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CABINET

COUNCIL HOUSE RENTS: PUBLIC EXPENDITURE OBJECTIVES

Memorandum by the Secretary of State for the Environment

1. In the course of our discussion on cuts in housing public expenditure the Chief Secretary and I agreed that the issue of council house rents should be a matter for Cabinet decision. This paper accordingly sets out proposals on guidelines for council house rent increases over the Public Expenditure Survey Committee (PESC) period.

PRESENT RENT LEVELS

2. Under the new housing subsidy system, local authorities will continue to set rent levels, but I shall increasingly influence their decisions. At present, the average council house rent for England is about £6.50 per week - though the average conceals wide variations. It was allowed to fall in real terms under the previous Government. In 1974, the average rent accounted for 8.6 per cent of gross earnings; in 1977 for 7.6 per cent; and now it accounts for 6.6 per cent. This shows that there is scope for local authorities meeting a greater proportion of their housing costs from rents. The resulting savings in subsidy will reduce public expenditure. I should mention that the calculations which underlay the cuts in subsidies which we suggested in Opposition, and which formed the basis of the Treasury's proposals (Option E below) were based on an arithmetical mistake. They assumed that any given rent increase would yield subsidy savings about 50 per cent higher than the true figure.

CONSIDERATIONS GOVERNING FUTURE POLICY

3. I agree with the Chief Secretary's view (C(79) 42) that council house rents should be increased in real terms. Inevitably, however, increases in council house rents will become a factor in wage negotiations. Our judgment on how fast rents are to rise will therefore relate to broader political as well as to immediate financial considerations. Purely on the financial side, however, it might be borne in mind that 1 per cent increase in local authority rent levels yields public expenditure savings of £10 million, but should this lead to an extra 1 per cent going on to the public sector pay settlements this would require an increase in public expenditure of £200 million.

ACTION NEXT YEAR

4. For 1980-81, I intend to set a rent guideline for an increase in rents of £1.50p on average; this will represent an average increase in rent of 23 per cent as compared with the forecast 15 per cent rise in earnings. This will provide for the £35 million subsidy savings which I have agreed to find next year.

OPTIONS FOR REMAINDER OF PESC PERIOD

5. For 1981-82 to 1983-84, I have set out 5 possible options for rent increases. The Annex to this paper provides a full comparison of their effects. It illustrates the average cash and percentage annual increases in rent, the average cash rent payable each year, and the resulting public expenditure savings in real terms. Increases in rent are shown in declining percentage terms to get the worst over in early to middle years of this Parliament and at the same time provide bigger savings by getting increases sooner than would be achieved by a more even spread.

OPTION A - RENTS TO GREEN PAPER PERCENTAGE OF EARNINGS

6. Option A represents the least difficult course politically. It would consist of restoring the relationship of rents to earnings to that which obtained in July 1977 - 7.6 per cent. This was the date of the previous Government's Green Paper on Housing Policy which declared that over a run of years rents should keep broadly in line with changes in money incomes. Recovering the ground lost since then would enable us to secure rent increases in real terms whilst at the same time presenting them as being in accordance with the previous Government's rent policy. Option A would result in rent increases, and total savings (including additional savings set out in paragraphs 12-15 below), as follows:

| | 1981-82 | 1982-83 | 1983-84 |
|---------------------------------------|---------|---------|---------|
| Average rent increase (cash) £ | 1.50 | 1.00 | 0.65 |
| Savings £m (in 1979 Survey prices) | 190 | 245 | 290 |

OPTION B - RENTS TO PERCENTAGE OF EARNINGS WHEN WE LEFT OFFICE IN 1973-74 - 8.6 per cent

7. Option B would restore the relationship of rents to earnings (8.6 per cent) which obtained when we left office in 1974. This Option would yield significantly greater savings than Option A, but the political downside would be that much greater. It would result in rent increases and total savings as follows:

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| | 1981-82 | 1982-83 | 1983-84 |
|---------------------------------------|---------|---------|---------|
| Average rent increase (cash) £ | 1.80 | 1.55 | 1.30 |
| Savings £m (in 1979 Survey prices) | 225 | 340 | 445 |

OPTION C - RENTS RISING IN LINE WITH EARNINGS PLUS AN EXTRA £1 CASH INCREASE EACH YEAR

8. Option C would provide for still more savings but we would be seen to be going well beyond the ratio of rents to earnings when we were last in office. The ratio of rents to earnings would rise to 9.0 per cent. It would result in rent increases and savings as follows:

| | 1981-82 | 1982-83 | 1983-84 |
|---------------------------------------|---------|---------|---------|
| Average rent increase (cash) £ | 1.90 | 1.80 | 1.55 |
| Savings £m (in 1979 Survey prices) | 240 | 375 | 510 |

OPTION D - RENTS RISING TO 10 per cent OF EARNINGS BY 1983-84

9. The rent increases and total savings which would be achieved under this option are set out below. This is a more extreme version of Options B and C.

| | 1981-82 | 1982-83 | 1983-84 |
|---------------------------------------|---------|---------|---------|
| Average rent increase (cash) £ | 2.50 | 2.15 | 2.00 |
| Savings £m (in 1979 Survey prices) | 310 | 480 | 650 |

OPTION E - THE CHIEF SECRETARY'S PROPOSAL

10. Option E is that proposed by the Chief Secretary. It would secure savings of some £1565 million over the three years and increase average council rents to 11 per cent of earnings. The order of rent increases which it implies, however, seems politically unacceptable. It would certainly necessitate council rents on average rising above fair rents in the private sector - a large number of individual rents would in fact be way above fair rents. We would be seen to be offering council tenants a more severe regime than under the Housing Finance Act 1972, and it would be claimed

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that we were discriminating against them as compared with private tenants. Option E would result in rent increases and savings as follows:

| | 1981-82 | 1982-83 | 1983-84 |
|---|---------|---------|---------|
| Average rent increase (cash) £ | 2.50 | 2.85 | 2.70 |
| Total Savings £m desired by (in 1979 Survey prices) | 295 | 520 | 750 |

CONSIDERATION OF THE OPTIONS

11. In deciding between the possible options it is necessary to have in mind that:

- a. the increases for individual tenants will vary widely, with 10 per cent of tenants paying at least 20 per cent above average.
- b. In addition to these rent increases tenants are likely to face substantial increases in rates.

ADDITIONAL SUBSIDY SAVINGS

12. In addition to the rent increases, there are three additional sources of public expenditure savings on subsidies which have been included in the calculations in this paper.

13. First, as agreed in the Home and Social Affairs Committee, we propose to make the subsidy adjustment when a council house is sold in a way that gives greater benefit to the Exchequer - and accordingly reduces the subsidy to local authorities. My proposals should produce a further £10 million a year subsidy savings cumulatively from this source.

14. Second, I have agreed not to provide housing subsidy for any growth in real terms in management and maintenance expenditure. This will save some £45 million in 1981-82, £70 million in 1982-83 and £100 million in 1983-84, and this disposes of one of the points in the Chief Secretary's paper.

15. Third, because of pressure on rates in 1981-82 local authorities may be expected to charge to rents any additional current expenditure by way of loan charges arising on the element of new capital expenditure which does not rank for housing subsidy. Savings of £30 million are included on this account.

16. The annex shows the total public expenditure savings on Options A to D including (a) rent increases, (b) suggested adjustment on sales, (c) management and maintenance, and (d) the prospect of all unsubsidised expenditure being borne on rents. The Chief Secretary's desired savings arising from (a) and (c) above are likewise shown.

CONCLUSIONS

17. In the Chief Secretary's view even Option E would fail to secure full economic rents and his proposal is justified in view of the pressing need for public expenditure savings. The rents in the Annex are all in cash terms. The rent increases required are less severe when expressed in constant prices. The effect on less well-off tenants would be moderated by rent rebates and supplementary benefits which in aggregate would fund 40 per cent of the increases in rent.

18. The Chief Secretary's view is that we should adopt Option E. My own preference, against the background set out above, is for Option R. This would yield total housing savings of nearly £1,300 million in 1981-82, £1,650 million in 1982-83 and £1,850 million in 1983-84 - much greater than those on any other programme and some £150 million to £250 million a year greater than the reductions provisionally agreed and shown in Annex B of the Chief Secretary's paper. Whatever our conclusion, the public presentation and timing of an announcement of our views on rents will need very careful handling. I would consult colleagues principally concerned and report separately to the Prime Minister on this aspect.

M H

Department of the Environment

16 October 1979

| | 1981-82 | 1982-83 | 1983-84 | Total Weekly Rent Increase from present levels by 1983 | Percentage Rent Increase on present levels | Total Savings £m |
|---|---------|---------|---------|---|--|------------------------|
| <u>Option A</u> (rents rising so as to reach 7.6% of earnings by 1983/84). | | | | | | |
| (a) Average annual increase in weekly rent (cash) £ | 1.50 | 1.00 | 0.65 | 4.40 | | |
| (b) Percentage increase over previous year | 19 | 11 | 6 | | 71 | |
| (c) Average weekly rent payable (cash) £ | 9.25 | 10.30 | 11.00 | | | |
| (d) Public expenditure savings £m. | 190 | 245 | 290 | | | 725 |
| <u>Option B</u> (rents rising to 8.6% of earnings by 1983/84) | | | | | | |
| (a) | 1.80 | 1.55 | 1.30 | 5.90 | | |
| (b) | 23 | 16 | 12 | | 94 | |
| (c) | 9.55 | 11.15 | 12.50 | | | |
| (d) | 225 | 340 | 445 | | | 1010 |
| <u>Option C</u> (rents rising in line with earnings plus an extra £1 cash increase each year) | | | | | | |
| (a) | 1.90 | 1.80 | 1.55 | 6.50 | | |
| (b) | 25 | 19 | 13 | | 103 | |
| (c) | 9.65 | 11.50 | 13.10 | | | |
| (d) | 240 | 375 | 510 | | | 1125 |

| | <u>1981-82</u> | <u>1982-83</u> | <u>1983-84</u> | <u>Rent Increase from present levels by 1983</u> | <u>Percentage Rent Increase on present levels</u> | <u>Savings £m</u> |
|---|----------------|----------------|----------------|--|---|-----------------------|
| <u>Option D</u> (rents rising so as to reach 10% of earnings by 1983/4) | | | | | | |
| (a) | 2.50 | 2.15 | 2.00 | 7.40 | | |
| (b) | 32 | 21 | 16 | | 125 | |
| (c) | 10.25 | 12.45 | 14.50 | | | |
| (d) | 310 | 480 | 650 | | | 1440 |
| <u>Option E</u> (rents rising as proposed by Chief Secretary) | | | | | | |
| (a) | 2.50 | 2.85 | 2.70 | 9.30 | | |
| (b) | 32 | 28 | 21 | | 145 | |
| (c) | 10.25 | 13.15 | 15.90 | | | |
| (d) Chief Secretary's desired savings. | 295 | 520 | 750 | | | 1565 |