PRIME MINISTER

WANDSWORTH

Back in May, following correspondence and exchanges you had had with Councillor Paul Beresford of Wandsworth, you asked the Department of the Environment to consider two possible changes to the local authority capital regime:

- changing the debt redemption ratio for housing receipts to 60/40 in Inner City areas as compared with the present single national rate of 75/25;

- taking into account local authorities' track record on asset disposals in the distribution to them of credit approvals.

After repeated prodding DoE have now come forward with a response in the form of a letter at Flag A, which was authorised by Nick Ridley before his deparature. This letter argues that, on balance, neither of these two adjustments to the capital regime would be desirable. But Nick Ridley acknowledged the strength of Councillor Beresford's concerns and suggested two further options that might be considered:

i) setting normative receipts targets for local authorities, with extra credit approvals being given to those - like Wandsworth - who exceeded the target;

ii) excluding from the debt redemption rules expenditure carried out on improving properties before they are sold. This would go to the heart of the point to which Beresford has objected.

Nick Ridley has already taken action to amend the Local Government and Housing Bill so that, if either of these changes was judged desirable, they could be implemented. He proposed that discussions with Beresford should now be opened to discuss the new options.

Tony Newton (in his former capacity) supported the idea of pursuing these new options, particularly the second. John Major (again in his old capacity) was more cautious, given the potential expenditure implications, but again was content for the ideas to be explored.

John Mills' note (Flag B) provides Policy Unit advice:

- he welcomes the proposed new options, in particular the second;
- he urges that the second option be worked up urgently and discussed with Beresford;
- on the assumption that this new option proves viable, he recommends that the two earlier ideas need not be pursued further;
- in passing, John also mentions an earlier letter about the Community Charge in Wandsworth, which I did not trouble you with; your concerns on this point were overtaken, and taken account of, in the work leading up to the safety net announcement.

Responsibility for all this has now of course passed to Chris Patten and, as regards the Inner City aspects, to David Hunt. Content for me to minute back saying that you assume they will now be considering these issues, but that:

i) you welcome the two new options identified, particularly the second one, and agree that there should be urgent further work and discussions with Beresford? Yes

ii) you are now content to let the earlier two possibilities lapse?

PRCG. Yes

P. GRAY
28 JULY 1989

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SECRETARY OF STATE FOR THE ENVIRONMENT

2 MARSHAM STREET
LONDON SW1P 3EB
01-276 3000

My ref:

Your ref :

Paul Gray Esq
Private Secretary to
The Prime Minister
10 Downing Street
LONDON
SW1A 2AA

21 July 1989

Dear Paul,

File with PG.

CORRESPONDENCE WITH COUNCILLOR BERESFORD

Following my letter of 13 June, I enclose the two notes the Prime Minister asked for in respect of the capital finance issues raised by Councillor Beresford. The first assesses the arguments for a lower debt redemption rate for inner city housing receipts. The second outlines how authorities with a good track record of asset disposals might be rewarded.

Wandsworth have capital spending power of over £100m under the present capital control system, compared to an average of £50m for Inner London boroughs. This is a result of their successful sales policy, and the unintended freedom under the present system to spend all capital receipts over time, which in turn has led to a substantial reduction in Ministers' ability to determine the distribution and use of capital resources. The new system is intended to retain an incentive for authorities to dispose of assets and that is why they will be able to spend 25% of their housing receipts and 50% of other receipts. With these percentages Wandsworth are still likely to have more capital spending power than all, or nearly all, other Inner London boroughs. But a fundamental objective of the new system is to redress the balance in favour of the Government's ability to target resources. For that reason my Secretary of State and the Chief Secretary have been keen not to increase the benefit of receipts in the new system beyond that already proposed.

Against that background, my Secretary of State has considered very carefully the two options described in the notes below. In his view neither would be appropriate. Although the first could be presented as a positive move to help the inner cities, it goes against the fundamental objectives of improved targeting and suffers from two other disadvantages. Firstly, the Government's supporters in shire districts, many of whom have pursued aggressive sales policies like Wandsworth, would feel aggrieved that the debt redemption rules were being relaxed for those authorities with the highest debt. Secondly, it would place great weight on the list of inner city authorities who would qualify. In particular it would make it very difficult to amend that list when it was sensible to do so. The proper way to help inner cities is to reflect their special needs in the assessments underlying the distribution of credit approvals.

The reward for asset disposals discussed in the second note also does not fit into the logic of the new system and on reflection has even less merit than the inner city approach. It would be very difficult to operate in a fair way. And it would be regressive, in that the more an authority generated from receipts, the greater proportion of them they would be able to spend. Nevertheless my Secretary of State appreciates the strength of Councillor Beresford's concerns and would like to provide whatever relief for Wandsworth he is able to within the objectives of the new system. He is considering two further options which may help.

Local authorities' credit approvals will be based on an assessment of their needs less a deduction to reflect their ability to meet those needs from capital receipts. It had been intended that the deduction should be based on authorities' actual receipts. But my Secretary of State has now asked officials to look at another approach, which would be to set "normative" receipts targets for authorities and to deduct a proportion of these from authorities' needs when setting credit approvals. That should benefit authorities like Wandsworth who would be likely to achieve more receipts than their target. My Secretary of State is amending the Bill to ensure such an approach could be adopted. But considerable further work is needed on the mechanism from setting targets and this option could not operate for 1990/91.

The second option would help Wandsworth and other authorities invest in their assets in order to encourage sales. Councillor Beresford refers to the importance of such investment in his letter to the Prime Minister. The option would relax the debt redemption provisions in relation to properties which had been improved before they were sold. When a local authority received a capital receipt from a property sale then the debt redemption rules would not apply to an amount of the receipt equal to the cost of capital works carried out on the property in a recent period. Again my Secretary of State is amending the Bill to allow such a relaxation to be given by regulations. Such a concession would apply to all property rather than just housing and could be justified as a means of encouraging cost effective improvement and rationalisation.

The Chancellor of the Duchy of Lancaster agrees that neither of the original options described in the notes below would be appropriate but that two further options are worth considering. Of the two, he finds the second more attractive. It would be of particular benefit to inner city authorities with large numbers of properties requiring improvement.

The Chief Secretary has no objection to further examination of the two new proposals. However, he is concerned about the effects on public expenditure of large deductions from receipts prior to the reserved part being applied. He has therefore asked officials to assess the likely impact on public expenditure and an appropriate length of time over which refurbishment may be scored in order to minimise that impact. He recommends that final decisions be taken in the light of this further work.

Subject to the agreement of the Prime Minister, and to the Chief Secretary being satisfied about the details of the second option, my Secretary of State would propose to go back to Councillor Beresford outlining the options we are considering.

I am sending a copy of this letter to Carys Evans and John Alty.

Yours

A D RING
Private Secretary

LOWER DEBT REDEMPTION RATE FOR INNER CITIES

1. Under the new capital finance system local authorities will have to set aside 75% of their housing capital receipts and 50% of their other capital receipts for debt redemption. Councillor Beresford suggested there should be a lower debt redemption rate for inner city authorities. This note considers the case for reducing the debt redemption rate for housing receipts in the 57 urban programme authorities to 60%.

2. The debt redemption provisions serve two purposes. First they ensure that a prudent amount of capital receipts are applied to reduce local authority debt, which stands at £45 billion nationally. The case for this is greatest in the urban programme authorities, where debt per head is £1400 on average compared to £740 elsewhere. The second purpose is to improve the Government's ability to target resources on areas of need. The major problem of the present capital control system has been that spending from capital receipts has increasingly pre-empted capital resources and reduced the capital allocations which the Government can issue. The debt redemption provision in the new system will remove some of the spending power from receipts and thus enable the Government to issue more credit approvals for new borrowing.

3. This improved targetting will generally benefit inner cities, since their special factors lead to them being assessed as having high needs. Wandsworth, however, are an exception. Because of their very high cash backed receipts (£71m at March 1988 compared to an average of £21 m for Inner London boroughs), they will lose more from the debt redemption than they will gain from additional credit approvals.

4. A reduction to 60% in the debt redemption rate for inner city housing receipts would, unless public expenditure plans were increased, reduce the national total for credit approvals by about £100m from the present level of £2780m. Inner city authorities would benefit at the expense of other areas. The precise size of the benefit would depend on the extent to which we took account of their additional receipts spending power when setting credit approvals.

5. The advantage of this proposal is that it could be presented as a positive step to recognise the special needs of inner city authorities. It would enable these authorities to help themselves by generating more receipts rather than relying on credit approvals issued by the Government.

6. The main disadvantage is that it is hard to justify relaxing the debt redemption provisions for the authorities with the greatest debt. Inner city needs are already reflected in the distribution of resources. Many shire districts, who argue they too have special needs and have worked hard to generate receipts, would feel they merited the same treatment. And it would place great weight on the present list of 57 urban programme authorities. For some of these, the benefit of being on the list would be far greater as a result of relaxation of the debt redemption requirement than it is from the urban programme itself. For example, Wandsworth would enjoy £20m more spending power from receipts compared to an urban programme allocation of £3m this year. So the boundaries of the list would be subject to great scrutiny and any future changes to it, which may be justifiable on urban programme grounds, would become more difficult to make. Ministers have already told a number of local authorities that a review of the list is likely to be undertaken later this year.

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TAKING ACCOUNT OF AUTHORITIES' PERFORMANCE ON ASSET DISPOSALS IN SETTING HOUSING CAPITAL RESOURCES

1. This note explores the way in which the Department might reward local authorities with a good track record on asset disposals in determining resources for housing capital expenditure under the new capital system. The reward could take one of two forms, either:

(a) higher housing allocations (eg supplementary allocation from a central reserve);

(b) a higher percentage of receipts usable at the authority's discretion.

Of these the former would be a departure from the normal principle of distributing capital guidelines by reference to local need. By contrast (b) would operate on the receipts themselves, and appears more appropriate. Furthermore it could apply, if desired, once only: to accumulated receipts at the start of the new system.

2. The Department at present collects information from local authorities on sales of council dwellings, and has done so since 1979. This information can be compared with each authority's total housing stock. However, the data on some 50 (out of 366) authorities is incomplete, and cross checking against other returns submitted by authorities reveals high levels of inconsistency in the data we have.

3. It would therefore be necessary to devise a new return for authorities to record sales since 1979, together with the total stock remaining in each year, and this would be subject to certification by the authority's auditor. If the Department was to award higher capital allocations (option 'a') as a result of successful asset disposal, authorities would have to submit these forms or fail to qualify; the allocations would run on data two years' old. Alternatively, if authorities were rewarded with a higher percentage of usable receipts (option

'b', they would not be required to make bids to the Department but would calculate their own entitlements to use receipts, under Regulations, and statistics could be collected for the year in question. A return to DoE would then be used to monitor the system.

<u>How the system would work</u>

4. The system would work by setting a threshold, with those authorities achieving asset sales above the threshold figure being rewarded for their performance. A simple system would consider asset sales from 1979 to 1989 and award additional resources once only at the start of the new system in April 1990. (This would be appropriate if, for example, the reward was a higher percentage of <u>accumulated</u> receipts to be usable at the authority's discretion). A more elaborate scheme would roll forward, to give additional incentives to future sales. If the scheme took the form of a single threshold of the percentage of dwellings sold since 1979, over time more authorities would reach it. But once that threshold was exceeded there would be no new incentive to authorities. Alternatively, the threshold could be applied year by year on the basis of the percentage of stock sold in a year, although that would induce authorities to avoid overshooting by a substantial margin in case next year's task was harder - it would therefore be necessary to ensure the threshold was not set too low. On balance, none of these more elaborate schemes appears satisfactory, and a once-for-all reward in 1990/91 seems preferable. Some 160 authorities might exceed a threshold of 25% sales in 1979-1989, and Wandsworth (who are thought to have sold 27%) would be included.

5. Whichever mechanism was adopted, it might be considered invidious to set a single, arbitrary threshold, especially if the reward for high sales were to be substantial. A system of two or three thresholds, with increasing rewards, might be fairer. Sales also vary for reasons outside authorities' control: they are higher where earnings are high (eg in the south east and east); and they reflect the popularity of houses over flats, and so tend to be lower in urban areas. It

might therefore be desirable for the upper threshold to be raised in the South East, East, East Midlands and South West (eg up to 30%), and reduced for the North and all metropolitan districts (eg to 20%). We estimate that around 84 authorities might be above these redefined thresholds - still a high number in relation to the 366 housing authorities.

Conclusion

6. A scheme that provided an extra inducement to new sales, year-by-year, and allowed authorities throughout the country the prospect of a reward for good performance, would be complex and costly to run. It does not appear to bring substantial extra benefits because authorities will already have the incentive of 25% usable receipts from the sales of dwellings (a higher reward for higher receipts). And in the housing field there are mandatory provisions for sale under the Right to Buy and Tenants' Choice, so the need for incentives is reduced.

7. However, a simpler scheme could be devised in relation to accumulated receipts at 1 April 1990. Further work would be required to assess the threshold to be set and, to prevent the scheme being seen as grossly invidious, different thresholds might be needed for different parts of the country. Whilst authorities achieving those thresholds could perhaps be given enhanced capital allocations from a central reserve (option 'a'), that could seriously distort the needs assessment on which the distribution is based. If performance on asset sales is to be pursued at all, we would recommend that it would be more appropriate to increase the usable percentage of accumulated receipts (option 'b'). This however is separately discussed in the context of a concession to the 57 inner city authorities.

LAH
June 1989

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10 DOWNING STREET

LONDON SW1A 2AA

From the Private Secretary

31 July 1989

CORRESPONDENCE WITH COUNCILLOR BERESFORD

Thank you for your letter of 21 July on the capital finance issues raised by Councillor Beresford, following up the earlier letter of 13 June on the Community Charge aspects. (The latter aspects were taken into account in the recent E(LF) discussions.)

The Prime Minister assumes that Mr. Patten and Mr. Hunt will want to consider the points arising on the capital finance issues. But she welcomes the two further options identified in your letter, particularly the possibility of excluding from the debt redemption rules expenditure carried out on improving properties before they are sold, and supports the idea that there should be urgent further work and discussions with Councillor Beresford. Assuming that these latest options can be satisfactorily developed she would be content to drop the earlier possibilities of changing the debt redemption ratio for housing receipts to 60 per cent/40 per cent in inner city areas, and taking into account local authorities' track record on asset disposals in distributing credit approvals.

I am copying this letter to Carys Evans (Chief Secretary's Office) and Trevor Beattie (Minister of State's Office, Department of the Environment).

PAUL GRAY

Alan Ring, Esq.,
Department of the Environment

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PAUL GRAY 25 July 1989

WANDSWORTH

Persistence has paid off and DOE have now come up with two new options. These should go some way to meeting Paul Beresford's concerns. But the precise impact is unknown until they are discussed with him.

The New Options

(i) Setting 'normative' receipts targets for authorities, with benefit, in the form of extra credit approvals, for authorities like Wandsworth which exceed the target.

The effect of this will be to create an incentive to sell assets. A power to do this will be put in the Local Government and Housing Bill, although DOE says it could not be implemented until 1991/2. But it could be a useful weapon to have in reserve.

(ii) Excluding from the debt redemption rules expenditure on improving property before sale.

This is the most promising option. It addresses Beresford's main concern that the new capital controls will simply penalise authorities for spending money on refurbishing property to make it saleable. Instead it should create an incentive to undertake such improvements and this in turn should boost sales.

There are two caveats:

(i) DOE are not as yet able to assess what benefit this will give Wandsworth. Reducing the ratio to 60:40 would increase its spending power from receipts next year from £40m to £60m. Beresford will be looking for similar orders of magnitude from this new option.

(ii) The <u>period of time</u> over which refurbishment costs can be "scored" needs to be settled. This will make a big difference to the final result. It clearly should be at least 2 or 3 years given the length of time it takes to refurbish whole blocks of flats. There is a danger if it is set too short - say only one year - of spoiling the ship for a ha'porth of tar.

<u>The former options</u>

These were **(a) a lower debt redemption ratio for inner city authorities, and (b) rewards for asset disposals.** DOE comes down quite firmly against them, with Treasury support. I am not convinced the case is proven against the lower ratio, but I do not think it needs to be pushed any further now provided the new options are shown to provide a reasonable solution. The ratio can in any case be changed by regulations at a later date if necessary.

<u>Community Charge in Wandsworth</u>

This was also raised in your letter of 15 May to DOE and they responded on 13 June.

Wandsworth has been able to subsidise rates from its housing revenue surplus (the reverse is true in most of the rest of inner London) and Beresford was concerned about the adverse impact on Wandsworth's community charge of ring-fencing the housing revenue account.

Beresford's concerns are not now borne out. Taking the overall position as agreed by E(LF), next year's Wandsworth community charge will probably be the lowest in London. The ILEA specific grant helps a lot to achieve this, but it remains a tribute to what has been achieved in Wandsworth and it will be an immensely valuable card in the 1990 local election.

The 13 June letter therefore simply needs to be noted.

Conclusion

The acid test is success in avoiding the difficulties in the new capital control regime identified by Beresford. This was the thrust of the Prime Minister's concern set out in your letter of 15 May. Removing refurbishment expenditure from the debt redemption rules looks like a promising way out but we need to be sure that it will actually solve the problem. The DOE therefore now needs to talk about it with Beresford, and final judgement should await this.

Recommendation

- Welcome the two new options

- Agree that the second of these (exempting refurbishment costs from the debt redemption rules) be worked up urgently, and an assessment made of the help it will actually give Wandsworth (Beresford will need to be consulted)

- On the basis that it will provide the necessary help, agree that the earlier ideas of a lower ratio and rewards for asset disposals should not now be pursued further.

John Mills.

JOHN MILLS