tenants	2.07	0.44 (21%)	0.58 (28%)	1.05 (51%)	2300
Total	5.44	0.526 (10%)	1.73 (32%)	3.185 (58%)	7950

1. No account is taken here of movement of tenants from the public to the private sector as a result of diversification policies
2. These are first estimates and need to be reworked in consultation with DHSS

HOUSING BENEFIT : AREAS FOR FURTHER WORK

HE Consequences

Extend calculations to cover different tenure and housing cost pattern in Scotland and Wales.

Uprating of benefits

Possibly develop methodology for and implications of excluding housing cost changes from uprating calculations for non-housing benefits; establish impact if any on pensioners not eligible for housing benefit.

Non-dependents

Possibly develop methodology for and implications of tapering the deductions from benefit in respect of assessed income from non-dependent members of households.

Individual contributions

If the principle of individual contributions to housing costs by all housing benefit recipients were adopted, this would mean savings in housing benefit costs. Net costs and savings of different options need to be exemplified, including consideration of increasing income support levels.

Changing profile of owner-occupiers

The benefit rules do not prevent a claimant buying rather than renting if that is the more economical course. But it has been difficult for householders to obtain mortgages if a large part of their income derives from housing or supplementary benefit. Cabinet has previously taken the view that benefit recipients should not positively be encouraged to become owner-occupiers. If owner occupation becomes significantly cheaper than renting, and particularly if individual recipients have to contribute to their housing costs, there may be pressure to change this approach. This will need to be explored.

Savings rule

The higher levels of rents could influence behaviour patterns by leading to households dispersing their savings to qualify for housing benefit. The implications of this need to be tested using various assumptions.

HB system based on notional rents

In principle a system of HB based at least partly on notional rents can operate on a uniform basis for both public and private sector tenants, and imposes satisfactory incentives towards reasonable rents and economy. Such a system would be superior to the existing proposals to impose economy through incentives in the subsidy system, though the practical difficulties may be greater and this needs to be fully worked through.

Timetable for changes

Changes to both HB and HB subsidy rules are implied. DHSS are making changes in April 1988, and further changes will flow in 1989 and 1990 from the introduction of the Community Charge. To minimise disruption a critical path for meshing in the additional changes needs to be drawn up.

ANNEX C

DIVERSIFYING OWNERSHIP AND MANAGEMENT OF LOCAL AUTHORITY ESTATES

Officials are examining the feasibility of the following options, or combinations of them, their likely impact and their implications for public expenditure and the PSBR:

(a) allowing tenants to opt for their housing to be taken over by housing associations, housing trusts or other private landlords;

(b) placing all local authorities (or perhaps just the worst authorities or authorities with the largest stock) under a statutory duty to plan for the transfer of their stock to independent ownership;

(c) transferring the stock of the worst urban authorities to Urban Development Corporations with housing powers;

(d) compulsory sale of local authority dwellings empty for more than a specified period, or of all dwellings as they become empty.

(e) establishing a charitable trust to promote home ownership amongst Council tenants, to facilitate coownerships and cooperatives and perhaps to assist with transfers of local authority stock of the kind mentioned in (a).

(f) changing the criteria for valuation of dwellings for right to buy purposes.

PERSONAL AND CONFIDENTIAL

FROM: D R INSTONE
DATE: 2 March 1987

CHANCELLOR

cc Chief Secretary
Financial Secretary
Sir Peter Middleton
Mr F E R Butler
Mr Anson
Mr Hawtin
Miss Peirson
Mr Scholar
Miss Noble
Mr Pirie
Mr Legg
Mr Cropper
Mr Tyrie

HOUSING POLICY - BRIEFING FOR MEETING ON 4 MARCH

This is a further meeting under the Prime Minister to carry forward discussion of Mr Ridley's housing policy proposals. This time Mr Fowler will be present as well.

2. Mr Ridley has circulated a note by officials under cover of his minute of 27 February, to form the basis of discussion.

Objectives of Meeting

3. We suggest these should be:-

(a) to agree whether the broad housing benefit consequences of Mr Ridley's proposal are acceptable; only if they are does it make sense to consider his options in detail;

(b) to agree whether all the ideas for further work proposed by Mr Ridley on housing benefit and diversification of local authority estate ownership should be pursued or whether some of them should be weeded out at this stage (see paragraphs 6 and 10 of Mr Ridley's minute and Annexes B and C of the officials' report);

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(c) to agree a target timetable for legislation; Mr Ridley's aim of legislation on all the main aspects for introduction in autumn 1987 looks very ambitious. (You have said this to him in your minute of 27 February; QL will have discussed this further earlier that day - the Financial Secretary is being briefed to make this point.)

Background

4. The main features of Mr Ridley's proposals, you will recall, are:-

(i) to encourage alternative ownership of local authority estates;

(ii) rents to rise to "economic levels" in the public sector;

(iii) deregulation in the private rented sector;

(iv) as a consequence of (ii) and (iii) substantial increases in housing benefit, but offsetting expenditure savings through eliminating direct subsidies to local authorities and increased receipts to them;

(v) a new system of local authority housing finance, which would provide greater incentives for higher rents.

5. The Prime Minister's meeting on 16 February endorsed Mr Ridley's first objective of moving as many council estates as possible out of public sector control. They agreed there were clear advantages in higher rents, but took no firm view on whether the consequences for housing benefit would be acceptable. The meeting rejected the No.10 Policy Unit's earlier "big bang" proposals, but agreed that a range of alternative measures for diversifying ownership and management of local authority estates should be pursued; these are broadly summarised in Annex C of Mr Ridley's minute.

Major Issues

(a) Housing Benefit Consequences

6. Mr Ridley's minute accepts that there is no getting away under his proposals from a substantial increase in housing benefit. Mr Ridley discusses three means of "mitigating" this effect:-

(i) holding rent levels to a 4%-5% return on assets (rather than the "economic return" level which he assumes is 6%-7%);

(ii) requiring all tenants to pay part of their rent, even those on housing benefit;

(iii) placing ceilings on benefit levels on different regions.

His minute suggests that the benefit bill in England alone could rise from £2.4 billion to nearly £8 billion by the year 2000 (though he suggests that this rise could be reduced by £2½ billion through (i)-(iii) above); Scotland and Wales would of course put up the figures higher still. Annex A to his minute also suggests that the proportion of tenants (public and private sector) whose rent would be wholly met through housing benefit would rise from 33% to 58% if rents are assumed to go up to provide a 6%-7% rate of return; even with a 4%-5% rate of return the rise (to 56%) is almost the same. (These figures have not been cleared with us but are probably of the right order of magnitude).

7. Mr Ridley strongly disputes the claim that this simply implies a large increase in the "benefit culture". He argues that the existing system of subsidies to local authorities - which his proposals would largely replace - are already effectively providing these subsidies by another, less transparent route.

8. We have set out some more detailed comments on the housing benefit consequences in the note annexed; you should note in

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particular the implied reduction in incentives to work through having more people on high marginal rates (paragraph 7 of the Annex).

9. The main question, on whether the housing benefit consequences are acceptable, is essentially a political one. Points you could make are:-

(i) If Mr Ridley's ideas are to be pursued further, the present meeting should reach a view on whether the housing benefit consequences are acceptable; whatever "mitigating" features are built in, Mr Ridley's proposals inevitably mean a big rise in housing benefit; so there is not much point in engaging officials to work these up in detail for legislation unless Ministers now think they can accept the benefit consequences.

(ii) If they are, then a good deal of further work is needed to decide how the new proposals would work (see the areas set out in Annex B).

(iii) Mr Ridley's proposed measures to mitigate the housing benefit consequences will only make a marginal difference to the balance of advantage, since:-

(a) going for a 4%-5% rate of return on rents still implies a £6 billion increase in HB.

(b) Mr Ridley assumes this would not be enough to provide an economic return; so he links this option with a proposal for "30% relief" through grants or the tax system to both public and private landlords; this could eat up the HB saving, and is anyway undesirable;

(c) the suggestion of requiring all tenants to pay part of their rents has additional

£6bn public expenditure!
lot must look @ annual profit of HBs
100s of millions
5000s.

Osypen

PERSONAL AND CONFIDENTIAL

costs (including deadweight) for DHSS's expenditure if this is compensated for by a general ^{rise} use in income support levels (see paragraphs 3-6 of note annexed).

So best to discount the "mitigating" proposals in deciding if Mr Ridley's main proposals are acceptable in terms of HB consequences.

(iv) Unless very early decisions can be taken (unlikely, see below), there may have to be one set of changes, of a less radical kind, in April 1988 - planned by Mr Fowler under his existing proposals - followed by another, more radical set, to meet Mr Ridley's aims, (say a year or two later). This is not impossible, but needs to be recognised.

(b) Areas for Further Work

10. Points you could make here are:-

(i) Endorse the proposed work programme set out in the officials' paper attached to Mr Ridley's minute.

(ii) Note that the public expenditure consequences of several of these proposals will need to be considered very carefully - for example the proposed additional urban development corporations and "charitable trust" ((c) and (e) of Annex C) may require significant amounts of public expenditure.

(iii) The new proposed local authority housing finance structure (paragraph 10(iii) of the officials' paper) will also need to be looked at very carefully, to ensure that it is workable; it must, of course, also be compatible with the reformed arrangements for LA current and capital spending in general.

(iv) Ministers should not at this stage take a firm decision on whether the precise figure of 6%-7% real

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✓ rate of return is the right rent figure to aim at; Mr Ridley thinks it important that local authority rent should be at the same level as those in the private sector (to provide a fully competitive market); this seems right; but it is by no means clear that 6%-7% (or indeed any other figure) is exactly the right figure to aim at; this needs further examination.

✓ (v) Very doubtful that case for a 30% grant - whether direct or through tax reliefs - should be pursued (as Mr Ridley proposes) if rent increases are only 4%-5%.

✓✓ (vi) Deregulation of the private rented sector - including on both rents and security of tenure - should be pushed ahead with urgency. It was not discussed at the Prime Minister's last meeting, but is an essential part of the programme.

(c) Timetable for Further Work

11. Points to make here are:-

|| (i) Mr Ridley's aim of legislation to be introduced in autumn 1987 looks over-optimistic. Paragraph 13 of his minute says that this implies decisions on the main features of the legislation being needed by Easter. This is extremely tight, especially to cope with:-

(a) the housing benefit consequences; and

(b) the proposals for reforming local authority housing finance.

(ii) It is more realistic to aim at legislation for introduction in autumn 1988; otherwise there is a clear risk of getting the legislation wrong.

(iii) As a compromise, it might be possible to take legislation on the private rented sector first, ie

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with its introduction in autumn 1987 and the public sector legislation in a separate bill in autumn 1988; the private rented sector legislation is likely to be easier to manage in the time available; and the housing benefit consequences are smaller.

DRly

D R INSTONE

COMMENTS ON THE HOUSING BENEFIT CONSEQUENCES

COMMENTS ON THE HOUSING BENEFIT CONSEQUENCES

Mr Ridley's letter makes it clear that his proposals would take the Housing Benefit Bill in England from 2.4 billion to nearly 8 billion. The tables attached show that the claimant load would rise from 3.8 million to 4.9 million, an increase of 1.1 million, and that also needs to be brought out. Moreover, the increase in claimant load from these higher rents would compound the increase already expected from introducing rebates for the community charge. The figures quoted for that last summer were 1.5 million. There will be some overlap with the 1.1 million; but not much, because the increase in claimant load from the community charge will mainly be among single non-householders.

2. Mr Ridley proposes three ways of trimming the prospective increase in the housing benefit bill. Firstly, he claims that reducing the rate of return to 4 or 5 per cent would cut the increase by £2 billion and reduce the increase in claimant loan to 0.9 million - but we have not been able to check either of these figures.

3. He proposes two other ways of containing the housing benefit bill: requiring all tenants to pay part of their rents; and placing a ceiling on benefit levels in different areas of the country. He claims this would save about £½ billion, but again we have no idea if that is in the right ball park or not. The costings would depend critically on whether DOE are assuming that there would be partial or full compensation through the income support rates, and at what level the benefit ceilings would be set. On the latter, if the benefit ceilings are set at less than "economic rents" the whole policy would be frustrated; so it is difficult to see how this will reduce the cost of the proposals.

4. The idea of making everyone pay a proportion of their rents is attractive in principle, but far from easy politically. And the issue of compensation is critical. It is clear Mr Ridley envisages at least partial compensation, and that would be

consistent with the line DOE took on rates (see below). They lost the argument on that, but the issue is the same one as they are now running on rents.

5. The point is that on April 1988, housing benefit claimants will be expected to pay 20 per cent of their rates, experiencing a loss on average of about £1 a week (20 per cent of the average rates bill of a little over £5 a week). There will be no compensation through the income support rates for this, and, largely as a result of that, we expect to make about £350 million of PSBR savings on rate rebates. DOE supported the principle of paying a proportion of rates, but have always argued that the income support rates should be set higher to compensate. However, it is impossible to compensate only those who are paying rates in the new income support scheme, since the new scheme abolishes the distinction in the present supplementary benefit scheme between householder and non-householder (all help with housing being given through HB). The deadweight cost of giving compensation for the 20 percent rates contribution would therefore have been very substantial, since it means giving the same extra amount to, for example, single non householders who have no rates bill.

6. The sums of money at stake in the latest proposals are even larger. Average rents are of the order of £15 a week, but under Mr Ridley's proposals would be expected to rise to about £30 a week. 20 per cent of that would be £6 a week. In London, however, average rents are substantially higher. A rent of, say, £25 a week would, under Mr Ridley's proposals, rise to £50 a week; and 20 per cent of that is £10 a week. People on income support could not possibly sustain such losses without compensating adjustments to the income support rates. But doing so on a national basis would leave those in high rent areas significantly worse off; in contrast, those in low rent areas would have an unexpected windfall. Regional variations in income support rates might be the answer; but we would then have a curious, and administratively complex, hybrid between housing benefit and income support. Increasing the income support rates across the board, irrespective of housing status would have an enormous deadweight cost. The increase would go to single non

householders and those with mortgages, for example. The higher income support rates would mean more people qualifying for that benefit. And because the income support rates will define the family credit and housing benefit needs allowances in the new scheme, raising the income support rates would also raise the cost of family credit and housing benefit, and the numbers qualifying. (We do not have estimates of all these costs; DHSS would need to provide them).

7. The effect on incentives is also something Ministers will need to bear in mind in considering these proposals. It is a point which has not come out so far. Mr Ridley seems to be arguing that those in rented property are already subsidised; a combination of higher rents and more people on housing benefit only makes explicit what is currently implicit, resulting, on balance, in an improvement in "incentives to behave responsibly" and with no net adverse effect on the "benefit culture". But against that, housing benefit is means tested benefit with a high marginal withdrawal rate (60 percent for rents, 20 percent for rates). Apart from increasing the exposure to all the paraphernalia of claimants' advisers, pressure groups etc, therefore, (and some LA's now use their HB claimant lists for mail shots encouraging take up of other social security benefits) everyone put onto HB has their "marginal tax rate" increased to at least 60 per cent. And because 100 per cent of rent is paid for those out of work, whereas those in work get only a proportion of their rent paid (providing their income is above the basic income support level), higher rents mean a lower absolute difference between in and out of work incomes - that is, they worsen the unemployment trap, as well as holding people in the poverty trap.

PERSONAL AND CONFIDENTIAL

FROM: A TYRIE
DATE: 3 MARCH 1987

CHANCELLOR OF THE EXCHEQUER

cc: Chief Secretary
Mr Cropper
Mr Ross Goobey

HOUSING POLICY

I have seen Mr Instone's note of 2 March and strongly agree with the line to take he sets out in paragraph 10, not to close doors of any of Mr Ridley's proposals except his "30% relief" proposal.

2. I would like to emphasise a few points:

- (i) if we want to make radical changes to council estates there is no alternative but to grasp the housing benefit mettle. It is the price we must pay for the past few decades in which we have asked private sector landlords and ratepayers to subsidise housing in lieu of the Exchequer. The Rent Acts have served as a form of public expenditure control for too long;
- (ii) greater dependence on housing benefit does not increase dependence on the state. It would replace the blurred and fudged dependence from several quarters with a single transparent subsidy;
- (iii) Mr Ridley is surely right to see this as a Year 1 measure, something it will be all too easy to find excuses to shelve, if not enacted quickly. On a cautionary note, I see dangers in acting simultaneously to move to market rents and vigorously to attempt to transfer local authority estates to other owners. The combination of these two measures would provide Labour local authorities with a golden opportunity to portray themselves as valiant protectors of their vulnerable tenants. I think we will have to move more cautiously on policies to transfer estates in the first year at least;

(iv) I see advantages with giving a lot of Ministerial impetus to the proposals in Annex C on which officials are working (with the possible exception of (b) and (c)). Over the life of a Parliament these salami tactics could prove very valuable, with concomitant expenditure savings.

AGT.

A TYRLE



FROM: A C S ALLAN
DATE: 3 March 1987

CHANCELLOR

HOUSING POLICY

I find it very wet to simply say (paragraph 9) that "the main question, on whether the housing benefit consequences are acceptable, is essentially a political one". At issue is an extra £6 billion public expenditure.

2. What we need is an analysis of how quickly the extra housing benefit expenditure and the various offsetting savings would feed through. It makes an enormous difference whether we have an extra £6 billion to pay early on, with the savings on other spending flowing through only slowly; or if the whole thing is more balanced, and any extra spending builds up slowly. This must be a priority for further work.

AA

A C S ALLAN

ACSA
TO
CH/EX
3/3

CH/EXCHEQUER	
REC.	-6 MAR 1987
ACTION	MR WSTONE
COPIES TO	CST SIR P. MIDDLETON
	MR FER BUTLER
	MR ANSON MR SCHWARZ
	MISS PETERSON MR HALTIN
	MISS NOBLE
	MR TYRRE
	MR CROPPER.

PERSONAL AND CONFIDENTIAL



10 DOWNING STREET
LONDON SW1A 2AA

From the Private Secretary

pyg

Have you spoken to Mr. Hawton?

done VAA 6/3 X 27

(sp X)

Dear Bob,

HOUSING POLICY

The Prime Minister yesterday held a meeting to discuss housing policy on the basis of your Secretary of State's minute and paper of 27 February. There were present your Secretary of State, the Chancellor of the Exchequer, the Secretary of State for Social Services, and Mr. Peter Stredder, No.10 Policy Unit.

non-seq { Your Secretary of State said that in his view it was right to expect people to pay a proportion of their rent as well as their community charge. Housing benefit would need to be increased in that event, and this would have a substantial cost because of the dead weight. The cost could be reduced by perhaps £1 billion through placing a ceiling on benefit levels in different areas of the country. Requiring all tenants, even those on benefit, to pay some part of their rent themselves, might save another £2 billion. It also had to be kept in mind that the very poor state of large parts of the country's council housing would require substantially higher expenditure in any event and the only question was whether this would be provided through a combination of higher rent and higher housing benefits, or directly through expenditure on bricks and mortar. The first course would create less dependency than the second, because it would encourage greater mobility and personal responsibility.

by whom? In discussion, it was argued that your Secretary of State's proposals would lead to a very substantial increase in the number of people receiving housing benefit, even if, as the Chancellor agreed would be reasonable, rent levels were held to a 4-5 per cent return rather than 6-7 per cent. Higher rents would encourage perhaps a million or so more people to buy rather than rent, but both the proportion receiving housing benefit and the absolute number would rise. This would increase dependency and damage incentives to work. Higher rents would also increase inflation as measured by the RPI. There were particular difficulties about canvassing an option of this kind towards the end of a Parliament. It would be preferable to try to tackle the problems through for example reducing the price at which tenants could buy their homes, reviving the private rented sector through decontrol,

PERSONAL AND CONFIDENTIAL

NOV 20 1987
TO
YOUNG
5/3

allowing transfer of council housing to housing associations and private landlords and other ways which had been discussed at the last meeting of the group. These changes might be encouraged by a more gradual increase in rents, with increases taking place particularly after the housing concerned had been renovated.

Your Secretary of State doubted whether changes of this kind would meet the problem. They would not create enough incentive for radical change; nor would they allow expenditure on the scale needed to renovate the council housing stock. Rents had increased in the last Parliament, though not by very much, and in this Parliament they had been declining in real terms. All analysis of the problems eventually concluded that higher rents were a pre-condition for reform of the housing market and the opposition parties themselves had begun to acknowledge this.

X | It was agreed that the work now under way following the group's last meeting should cease for the present. It would however be useful for the group's next meeting to have available a year by year analysis of the effect of Mr. Ridley's proposals on public expenditure and PSBR, together with a similar assessment of the effects of a more gradual increase in rents, with rents being increased particularly after renovations. The Secretary of State for Social Services would prepare illustrative examples of the effect on housing benefit recipients of different family types, of higher rents and of requiring everyone to pay a proportion of their rent. He would also consider their effects on income support, to include both an assessment of the consequences for public expenditure of compensating people through higher income support in full or in part, and illustrative examples for different family types. The effect on work incentives should be discussed with the Secretary of State for Employment, who would be invited to the next meeting of the group.

Y |

I am copying this letter to Alex Allan (HM Treasury) and Geoffrey Podger (Department of Health and Social Security).

David

(DAVID NORGROVE)

Robin Young, Esq.,
Department of the Environment.



10 DOWNING STREET
LONDON SW1A 2AA

From the Private Secretary

CH/EXCHEQUER	
REC.	10 MAR 1987 10/3
ACTION	MR INSTONE
COPIES TO	CST SIR P. MIDDLETON MR FERRELL MR ANDSON MR SCHOLAR MR HALPIN MR PERKINS MISS NOBLE MR TYRRE MR CROPPER
10 March 1987	

purp

NOV, ROVE
TO
YOUNG
10/3

Dear Mr. Young,

HOUSING POLICY

The Prime Minister this morning had a word with your Secretary of State about his proposals for reform of housing policy.

Mr. Ridley explained that his proposals had a number of elements. New private lettings would be deregulated. Limits on housing benefit would be set by area. The housing accounts of local authorities would be ring-fenced with the result that central government would gain control over council rents, the community charge and hence the transitional period would be lower and most of the problem with capital controls would be removed. Payment of housing benefit would be brought within the scope of the ring-fenced accounts. New council house construction would be controlled. Tenants would be allowed to opt for a change of landlord (acting together in blocks or estates, not as individuals) with help from an outside organisation, which might be housing associations or a private sector body. Urban development corporations would be created in the worst areas which could take over responsibility for housing under existing legislation. The UDCs could later sell the housing to housing associations, trusts or private landlords. The UDCs would need to take over responsibility for the associated debt with the housing stock. Your Secretary of State commented that the scale of rent increases needed would vary between different parts of the country and in some areas no increase might be needed at all. It would be within the Government's discretion to determine how far and how fast rents increased in any particular area.

The Prime Minister said that the presentation of Mr. Ridley's proposals would require the most careful consideration. It would be important to link rising rents to renovation, and to show that one result would be demolition of tower blocks and their replacement by low rise, crime resistant housing. An assurance could be given that rents would not exceed the proper level for the quality of housing concerned and the locality.

Your Secretary of State mentioned finally his concern that the length of the transitional period to the community charge in England should be reduced. His housing proposals would help with this. But the position in London

remained particularly difficult as a result in part of the expense of the ILEA. The Prime Minister invited your Secretary of State to discuss this with the Secretary of State for Education, who was at present preparing a paper on the position of the ILEA.

This discussion need not affect the papers being prepared for the next meeting of Ministers on housing policy, namely, a paper on the year by year public expenditure and PSBR implications, and a paper (or papers if more convenient) on the implications for housing benefit, income support and work incentives, to include the effect of requiring everyone to pay some proportion of their rent. You are no doubt taking the lead on the first of these papers and DHSS on the second. The papers should of course be given the most limited possible circulation within departments.

I am sending a copy of this letter to Alex Allan (HM Treasury), Geoffrey Podger (Department of Health and Social Security) and John Turner (Department of Employment).

Yours sincerely,

Deborah Greer

p.p. (DAVID NORGROVE)

Robin Young, Esq.,
Department of the Environment.

PERSONAL AND CONFIDENTIAL

FROM: D R INSTONE
DATE: 16 March 1987

PS/CHANCELLOR

cc PS/Chief Secretary
Mr F E R Butler
Mr Anson
Mr Hawtin
Miss Noble
Mr Tyrie
Mr Cropper

HOUSING POLICY

Mr Ridley has now circulated his paper for discussion at the Prime Minister's next meeting on 18 March.

2. At the last meeting the Chancellor put particular emphasis on the need to show the year by year public expenditure and PSBR effects of Mr Ridley's proposals.

3. In fact, however, the paper circulated by Mr Ridley does not do this adequately, in particular because:-

(a) it does not show the effects of measures to deregulate the private rented sector; the figures only cover the local authority sector; so the housing benefit cost is understated;

(b) the figures shown only cover one main assumption - ie capital expenditure on renovation continuing at least as high as that in the PES baseline now; alternative assumptions are not explored which would still be consistent with Mr Ridley's proposals; these could alter Mr Ridley's conclusion that the effects of his proposals are PSBR neutral;

(c) the public expenditure, as distinct from the PSBR effects are not shown.

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4. DOE officials discussed the drafting of the paper with us, but in the event appear to have taken little account of our comments.

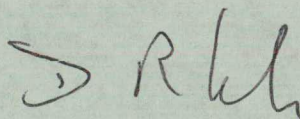
5. There is no obvious operational reason why the meeting need go ahead on Wednesday. The alternatives are:-

(a) to let the meeting go ahead as planned, with the Chancellor relying on briefing to make the kind of points mentioned above;

(b) to seek a postponement of the meeting, with the aim of getting Mr Ridley to cover more fully the public expenditure/PSBR implications in advance.

6. There seems a good case for seeking a postponement. The meeting will in any case need a further input from DHSS on the effects on work incentives, which has yet to arrive. I suggest therefore you might speak to Mr Norgrove to see if he will agree to a postponement of the meeting. He will then also need to ask Mr Ridley's office to cover the public expenditure and PSBR effects more fully in a revised paper agreed with us.

7. We shall of course provide fuller briefing if the meeting goes ahead.



D R INSTONE

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	MR HAUTIN
MISS PEIRSON	
MISS NOBLE MURPHY	
MR CROPPER.	

10 DOWNING STREET
LONDON SW1A 2AA

*ALSA
for speaker.
I have written
down to send
this @ all*

16 March 1987

Rt Hon Nicholas Ridley Esq
Secretary of State for the Environment
Department of the Environment
2 Marsham Street
LONDON SW1

*BP for meeting
Peter.*

Dear Secretary of State,

In preparation for this Wednesday's meeting you may like to see the attached note setting out the Policy Unit's current thinking on housing policy.

A copy of this note has already been passed to the Secretary of State for Employment and I am sending a copy to the Chancellor and Secretary of State for Social Services with this letter.

Yours sincerely

Peter Stredder

PETER STREDDER

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TO
DOE
16/3

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AN EIGHT POINT PLAN FOR HOUSING

The main housing problems are lack of an adequate private rented sector, council tenants who feel trapped, a deteriorating council house stock and bad management by local authorities.

We recommend an eight point plan for housing. Each of our proposals is a distinct step forward. None involves an upheaval but taken together they represent a major shift in the direction of greater choice and more control over their affairs for council tenants.

1. Encourage owner occupation

- a. Renew the commitment not to withdraw mortgage interest relief.
- b. Continue home improvement grants targetted on the least well off owner occupiers.

2. Revive the Private Rented Sector

- a. Allow rents and security of tenure to be freely negotiated when existing tenants leave and on all properties newly brought into the private rented sector.
- b. Encourage housing associations to play a major role in the new private rented sector by providing pump priming grants for new housing for letting at deregulated rents.
- c. Impose strict controls on the level of new council house building.

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- d. Prevent local authorities subsidising rents from the rates.

3. Increase Council House Sales

- a. Increase discounts on council house sales to the level needed to make it worthwhile at present rent levels for all tenants not dependent on state support to buy their homes. We suggest maintaining the starting discount at 30% (40% for flats) but increasing this by 3% for each year purchasers have been public sector tenants up to a maximum of 75% (85% for flats) after 15 years.
- b. Require local authorities to sell flats and houses that have remained empty for longer than a specified period (say, 6 months) first to tenants and, failing a purchaser, by auction on the open market.
- c. Develop a scheme to enable unemployed tenants from their own resources (ie not extra housing benefit but possibly by setting aside a small part of their supplementary benefit) to build up a capital sum for home purchase. This could be done by giving tenants part of the equity in their house in return for labour on DIY improvements; by allowing tenants to purchase a small portion of the equity in their dwelling with regular weekly payments and by developing a special savings scheme exempt from the normal social security savings rules provided the money is eventually invested in housing.

4. Establish an Independent Housing Trust

Create a new trust (on the lines suggested in Annex C) funded largely by the private sector but with some public funds diverted from voluntary bodies such as Shelter to:

- a. Advertise the right to buy scheme and provide tenants with advice on options and practical assistance.
- b. Put tenants who wish to transfer in contact with possible independent owners and help organise transfers of tenanted property.
- c. Assist groups of tenants who wish to establish and transfer ownership to estate based trusts, cooperatives or housing associations.

5. Renovate Council Housing

- a. Give local authorities an incentive to correct the design mistakes of the past including pulling down the worst blocks that cannot economically be repaired.
- b. Encourage local authorities to implement Dr Alice Coleman's ideas for modifying features that encourage crime and vandalism - for example by breaking up communal space into private areas for which individual tenants are responsible.
- c. Enable improvement work to be funded from higher rents.
- d. Continue to encourage local authorities to develop improvement schemes in partnership with the private sector.

6. Strengthen Tenants Rights

- a. Give council tenants individually the right to transfer their house to independent ownership at a fixed price - say $7\frac{1}{2}$ times net rental income - that allows the private landlord at least to cover his costs without a rent increase. Further details are at Annex B. This would give tenants in badly managed authorities or run down

housing the opportunity to improve the quality of their housing by choosing a housing association with a proven record in management and access to private sector funds for refurbishment.

- b. Allow tenants to carry out DIY improvement at their own expense without authority from the council.
- c. Remove constraints on tenants working from home.
- d. Let unemployed tenants pay for major refurbishment by working at benefit rates on major refurbishment schemes.

7. A Charter for Council House Tenants

Bring together the relevant points in this note, Norman Blackwell's note on unemployment and Hartley Booth's note on crime and council housing into the Charter for Council Tenants at Annex A.

8. Homelessness

This policy may be criticised for doing nothing for the homeless. But we can:

- a. Ensure that adequate housing is available before patients are discharged from long stay institutions.
- b. Provide pump priming grants to housing associations to fund hostels for the homeless with private finance.
- c. Point out that the long term solution to homelessness is to revive the private rented sector.

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Conclusion

This approach is attractive and could prove popular because there would be:

- i. a major drive to sell as many council houses as possible;
- ii. a route out of council housing for those tenants who want one but no compulsory transfers;
- iii. no major increase in the cost of housing benefit or the number of recipients but rents could be increased to pay for improvements. It will avoid the adverse impact (as illustrated in Annex D) of a general increase of up to 100% in council house rents.

PETER STREDDER

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A CHARTER FOR COUNCIL TENANTS

1. Housing Rights

- a. Increased discounts on council house sales and practical help and advice from an Independent Housing Trust.
- b. A first option to buy vacant council houses.
- c. A new scheme enabling unemployed tenants to build up a capital sum for house purchase exempt from the social security savings rules.
- d. A right for the individual tenant to transfer from the local authority to independent ownership and to help and advice from an Independent Housing Trust.
- e. The right to carry out improvements to their own house.
- f. The opportunity to pay for renovation work by working on more major renovation schemes.

2. Employment

- a. The right to work from home.
- b. The opportunity and motivation provided by bringing Department of Employment and MSC programmes onto council estates - establishing local job centres, Restart programmes, job clubs, community programmes and training schemes.
- c. An opportunity for local enterprise - enabling tenants to rent starter workshops converted from disused ground floor flats or build new workshops erected on council estates.
- d. Include more shops on estates.

3. Crime

- a. Priority for elderly tenants who wish to transfer out of high crime estates.
- b. A basic security lock package for elderly tenants on supplementary benefit.
- c. A new type of better trained special constable who could help the police to organise neighbourhood watch schemes on council estates.
- d. Funds for youth and sports centres to give young people on council estates something to do.

A RIGHT TO RENT

This note proposes that council tenants should be given a right to choose, individually, a new private sector landlord. This would enable tenants to choose to transfer to a local housing association or to a tenant trust set up for the purpose. This 'right to rent' would work as follow:

- Legislation would specify the terms on which an individual house should be transferred to a private sector landlord. As in the 'right to buy' legislation these should be generous to encourage transfers and should take account of the need to fund renovation work. These terms will determine the effect of transfers on rents.
- Initially the right would apply only to houses (two thirds of the council stock). We see no difficulty in several landlords owning houses in the same street. This is what happens with owner occupation and what would happen with a flourishing private rented sector.
- Later it could be extended to flats. A company would be set up to own the freehold and be responsible for repairs to the common areas (just as with some owner occupied flats). Initially the local authority would own all the shares in the company. The new landlord of a flat would purchase a long lease as well as a share in the company.
- There would be no compulsion on housing associations or other landlords to take over estates but many might wish to make themselves available. If a group of tenants wished to form a trust to manage part of an estate they could do so provided the trust deeds conformed to certain standards without needing to secure the agreement of the

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remaining tenants who would stay tenants of the local authority until individually they choose otherwise.

This policy is exciting and tackles the heart of the problem of council housing because:

- It gives those tenants who are not in a position to buy hope.
- It does not force transfer on those tenants who do not want it.
- It attacks the collectivist mentality of tenants (and, it must be said, the collectivist mentality of other proposals for transferring council estates to the private sector) by allowing them to take individual decisions about their futures.

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A CHARITABLE TRUST TO PROMOTE PRIVATE OWNERSHIP OF
COUNCIL HOUSING

The Desire for Ownership

There are currently 4.3 million council tenants in England. About 1.5 million of these (35%) are paying their rents in full. Most of these will be in full or part-time work although some will be occupational pensioners. In addition some tenants in full or part-time work or with a smaller occupational pension have part of their rent paid through housing benefit. Almost all the tenants not at present on housing benefit and some of those receiving partial benefit are potentially in a position to purchase their houses.

The DoE believe that perhaps 0.5 million tenants (12%) are likely to buy their homes at some time in the future on present policies but that a further 0.4 million (9%) would do so if rents were raised to economic levels as proposed by Mr Ridley.

The annex summarises recent market research on council tenants' attitudes to house purchase. This shows more extensive interest in home ownership than the DoE estimates suggest. 39% of tenants would prefer to own and 46% thought it likely that they would own in 10 years time. A smaller

percentage (15%) of tenants thought it likely or very likely that they would buy. This is still larger than the DoE's estimate that 12% will purchase at current rent levels. In the long term the market research figures show that there is no reason why the other 23% of tenants in work should not buy. So there may be much more scope for sales than the DoE suggest.

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The research also suggests that, whilst financial considerations play a part in the decision, they do not predominate. Tenants are motivated to own by many other factors such as a desire for independence, pride in ownership, freedom to carry out repairs and improvements and liking the house or the area. On the other hand some authorities actively discourage 'right to buy' applications. You may be aware of the recent scandalous campaign by Islington to discourage right to buy sales by refusing to undertake all but the legal minimum of repairs once a tenant has applied to exercise his 'right to buy'.

A major selling campaign emphasising financial and non-financial benefits of ownership and practical help for tenants, including dealing on their behalf with unsympathetic authorities could play a major role in realising the maximum potential for sales.

Doing something for those who remain tenants

However successful the campaign to sell council houses, at least some two million tenanted dwellings are likely to remain for the foreseeable future. The market research evidence shows that a significant minority (11%) of tenants are dissatisfied with their housing. Lack of repairs, cold, damp and bad neighbours are some of the reasons for this dissatisfaction. This suggests that tenants could be won over to private sector ownership of their estates if we emphasise the freedom the new landlords will have to fund repairs. As Norman Blackwell's note points out, some 55% of unemployed people live in council houses. Less than half these, some 0.75 million are heads of households and comprise some 15% of council tenants. It is particularly important to motivate this group of tenants by giving them more opportunity to get involved in managing their housing or undertaking DIY and other repair work. This means transferring their housing to private sector

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ownership - perhaps a cooperative or trust with a measure of tenant involvement.

Many local authorities will be hostile to this approach and will endeavour to discourage transfers of estates to independent ownership. We need to provide encouragement and support to tenants who wish to transfer their estates to private ownership.

The Charitable Trust

We therefore envisage establishing a trust to encourage and facilitate right to buy sales and facilitate transfers to private ownership. It might need to be established by statute in order to ensure that it had powers to carry out its responsibilities effectively. The trust would be funded as far as possible by charitable donations and business sponsorship, for example from banks, building societies and companies with an interest in housing. But it might also need some public grant aid, some of which could be found within existing resources by diverting money from pressure groups such as Shelter.

I was recently given a presentation of a possible marketing campaign by DMB&B, of which Ian Sproat is a director. They have already sounded out several companies (Servowarm, Central Heating, Everest Double Glazing, MFI Kitchens) who expressed interest in a campaign which would give council tenants exercising the right to buy a substantial discount on their products. The DoE are considering this proposal but it may not get very far because of rules requiring central Government advertising campaigns to 'tell' rather than 'sell'. One of the main advantages of the Trust would be that it could run such a campaign.

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Home Ownership

The trust would set about encouraging sales of council houses as follows:

- there would be a national advertising campaign on press, TV, radio and by direct mail designed to sell council houses not merely inform tenants as Government rules require for existing campaigns (I attach the DoE's current promotional material). Care would need to be taken to avoid implying that tenants should over-commit themselves.
- Other marketing incentives could be used if funds or commercial sponsorship were available.
- There would be a 'one-stop' advice service at the end of a free telephone number, also accessible by reply paid cards included in direct mail advertising and freepost.
- This service would be able to tell individual tenants what options were open to them in their particular circumstances - such as shared ownership or full purchase.
- It would also undertake the necessary paper work, dealing with councils, building societies, surveyors and solicitors on tenants' behalfs if they wished. Part or all of the cost of this service could be recovered in a fee which could be rolled up in the mortgage.
- This programme might also be supplemented by visits to estates which could include mobile offices, meetings and (possibly) visits to individual tenants.

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Transfers of Tenanted Estates

An equally important role of the trust would be to encourage tenants to transfer their estates to independent ownership, with the maximum possible element of tenants' involvement. It would proceed as follows:

- As for home-ownership, it would publicise the benefits to tenants of transfer to independent ownership and their statutory rights.
- It would provide a readily accessible advice service for tenants considering transferring their estate to private ownership and work up specific proposals if they wished.
- It would evaluate proposals for transferring estates put forward by tenants, local authorities or third parties as a basis for tenants to take a decision.
- It would supervise the process of consulting tenants about proposals (which might include a ballot).
- It would arrange management support for estates that had been transferred to independent ownership where required.

Method of Operating

The trust would not need a large staff of its own. Much of the work could be sub-contracted to private sector organisations. For example, the point of contact in 'one-stop' service for purchases could be run by Teledata, Access, Barclaycard, the AA or one of the many other private sector organisations based on telephone contact with customers and a computer database. Advertising would be

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handled by commercial agencies. Management support would be contracted out, for example to existing housing associations.

Conclusion

A new national charitable trust is needed to maximise the potential for council house sales and transfers of tenanted estates to independent ownership. Using a variety of means it could circumvent the likely inertia and resistance of local authorities and so help to speed up the transfer of housing from the public sector whilst relying on a voluntary approach.

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COUNCIL TENANTS ATTITUDES TO BUYING THEIR HOMES

The April 1986 Housing and Savings Survey conducted by the British Market Research Bureau for the Building Societies Association includes the following fascinating information about the attitudes of council tenants to buying their homes.

Desire for Ownership

39% of council tenants' preferred tenure in two years' time is owner occupation. 46% of council tenants hoped to be owning their homes in ten years' time. The main reasons given by tenants for wanting to own were:

Wanting to be an owner	42%
Cheaper in long run/can't be evicted	24%
Good investment	17%
Flexibility to do DIY etc	14%
Independence/Pride of ownership etc	13%

The main reasons cited by tenants who wanted to buy as possibly preventing them from buying were lack of money (26%) and redundancy (14%).

Interest in buying present house

Not all the tenants wanting to become owners would buy their existing house. But 31% of tenants (ie about 80% of those wanting to be owners in two years' time) were interested or very interested in buying their present home. The main reasons given were:

Wanting to be an owner	31%
Liking the area	23%
Liking the house	13%
Value as an investment/availability of discount	11%

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The incomes of those who were interested or very interested in buying their present home were:

Under £3,000 pa	26%
£3,000-£5,000 pa	22%
£5,000-£7,000 pa	16%
£7,000-£10,000 pa	13%
above £10,000 pa	5%
Don't know	18%

For comparison, a tenant buying an average price council house would require an income of £4,000 to £7,000 depending on discount to raise a 100% mortgage.

Likelihood of Buying Present House

15% of tenants thought it likely or very likely that they would buy their own house but only 7% of the 25% in maisonettes or flats. Reasons for being likely or very likely to buying their present house were:

Can afford	18%
Waiting for funds/intend to apply	17%
Like area	14%
Good investment	14%
Always wanted to own	13%

Dissatisfaction with Council Housing

11% of council tenants said that they were dissatisfied with their present accommodation compared with under 1% of owner occupiers. Reasons given for dissatisfaction were:

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<u>Unprompted</u>		<u>Prompted</u>	
House needs repairs	30%	Needs repairs	66%
House cold/damp/draughty	28%	Too small	36%
Specific problems with house	22%	Expensive to	
Size/lack of garage	18%	maintain	27%
Area/Behaviour of neighbours	17%	Area	24%
House needs modernisation/ repairs	12%	Neighbours	17%
House lacks central heating	8%	Location	15%
		Transport	13%

Reasons for lack of interest in buying

Reasons given by tenants for not being interested in buying were:

Too old (tenants, not house)	30%
Don't like area	22%
Cannot afford	22%
Don't like house/structure/size	17%
Satisfied with renting	9%

Reasons given for not being likely to buy were:

<u>Unprompted</u>		<u>Prompted</u>	
Financial situation	13%	Too old (tenant, not house)	45%
Too old (tenant, not house)	8%	Too expensive -	
		to buy	33%
		to maintain	20%
		House needs repairs	19%
		Too small	11%
		Don't believe council houses should be sold	12%

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EFFECT OF DOUBLING RENTS OF WORK INCENTIVES FOR A MARRIED
MAN WITH 2 CHILDREN AGED 6 AND 13 - NOVEMBER 1985 PRICES

<u>Gross Earnings</u>	<u>Gain from working at Present Rents (1)</u>	<u>Gain from working at Doubled Rents</u>	<u>Charge</u>
	£ per week		
40	1.63	1.63	Nil
70	4.60	4.60	Nil
100	6.77	6.24	-8%
130	12.27	8.44	-31%
170	27.07	14.36	-47%
190	39.27	22.77	-42%

- (1) £16.50 per week
- (2) £33 per week
- (3) Average earnings



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PRIME MINISTER

meeting folder
when is briefing
expected.

HOUSING POLICY

CR

1 We are to meet again on 18 March to resume the discussion of housing policy.

Costings

2 As requested at our last meeting I attach at Annex A figures showing the public expenditure and PSBR effects year by year of the proposals I put forward up to 1993/94. The figures have been reworked to illustrate a step-by-step approach to rent increases. They illustrate local authority rents rising by either 5% per annum in real terms or 10% per annum, with the increased rents being linked in both cases to increased capital spending on renovation (so that tenants who pay higher rents enjoy better maintained housing).

3 You will see that these assumptions produce results which are broadly neutral in PESC/PSBR terms. But even on the 5% p.a. real rent increase they would generate an extra £2bn cumulatively over the next 5 years to finance renovation. This would make a significant impact on the disrepair which authorities have allowed to build up by charging rents which are too low to meet essential maintenance. We could of course decide each year how much we could afford to spend on capital renovation of housing.

Presentation of main policies

4 The main policy instruments I have proposed are:

- (i) unified housing accounts for local authorities;
- (ii) decontrol of new private lettings;

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- (iii) removal of housing from local authority control;
- (iv) linking housing benefit to reasonable rent levels.

The political and operational advantages to us of each of these are clear. They will of course require very careful public presentation. This paper does not yet attempt to do that, but the key points which we would want to stress are as follows:

- (i) Unified housing account for local authority housing.

Separating housing from other services, and ending ratepayer subsidy, will compel all authorities to manage and account for their housing operations in a responsible and business-like way (as the best already do). In particular they will have to make proper provision for repairs and maintenance so that deterioration does not build up again. We shall have a strong influence through a financial régime which will ensure that authorities follow responsible practices on rent levels and repair. It will also enable us to allocate resources more sensibly: authorities will be able to use their own resources of rents and capital receipts in full for the needs of their own areas; we will be able to allocate a smaller quantity of top-up resources by way of borrowing or Exchequer grant to deal mainly with the problems of the most needy areas. The separate housing account will also simplify reform of the general capital control system for local authorities, and will reduce the problem of the burden on the community charge, particularly in London.



(ii) Deregulation of rents for new lettings in the private rented sector.

There is a wide consensus now that this is an essential step towards private investment in the rented market. The measures I propose would maintain the rights of existing tenants. Although those in new lettings would not have controlled rents, they would still enjoy some security of tenure by contract and - like commercial tenants at present - would have a right to have their new rent settled by arbitration if they so wished when an existing tenancy was to be renewed. We would strengthen controls against harrassment. This would greatly increase freedom of choice and mobility.

(iii) Reducing the local authority estate.

The private rented sector will include housing associations and co-operatives as well as traditional company or individual landlords. Tenants of local authorities may increasingly come to feel that they would do better with one of these other forms of landlord, operating closer to them, more responsive to their needs, or more under their own control or influence. We have already given them a right to suggest such transfers and have them considered. Now we would go further and give them the right to insist. In cases where an authority is patently mismanaging its housing or neglecting its tenants' interests, we would provide powers for the Government to put in a suitable body to take over the authority's housing, and sell it on to new landlords in due course, perhaps after renovation.

(iv) Housing Benefit.

Housing benefit will continue to be available to help those who cannot afford to pay. We must of course press ahead



with refinement of the arrangements for limits on benefit which DHSS are already developing to prevent landlords and tenants agreeing excessive rents at the Exchequer's expense. DHSS's existing policies to reform access to benefits so as to avoid an "employment trap" are consistent with the new housing policies and should go ahead. I am also consulting David Young about the "why work" implications of this.

Other Issues

5 All of this concerns reform of the rented sector, public and private. At the same time we must of course press on with our major policies to sustain and extend home ownership. Mortgage tax relief underpins purchase. The Right to Buy has still a good way to go. Improvement and repair policy needs to be reshaped to encourage all owners to look after their property properly, and to target such grant assistance as is needed more accurately on needier groups and the worst housing.

6 I attach at Annex B a checklist of the components of the policy I am proposing. We do not need to take decisions on the progression of rents at this stage. But we shall soon need to take a view on the general strategy and in particular on the instruments which might be included in a Bill this autumn.

7 I am copying this to Nigel Lawson, Norman Fowler and David Young.

A handwritten signature in dark ink, appearing to be the initials "N.R." with a stylized flourish.

N.R.

13 March 1987

Ridley Annex A

LOCAL AUTHORITIES: ENGLAND

ANNEX A

(£ million at 1986/87 prices)

	1986/87	1987/88	1988/89	1989/90	1990/91	1991/92	1992/93	1993/94	Cumulative Total
<u>Basic Case</u>									
HRA Deficit	1,043	1,031	1,032	1,029	1,058	1,112	1,177	1,263	8,750
Housing Benefit	1,854	1,855	1,795	1,820	1,843	1,866	1,892	1,917	14,850
less: Capital Receipts	-1,513	-1,405	-1,384	-1,359	-1,079	-934	-720	-546	-8,950
<u>Sub-Total</u>	<u>1,384</u>	<u>1,481</u>	<u>1,443</u>	<u>1,490</u>	<u>1,822</u>	<u>2,044</u>	<u>2,349</u>	<u>2,634</u>	<u>14,650</u>
Capital expenditure	1,927	2,073	1,936	2,119	2,108	2,098	2,098	2,080	16,450
<u>Net PSBR Effect</u>	<u>3,300</u>	<u>3,550</u>	<u>3,400</u>	<u>3,600</u>	<u>3,950</u>	<u>4,150</u>	<u>4,450</u>	<u>4,700</u>	<u>31,100</u>
Rent (£p.w., 1986/87 prices)	16.75	16.75	16.75	16.75	16.75	16.75	16.75	16.75	
<u>Rents Rise by 10% a Year in Real Terms</u>									
HRA Deficit or Surplus (-)	1,043	1,031	1,032	686	349	37	-280	-597	3,300
Housing Benefit	1,854	1,855	1,795	2,118	2,413	2,735	3,100	3,507	19,400
less: Capital Receipts	-1,513	-1,405	-1,384	-1,411	-1,534	-1,601	-1,608	-1,593	-12,050
<u>Sub-Total</u>	<u>1,384</u>	<u>1,481</u>	<u>1,443</u>	<u>1,393</u>	<u>1,228</u>	<u>1,171</u>	<u>1,212</u>	<u>1,317</u>	<u>10,650</u>
Capital Expenditure	1,927	2,073	1,936	2,216	2,698	2,956	3,200	3,355	20,350
<u>Net PSBR Effect</u>	<u>3,300</u>	<u>3,550</u>	<u>3,400</u>	<u>3,600</u>	<u>3,950</u>	<u>4,150</u>	<u>4,400</u>	<u>4,650</u>	<u>31,000</u>
Rent (£ p.w., 1986/87 prices)	16.75	16.75	16.75	18.45	20.25	22.30	24.50	27.00	
<u>Rents Rise by 5% a Year in Real Terms</u>									
HRA Deficit	1,043	1,031	1,032	856	711	589	481	386	6,150
Housing Benefit	1,854	1,855	1,795	2,001	2,149	2,311	2,484	2,669	17,100
<u>Sub-Total</u>	<u>1,384</u>	<u>1,481</u>	<u>1,443</u>	<u>1,446</u>	<u>1,456</u>	<u>1,499</u>	<u>1,696</u>	<u>2,077</u>	<u>12,500</u>
Capital Expenditure	1,927	2,073	1,936	2,162	2,460	2,612	2,687	2,560	18,400
<u>Net PSBR Effect</u>	<u>3,300</u>	<u>3,550</u>	<u>3,400</u>	<u>3,600</u>	<u>3,900</u>	<u>4,100</u>	<u>4,400</u>	<u>4,650</u>	<u>30,900</u>
Rent (£ p.w., 1986/87 prices)	16.75	16.75	16.75	17.60	18.45	19.40	20.40	21.40	

Notes:

- (1) Capital expenditure in the "Basic Case" is 1989/90.PESC provisions projected on in real terms, but with a continuation in the decline in re-purchases of defective dwellings
- (2) In the other cases, capital expenditure = expenditure in basic case plus additional capital receipts plus additional net rents paid by tenants
- (3) The PSBR effect is not identical in the three cases because the extra capital expenditure offset by higher net rents has consequential effects on loan charges, and the extra sales have consequential effects on interest received.
- (4) These figures relate to the local authority stock only; the effect on the private rented sector is not included.
- (5) HRA surpluses ^{do not} count as negative public expenditure on present PESC conventions so the PESC effects of these changes will be different from the PSBR figures illustrated here.

Objectives

- Encouraging home ownership.
- Revival of private rented sector.
- Better management of local authority stock.
- More tenant involvement in improving, managing and owning estates.
- More discipline in the housing benefit system.
- Leading to more choice in rented housing.

Legislative measures

- Deregulation of rents of new private sector lettings. *? Tenure*
- Reformed management and accounting framework for local authority housing.
- Rights for local authority tenants to opt for transfer to other landlords.
- Power for Government to transfer housing from incompetent authorities to UDCs or similar bodies.

Non-statutory measures

- Involving tenants in programmes to carry out improvements and repairs in estates.
- Developing Estate Action initiatives further.
- Helping tenants to exercise the right to opt for new forms of landlord.

PESC strategy

- Encouraging more RTB sales to generate receipts.
- Some extra capital spending on repair and improvement, generating additional sales of improved property.
- Some higher rents following improvement in property.
- Benefit costs contained.



Ch
For meeting notes
AA

CH/EXCHEQUER	
REC.	18 MAR 1987 ✓ 18/3
ACTION	MR INSTONE
COPIES TO	CST
	SIR P MIDDLETON
	MR FER BUTLER
	MR ANSON
	MR SCHOLAR
	MR HAWKIN
	MISS PERSON
	MISS NOBLE

MR CROPPER
 MR TYRRE

PRIME MINISTER

HOUSING POLICY

As agreed at the last meeting, officials in my Department have produced the note and tables attached with some illustrations of the housing benefit effects of the proposals under discussion. The assumptions were discussed with officials in other Departments but in the time available only a limited range of variables could be modelled.

Most of the figures illustrated (on a Great Britain basis) will be sensitive to changes in the base assumptions, in particular on the pace at which rent levels are expected to rise. But certain features can be regarded as constants:

1. Housing Benefit expenditure and caseload will rise as rents are increased.
2. The increase in expenditure and caseload can be reduced by requiring everyone to make a contribution towards their rent.
3. A minimum contribution to rent of 10 or 20 per cent makes a very significant impact on the disposable income of families receiving income-related benefits.
4. Building flat rate compensation into income support rates, such as 10 or 20 per cent of average rents, substantially increases income support caseload and expenditure.

Foster's minute

E.R.

One further factor I should mention is the interaction between the 1988 social security reforms and changes in housing policy. The reforms remove the current unemployment trap whereby a household on supplementary benefit, who are therefore entitled to full reimbursement of their rent and rates bill, can be worse off by moving into relatively low-paid employment. This is accomplished by using the same test of net income for all those on housing benefit and income support and providing maximum assistance with rent and rates to households on income support or with equivalent net income. This is helpful in avoiding a widening of the unemployment trap as rents increase. But by giving 100 per cent protection against increases in rents it calls for measures to prevent rents rising unnecessarily through collusion between landlord and tenant. We are developing proposals to prevent such collusion and these would be quite consistent with the proposals put forward by Nicholas Ridley in his housing policy paper. There is also the wider question of the strength of work incentives where increased income results in a rapid withdrawal of income-related benefits. This is the subject of a separate study by our officials but the steep withdrawal of housing benefit has been identified as a significant factor. Its importance may well be increased if rents rise fairly rapidly and further measures are taken to reduce the effect on housing benefit expenditure and caseload. This would require further study.

I am copying this minute to Nigel Lawson, Nicholas Ridley and David Young.

17 March 1987



N F

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HOUSING POLICY: EFFECTS OF HIGHER RENTS ON HOUSING BENEFIT

1. The attached tables set out the information, which could be assembled in the time available, to illustrate the housing benefit effects of increased rents and the impact of measures which might be taken to limit increases in expenditure and caseload.

Overall Caseload and Expenditure Effects

2. Table A shows changes in the numbers on benefit and Table B the expenditure effects as compared with the arrangements to be introduced in April 1988 if rents rise in line with prices:

- Option A assumes that rents will rise by 10 per cent a year for five years with no change to the April 1988 arrangements
- Option B makes the same assumptions about rent rises, but also assumes that everyone is expected to pay at least 20 per cent of their rent.
- Option C makes the same assumptions as Option B, but also assumes that the personal allowances in income support are increased by 20 per cent of average local authority rent.

3. Option A shows the numbers of tenants in receipt of rent rebates rising from 3 million to 3.5 million. These figures apply to Great Britain but are otherwise broadly consistent with the figures presented in the papers from the Department of Environment.

4. Option B shows that the requirement for everyone to pay at least 20 per cent of their rent reduces the caseload to 3.2 million for rent rebates.

5. Option C shows a further small increase on Option B if 20 per cent of average LA rent is added to the personal allowances in income support. But there is a very large increase of 1 million, almost 25 per cent, in the numbers of people on income support. There is also a small increase in the numbers of people receiving housing benefit in respect of domestic rates because other benefits are linked to income support rates. Numbers on rent allowance and family credit would also rise.

6. Spending on rent rebates would double under Option A and rise by about 50% under Options B & C. Under Option C, spending on income support would rise by over a quarter.

ie + £2 billion
total + £2 1/2 billion

Losers and Gainers

7. Table C shows the scale of losses expected on means-tested benefits under the same three options. With no compensation the losses in weekly net disposable income for those on benefits are split roughly equally between those losing £2-5 (1.8 million) and those losing £5-10 (1.9 million). With compensation in income support there are far fewer losers on means-tested benefits - 600,000 lose £2-5 a week and 1.6 million £5-10 per cent. There are also 1.6 million gainers. In addition (not shown in Table C) there are still very large numbers of losers not on housing benefit and therefore not affected by compensation payments - 1.4 million lose £5-10 per week and 1 million lose £10-15 per week.

Effect on Selected Family Types

8. Table D shows the effect of the different options on pensioners. Under Option A a single pensioner with just the basic pension would be protected against the rise in rent, but for those with an average occupational pension would be £2.80 worse off. Paying 20 per cent of rents (option B) would result in a weekly loss of £4.50 for a single pensioner with a basic pension and £7.20 for a single pensioner with an average occupational pension. With compensatory adjustments to income support (option C) the effect would be a 50p gain and a loss of £4.20 respectively.

9. Table E has similar illustrations for a couple with 2 children at different bands of income and for a single parent. Couples with younger children on three quarters of national earnings would have to bear the full loss of over £10 a week on all three options.

Effect on Work Incentives

10. Table F shows the gain from working under the April 1988 arrangements, and compares this with the effects of Options A, B and C. Under Options A & C, the gain to a married man with two younger children or taking a job on three quarters national earning would be reduced from almost £30 per week to less than £20.

Summary

11. Most of these figures will be quite sensitive to changes in the various assumptions made about levels of rent. The two most stable elements are that the requirement to pay a proportion of rent quickly makes a substantial impact on disposable income and building protection into income support has a significant effect on income support caseload. The other effect which could not be modelled fully in the time available is the effect on overall incentives to work at different income bands. A steep withdrawal of housing benefit assistance with rents, as income rises, is a powerful factor in determining the "gains" of full-time employment and the effect of the proposals on different income bands would require further study.

TABLE A

NUMBERS ON BENEFIT

	Numbers on benefit after social security reforms if rents rise in line with prices	<u>Additional numbers on benefits if rents rise 10 per cent a year faster than prices and:-</u>		
		(a) No change to benefit system.	(b) Minimum 20 per cent contribution to rent - <u>no</u> compensation	(c) Minimum 20 per cent contribution to rent - <u>with</u> compensation
	(mn)	(mn)	(mn)	(mn)
<u>HOUSING BENEFIT:</u>				
rent rebates	3.0	+0.5	+0.2	+0.3
rate rebates	5.0	no change	no change	+0.3
<u>INCOME SUPPORT</u>	4.5	no change	no change	+1.0

COST OF BENEFITS

TABLE B

	Costs of benefits after social security reforms if rents rise in line with prices	<u>Additional cost of benefits if rents rise 10 per cent a year faster than prices and:-</u>		
		(a) No change to benefit system	(b) Minimum 20 per cent contribution to rent - <u>no</u> compensation	(c) Minimum 20 per cent contribution to rent - <u>with</u> compensation
	£bn	£bn	£bn	£bn
<u>HOUSING BENEFIT</u>				
rent rebates	2.2	+2.1	+0.8	+1.0
rate rebates	1.2	no change	no change	+0.1
<u>INCOME SUPPORT</u>	5.0	no change	no change	+1.3

Note: :

Costs are at November 1985 prices

Table B

AMOUNTS OF LOSS FOR LOCAL AUTHORITY TENANTS ON INCOME-RELATED BENEFITS

Size of loss, <u>£ per week</u>	<u>Rents rise by 10 per cent a year faster than prices and:-</u>		
	(a) No change to benefit system	(b) Minimum 20 per cent contribution to rent - <u>no</u> compensation	(c) Minimum 20 per cent contribution to rent - <u>with</u> compensation
	(000s)	(000s)	(000s)
Over £15	n/a	-	-
£10-15	n/a	100	-
£5-10	n/a	1900	200
£2-5	n/a	1800	600
£0-2	n/a	100	1600
Total losing	<u>3900</u>	<u>3900</u>	<u>2500</u>
(Number of gainers)	(-)	(-)	(1600)

Note:

At November 1985 prices.

(1)
IMPACT ON PENSIONERS

TABLE D

November 1985 prices	<u>Rents rise 10 per cent a year faster than prices and:-</u>		
	(a) No change to benefit system	(b) 20 per cent minimum rent contribution - <u>no</u> compensation	(c) 20 per cent minimum rent contribution - <u>with</u> compensation
	£pw	£pw	£pw
<u>SINGLE</u>			
- with only basic pension	Nil	LOSE 4.50	GAIN 0.50 ⁽²⁾
- with basic pension and average occupational pension	LOSE 2.80	LOSE 7.20	LOSE 4.30
<u>COUPLE</u>			
- with only basic pension	Nil	LOSE 4.50	GAIN 0.50 ⁽²⁾
- with basic pension and average occupational pension	LOSE 4.30	LOSE 8.40	LOSE 5.80

Note:

- (1) Assuming average pensioner rent of £13.80 a week.
- (2) Pensioners with just the basic pension gain in case (c) because compensation is based on the average rent for all households which is above the average pensioner rent.

TABLE D

Loss in £ per week November 1985 prices	Rents rise 10 per cent a year faster than prices and:-		
	(a) No change to benefit system	(b) 20 per cent minimum rent contribution - no compensation	(c) 20 per cent minimum rent contribution - with compensation
<u>Couples with 2 children aged 4 and 6</u>	£pw	£pw	£pw
- on income support	Nil	-5.30	-0.40
- on $\frac{1}{2}$ average earnings	- 1.60	-6.90	-2.60
- on $\frac{3}{4}$ average earnings	-10.10	-10.10	-10.10
- on average earnings	-10.10	-10.10	-10.10
<u>Couple with 2 children aged 13 and 16</u>			
- on income support	Nil	-5.30	-0.40
- on $\frac{1}{2}$ average earnings	- 2.80	-8.10	-3.80
- on $\frac{3}{4}$ average earnings	- 8.90	-10.10	-6.60
- on average earnings	-10.10	-10.10	-10.10
<u>Lone Parent, 1 child aged 4</u>			
- on income support	Nil	-4.90	-0.02
- on $\frac{1}{2}$ average earnings	- 2.90	-7.80	-3.50
- on $\frac{3}{4}$ average earnings	- 6.60	-9.40	-5.90
- on average earnings	- 9.40	-9.40	-9.40

Note:

Figures assume rent for couples of £16.50 a week in November 1985 (£15.40 for lone parents)

Table E

GAIN FROM WORKING

£ a week, November 1985 <u>prices</u>	After social security reforms - rents rise in line with prices	<u>Rents rise 10 per cent a year faster than prices and:</u>		
		(a) No change to benefit system	(b) 20 per cent minimum rent contribution - <u>no</u> compensation	(c) 20 per cent minimum rent contribution - <u>with</u> compensation
<u>Couple, 2 children aged 4 and 6, man earning:</u>	£pw	£pw	£pw	£pw
$\frac{1}{2}$ average earnings	9.00	7.40	7.40	6.80
$\frac{3}{4}$ average earnings	29.50	19.40	24.70	19.80
average earnings	63.00	53.00	58.30	53.80
<u>Couple, 2 children aged 13 and 16, man earning:</u>				
$\frac{1}{2}$ average earnings	10.60	7.80	7.80	7.20
$\frac{3}{4}$ average earnings	20.70	11.80	15.90	14.40
average earnings	49.50	39.40	44.70	39.80

Note:

Gain from working is defined as the difference between income out of work on income support and income in work. 'Income' is calculated net of housing costs, tax and NI contributions.

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FROM: D R INSTONE
DATE: 17 March 1987

CHANCELLOR

cc Chief Secretary
Sir P Middleton
Mr F E R Butler
Mr Anson
Mr Hawtin
Mr Scholar
Miss Noble
Mr Legg
Mrs Holmans
Mr Cropper
Mr Tyrie

HOUSING POLICY - BRIEF FOR PRIME MINISTER'S MEETING ON 18 MARCH

x expected shortly, seen in draft
For the meeting you have Mr Ridley's minute to the Prime Minister of 16³ March, Mr Fowler's minute of 17 March^{*} and the No.10 Policy Unit's letter of 16 March to Mr Ridley.

OBJECTIVES FOR THE MEETING

2. I suggest these should be:-

(a) to reach a view on whether significant rent rises are an essential component of the Government's housing objectives;

(b) if they are, whether the implications for housing benefit, incentives to work and public expenditure generally are acceptable;

(c) to decide whether it is realistic to aim at legislation in Autumn 1987 or a year later;

(d) to decide whether officials should carry out the detailed work involved in working up Mr Ridley's proposals for legislation, together with those suggested by the Policy Unit.

BACKGROUND

3. At the Prime Minister's last meeting, it was agreed that, before further considering Mr Ridley's proposals for deregulating

BRIEF

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the housing market, further work should be done particularly on:-

(i) the year-by-year public expenditure and PSBR effects of Mr Ridley's proposals;

(ii) the effects on different family types of the consequences of Mr Ridley's proposals for housing benefit and income support.

4. The Prime Minister also suggested that a more gradual increase in rents than that proposed by Mr Ridley might be more acceptable, and suggested that increases might better take place only after the housing concerned had been renovated, so that tenants could better understand why their rents had risen. Mr Ridley did not accept that this would be sufficient.

POINTS TO MAKE ON THE MAIN ISSUES

Are Higher Rents Necessary for A Better Housing Policy?

5. (a) The evidence suggests that higher rents are needed if the housing market is to work effectively and if private finance is to be attracted.

(b) The Policy Unit imply that private sector landlords will be happy to take over from local authorities, if tenants want a change of landlord. But it is unlikely they will be prepared to do this, or tenants request the change, unless rents approach market levels.

(c) Mr Ridley is now assuming on his central case that rents would rise in real terms by 10% per year, which would get to a 4%-5% real rate of return after about 5 years - this is a slightly less ambitious target than his original one (of getting to 6%-7% real return), but is probably realistic. (It is also the case modelled in Mr Fowler's tables.) Mr Ridley's lower option - of going for a 5% real increase per year would only get

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to a "commercial" level after perhaps 10 years and so would probably make much less early impact.

(d) The suggestion of only contemplating rent increases after renovation has been carried out does not look attractive. The effects would be very uneven (eg no rent increases where no renovation was needed); private finance would not be attracted in large amounts; and it could be more expensive if there is no money to fund renovation beforehand.

(e) There is a danger of being too concerned about the presentational effects of higher local authority rents: many tenants would be insulated anyway by higher housing benefit; and DOE and (especially) Scottish Office Ministers have been preaching the need for this for some time already.

Are the Housing Benefit/Working Incentive Consequences Acceptable?

6. You will want to stress the importance of reaching a view on this key issue. You will want to note in particular the tables attached to Mr Fowler's minute; a commentary on this is at Annex A. Points to note are:-

(a) Mr Fowler is showing the effect after 5 years of a 10% real rise in rents per year compared with rents merely keeping pace with inflation: the effects in the early years will be much less (but are not shown).

(b) It is best to concentrate mainly on assuming tenants are not required to pay a minimum 20% contribution to rent - ie looking at the columns marked (a) in Mr Fowler's table. This shows that at the end of the 5 year period an extra ½ million people would be on housing benefit, at a cost of about £2 billion/ (tables A and B) About 4 million people would be worse off - tables (D) and (E) show this could be up to £10 per week, with the biggest effects for those approaching average earnings.

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Table F shows the gain from working, at the end of the 5 year period, could be reduced by up to £10 a week, or about 20%.

(c) Making everyone pay part of their rent to mitigate the effects on housing benefit does not look very attractive - see Annex A and columns (b)-(c) of the tables: either there are a lot more losers, or, if they are compensated, this is expensive and has perverse effects. So if Ministers agree to rent rises, better not to assume the contribution to rents from tenants.

Other Public Expenditure Effects

7. Note. Mr Ridley shows these in the table annexed to his minute. It purports to show the public expenditure and PSBR effects as neutral. (Nor does it show the public expenditure, as distinct from the PSBR, effects, though in practice these would be very similar.) Points you might make are:-

(a) The table is rather misleading, because it is only PSBR neutral because of Mr Ridley's starting assumption that just enough would be spent on capital expenditure on housing renovation to make it PSBR neutral: with more or less capital expenditure there would either be a PSBR cost or savings; the level of capital expenditure on renovation must be a matter for the Public Expenditure Survey and cannot be assumed in advance.

(b) The table is also misleading because it does not show the extra housing benefit consequences of rent rises from housing association or private sector lettings: depending on the rent rise assumed and the success of rent deregulation, that could increase the cost by a few hundred million a year (though the rise might only be a gradual one to this level if deregulation applied only to new lettings).

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A further note about the public expenditure effects is at Annex B to this brief.

Legislative Timetable and Further Work Programme

8. Points you might make are:-

(a) The proposals for further work in Annex B to Mr Ridley's minute are broadly acceptable (they are roughly the same as in his previous papers). They are only likely to have a major impact, however, if Ministers accept a significant increase in rents. Subject to that further work should continue as soon as possible.

(b) The Policy Unit proposals should also be pursued further - but again they need a good deal of further working up. Some of them, however, may have only limited impact - eg there may be only limited amounts of self-help which can be expected from the high proportion of single parents and pensioners on council estates.

(c) Priority should be given to deregulating private sector rents and reducing current security of tenure provisions in the private sector, as this is relatively self-contained and the public expenditure consequences are smaller.

(d) Measures which you have emphasised previously should be included in the further work by officials - especially changing the criteria of valuation of council dwellings (to prevent unattractive flats not being sold because the district valuer has put ridiculously high values on them) and compelling local authorities to give up properties which have been empty for more than a given period.

(e) Except for deregulation of private sector rents, the idea of introducing legislation in Autumn 1987

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looks highly ambitious: a large number of ideas have been floating around which have not been examined in any depth; this is essential before legislation can be introduced. 1988 is a better target for the bulk of legislation.

D R I

D R INSTONE

The DHSS paper

1. The DHSS tables illustrate the caseload and expenditure consequences and the effect on individuals, of an annual real increase in rents of 10 per cent; and of making tenants pay a 20 per cent of their rent, with and without compensating adjustments to income support levels. Other less severe options can be modelled, but DHSS did not have enough time to do so.
2. Table A summarises the caseload effects of the three illustrative options. The figures represent the position at the end of a five year period. Table B shows the expenditure consequences (the figures are extra cost per year at the end of the period, compared with rents rising in line with prices). Table C to E demonstrate the effect of the illustrative policies on individuals. The total number of gainers and losers of various amounts of money are summarised in Table C; and figures of individual losses are shown for pensioners (Table D) and for various family types both in and out of work (Table E.) These figures are the cumulative losses over a 5 year period, not the annual loss.
3. As Mr Fowler notes in his covering paper, the effect of real rent increases on housing benefit expenditure and caseload can be mitigated by making everyone pay a proportion of their rent; but the losses for individuals (columns b of tables D and E) do not look sustainable for those on income support in particular, even spread over 5 years.
4. Adjusting income support levels to compensate however is expensive and has somewhat perverse effects. Unlike supplementary benefit which has different rates for householders and non householders, the new income support scheme will not be distinguished by housing status. The idea is that income support provides for day to day living expenses, while housing benefit provides for housing costs. But this means that any adjustment to income support rates will go to householders and non-householders

alike, creating a large deadweight cost. The higher income support rates are, the more people qualify. Moreover, the income support rates will set the starting point for assessing entitlement to family credit and housing benefit; so the higher the income support rates the more people qualify for family credit and housing benefit (both rent and rate rebates).

5. Nor, of course, would such compensation eliminate the 'losers' problem; rents vary so much through the country that adding 20 percent of average rents to income support rates will under compensate some householders and over compensate others, (quite apart from the overcompensation of non-householders).

6. The consequences of all this are set out in column (c) of the tables. The incomes support caseload goes up by 1 million (table A) and expenditure on income support goes up by £1.3 billion (table B). The number of large losers falls significantly (table C) but 1.6 million people gain from the increase in income support.

7. Overcompensation of non householders creates a particular problem for work incentives, among the young, single unemployed who are generally considered to be the most sensitive to the gap between in and out of work income. Work which No.10 commissioned on the unemployment trap however, (which will be coming to you shortly) suggests that the majority of the unemployed who face a narrow gap between in and out of work income are married men with children, and that two thirds of them live in the public rented sector. Any real increase in rents will reduce the gap between in and out of work income for these people, as table F shows, particularly the comparison between the first and second columns. And more generally, any proposal which puts significantly more people onto the high marginal tax rates implicit in means tested benefits (albeit that some are pensioners) must give cause for concern.

8. The key points to emerge from the DHSS figures are summarised in the first page of Mr Fowler's letter:

- Real increases in rents inevitably add to housing benefit expenditure and caseload
- The effect can be reduced by making everyone contribute towards their rent.
- Even spread over 5 years, the losses look unsustainable without some compensating adjustment to income support rates; but such compensation has perverse effects on expenditure, caseload and incentives.
- The effect on incentives would need to be part of any further work commissioned on Mr Ridley's proposals

PUBLIC EXPENDITURE EFFECTS

The table at Annex A to Mr Ridley's minute gives a year-by-year breakdown of the PSBR effects (in this context equivalent to the PES effects) of the 5% and 10% rent increase options against base. However, the table only covers the local authority sector and so ignores the additional costs of housing benefit to those in housing association and private rented sector accommodation. The base case is broadly in line with existing PES in the first four years but we have not accepted the assumed £1 billion a year fall in receipts which helps lead to an additional annual PES bill of £1.4 billion by 1993/94. DOE have not explained why housing benefit costs rise at the same time as the HRA deficit worsens in this case, despite the assumption of no underlying price changes.

The alternative rent rise cases assume substantial £1-1½ billion switches in public expenditure from deficit subsidies to the Housing Revenue Account to indirect subsidy via Housing Benefit. They also assume that higher rents will provide sufficient incentives for house sales to maintain capital receipts at their current level, financing (together with an HRA surplus in the highest rent case) up to £1½ billion additional capital expenditure a year.

The rent rise cases assume rents increase gradually (ie by the assumed 5% or 10% real increase per year) and are not directly linked to renovation having already taken place on estates subject to a rent rise. As the main brief suggests, this seems a more realistic (and probably cheaper) assumption than renovation taking place before rents rise on each estate.



FROM: A C S ALLAN

DATE: 18 March 1987

CHANCELLOR

HOUSING POLICY

I have been through the numbers carefully with Daniel Instone. I attach an Annex which explains them. They are broadly okay, subject to the qualifications mentioned.

2. What they show is that by raising rents we can generate a lot more income, partly directly and partly from increased sales of council houses, and can use that extra income to undertake more capital expenditure on renovations etc while holding the PSBR costs constant. *(even after allowing for extra HB expenditure).*

3. This, however, means that quite a lot of people are going to be worse off. The main issue for decision is whether to continue with this line of work, accepting that this, and the extra HB caseload, is the price to pay for freeing up the housing market.

4. One other point for you to press (not covered in Daniel Instone's brief) is to pin Mr Ridley down on whether he really does mean to deregulate tenure as well as rents. Officials think he does: but the way he expresses it in 4(iii) and Annex B is not at all clear.

A C S ALLAN

HOUSING POLICY: EXPLANATION OF PUBLIC EXPENDITURE/PSBR EFFECTS**MR RIDLEY'S ANNEX A**

The various lines in Mr Ridley's table are:

Housing Revenue Account (HRA) deficit

2. Rents and housing subsidy (not housing benefits) are paid into the HRA; maintenance and debt servicing costs are paid out of it. Rises in rents automatically mean that the deficits are reduced.

3. There is one twist: at present, it is only deficits that are scored in public expenditure; if an authority is in surplus, this is scored as zero, not negative public expenditure. (There are two reasons for this: one is that if we did score surpluses as negative expenditure the housing programme in PES would almost disappear; the second is that if the change was carried through to GREs it would have major effects on grant distribution). Mr Ridley's numbers are based on counting the whole of the increased income from higher rents as reducing the PSBR - correctly; but this does mean that, on the present definition, public expenditure would rise by rather more, as there is no further public expenditure saving from higher rents once an authority has switched from being in deficit to being in surplus. DOE say they cannot redo the calculations in the time available. They point out - I think rightly - that the existing definition is very odd and is something we would change under a new structure of housing finance.

Housing benefit

4. These are the housing benefit costs for local authority tenants only. This is the same basis on which Mr Fowler's figures are constructed. Mr Ridley's figures are for England only; Mr Fowler's are GB. This explains the discrepancies: Mr Ridley's figures show an increase for 1993-94 of £1.6 billion for the 10 per cent case (£3,507 million minus £1,917 million); Mr Fowler's figures in his Table B show an increase of £2.1 billion.

5. The letter from Osborne (DOE) to Instone says that deregulating new private sector lettings would increase HB expenditure by about £150 million a year - though he is vague about the assumptions used.

Capital receipts

6. These are the proceeds of council house sales. Receipts are higher in the cases where rents rise, since that makes it more attractive for tenants to buy rather than continue to rent.

Sub-total

7. This is a particularly uninteresting sub-total that bears little relation to any other aggregate.

Capital expenditure

8. This is a rather odd line. The base case projects forward the existing levels of gross capital expenditure; the further table attached to Osborne's letter holds the net PES provision constant (ie capital expenditure minus capital receipts), and hence shows a lower level of new capital expenditure.

9. For the illustrations of what happens when rents rise, the capital expenditure figures are purely a residual: they are set so as to hold the net PSBR effect virtually constant.

PSBR effect

10. The result of the way gross capital expenditure is projected means that the PSBR effect is by definition neutral on these assumptions.

MR FOWLER'S TABLES

11. Mr Fowler's tables all show:

- (i) figures for local authority tenants only, except where income support levels increased;

- (ii) the figures are all for GB, rather than England alone;
- (iii) the base case is the same as Mr Ridley's, and the changes use the 10 per cent real rent rise assumption;
- (iv) the figures are for five years on, in effect the 1993-94 column in Mr Ridley's table.

Numbers on benefit: Table A

12. Half a million more HB claimants if the benefit system is left unchanged; a smaller increase if a minimum contribution to rent assumed; but a million more on income support if compensation given there.

Cost of benefits: Table B

13. This shows a similar pattern: a £2.1 billion increase with no change to the benefit system; a £2.4 billion increase if we make everyone pay 20 per cent but compensate via income support.

Gainers and Losers: Table C, D and E

14. This shows gainers and losers (among local authority tenants only). It looks as if it would be almost impossible to let rent rise by 10 per cent a year in real terms and impose a 20 per cent minimum contribution without some compensation: those on basic pensions would lose £4.50 a week, for example.

Work incentive effects: Table F

15. These show that - inevitably - the replacement ratios worsen with large rises in rents: those out of work get all of their rent paid via HB; but when they get a job part of this is withdrawn via the "taper".

pwp



10 DOWNING STREET

LONDON SW1A 2AA

19 March 1987

CH/EXCHEQUER	
REC.	19 MAR 1987
ACTION	Mr Instone
COPIES TO	CST Sir P Middleton
	Mr F R Butler
	From the Private Secretary
	Mr Anson Mr Slobar
	Mr Hawtin Miss Rowson
	Miss Noble Mr Tyne Mr Cropper
	Dear Robin,

HOUSING POLICY

The Prime Minister yesterday held a meeting to discuss housing policy on the basis of your Secretary of State's minute of 13 March and a minute from the Secretary of State for Social Services of 17 March. There were present your Secretary of State, the Chancellor of the Exchequer, the Secretaries of State for Social Services and Employment, and Mr. Peter Stredder (No.10 Policy Unit).

After your Secretary of State had outlined his proposals along the lines of his minute, the meeting discussed the problems of dependency which might be created by raising rents. Higher rents would lead to higher payments of housing benefit, with the effects of that on incentives (though there would be no effect on the unemployment trap because housing benefit was payable both to those in work and to those out of work) and greater dependency on social security. Against that, the creation of a market in rented housing and more council tenants buying their own homes would help to reduce dependency. If everyone were expected to pay some proportion of their rent this could lead to substantial losses for some people and extra burdens on social security particularly if those losses were met through higher income support. It was agreed that this possibility should not be pursued further.

The meeting noted that the scale of any effects on incentives, as on public expenditure, would be strongly influenced by the speed and size of any increase in rents. Arguably, most rents should increase by less than 5 per cent a year in real terms, perhaps by 2½ per cent, except where the property had been renovated. One possibility would be for council rents to move towards fair rents, which in some cases might mean no increase at all or even a reduction. However, a contrast might then be drawn between this and decontrol for new lettings in the private sector, even though many lettings in the private sector would probably remain at fair rent levels. The definition of fair rents might itself need to be modified, and this would be worth considering. The Secretary of State for Employment questioned whether any private landlord would expect to see a return on investment greater than 1 or 2 per cent, as against the 4 per cent or more which had earlier been considered by the group.

After further discussion it was agreed that the proposals put forward by Mr. Ridley would be worth pursuing, with or without any increase in rents. Ring fencing housing accounts would for example simplify reform of capital controls and reduce the problem of the burden on the community charge. There was no need at this stage to take a view on whether or how far rents might be increased. The level of rents could be considered year by year in the light of circumstances at the time in the context of the annual discussions of local authority finance and the public expenditure survey. The Prime Minister accordingly invited your Secretary of State to develop the proposals set out in his minute of 13 March in the light of the points made at the meeting and suggestions made in the earlier meetings of the group (recorded in my letters to you of 17 February and 5 March) and bring them to an appropriate Cabinet Committee before Easter. The Prime Minister noted your Secretary of State's intention to include the necessary provisions in a housing bill in the first session of the new Parliament.

I am sending a copy of this letter to Alex Allan (HM Treasury), John Turner (Department of Employment) and Geoffrey Podger (Department of Health and Social Security).

Yours,
David.

D. R. Norgrove

Robin Young, Esq.,
Department of the Environment.