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My ref:

Your ref:

The Rt Hon John Major MP
Chief Secretary to the Treasury
HM Treasury
Parliament Street
LONDON SW1

31 May 1989

Dear Chief Secretary

PES 1989 - DOE (CENTRAL)

1. This letter sets out my assessment of the provision required for Housing and DOE (Other) for 1990-91 to 1992-93. I am writing separately about the PSA.
2. My proposals are summarised in the attached tables. These take account of the new arrangements for considering local authority capital spending in this Survey. The housing table also shows gross local authority capital spending. It seems to me essential to have these figures in front of us, as well as the totals of credit approvals and capital grants, given the scale of housing capital spending financed from receipts, and the fact that the policies I am seeking to achieve stem, in large part, from an analysis of the overall levels of output that are required.

Capital receipts

3. In recent years, capital receipts on DOE programmes have made a major contribution towards keeping down net public expenditure, and delivering the Government's objective of reducing public expenditure as a proportion of GDP. From this Survey, local authority receipts will no longer be within my programmes. Though high interest rates are likely, so long as they persist, to reduce housing receipts below the levels previously envisaged, substantial receipts will continue throughout the PES period, and will, of course, still be within General Government Expenditure. The condition of local authority housing also has a knock on effect on the amount of receipts from right to buy and other housing disposals. Our officials will need to be in contact during the summer to monitor forecasts of local authority receipts.
4. New Town receipts remain on my programmes. A further increase in such receipts is expected in the PES period. There is, however, still considerable uncertainty about the likely amounts, and my officials have agreed with yours that New Town receipts should, as

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in 1988, be looked at separately. Meanwhile, the tables show a first indication of the increased sums that may be available from this source.

Context

5. Overall, my policies are directed towards ensuring that the public sector is involved only where it has to be; and that, where public money does need to be spent, we get the maximum benefit from every £. We continue to make progress towards both objectives - through, for example, measures to breathe new life into the private rented housing market; to introduce private finance wherever we can achieve better value for money by doing so, for example into investment by housing associations, or by increasing the importance of City Grant. In the local authority field, compulsory competitive tendering; continuing incentives and pressures to dispose of housing and other assets; the new local authority capital finance system; the ring-fenced housing revenue account; means-tested renovation grants; and progress towards a more market-related pattern of rents will all help.

6. That progress is reflected in the level of provision I am seeking. Where I am proposing increases, it is because, even after the benefits of such policy changes have been taken into account, the baselines (some of which are falling rapidly) still appear unsustainably low. On my capital programmes, most of the bids are affected by price rises in the construction industry in the recent past. I have assumed in my bids that the inflationary peak has passed. But the surge in prices has driven up unit costs and left us in a position where the outputs obtainable from my capital programmes at baseline have been considerably reduced compared with those that were envisaged a year or so ago.

Housing

7. In last year's Survey, I suggested that the existing shortfall of subsidised rented housing was 250,000, and that 50,000 new rented homes a year were needed to prevent the shortfall from increasing. I judged that the earliest we could realistically achieve this annual figure was the mid-1990s. At the conclusion of the 1988 Survey, I was able, within the provision we agreed, to maintain in full my plans for Housing Corporation expenditure in 1990-91 and 1991-92 in order to make progress towards that objective. This year I have had to take into account the effect of increases in construction costs over and above the rate of inflation, and a further shift in the programme to the south where the demand is greatest. Allowing for the diminishing number of new homes provided by local authorities, the expenditure baseline would now mean the output of subsidised rented housing falling from 30,000 in 1989-90 to 25,000 in 1990-91, and rising only to 32,000 by 1992-93.

8. On present policies, there is no reason to change the figure of 50,000 dwellings a year. It takes a stringent view of those who should benefit from subsidised accommodation - single people under 30, for example, are excluded entirely from the calculation. The assumptions make full allowance for improvements in supply,

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including an enhanced contribution from the private rented sector. Account is also taken of changes in demand, as living standards overall improve and so allow increasing numbers of people either to buy their own homes or to pay market rents. My officials will be sending yours a detailed paper setting out the assumptions.

9. The figures for new dwellings needed can be seen as part of managing the decline in the subsidised rented sector. If we achieve 100,000 right to buy sales each year, that would still mean that the total size of the subsidised rented housing market fell by 50,000 units a year. New Town and local authority homes have declined from 5½ million when we came into office to under 4½ million now.

10. The result of these calculations is the bids of £242m, £473m and £744m for the Housing Corporation, and £60m, £67m and £80m for local authority sponsored housing association schemes. They assume a 1% annual efficiency saving on the Housing Corporation programme; and nearly 90% of the Housing Corporation rented programme, and all the LCHO programme, using mixed funding by the end of the PES period.

11. By building up Housing Corporation investment gradually, the programme achieves good value for money. But the level of provision for the Housing Corporation would still mean a rapid increase in the shortfall in available rented housing over the next couple of years. Crucial indicators such as the number of families in temporary accommodation can be expected to deteriorate accordingly.

12. These figures are the result of seeking to get back to the position where, by the mid-1990s, we will be able to hold the position steady at a shortage of 300,000 subsidised houses. The bids would have to be higher if we were to seek to eat into the shortage.

13. I am not happy about these figures. Although they do no more than slow the rate of growth of the gap between supply and demand, they represent a big increase in spending in the present difficult economic situation. At the same time they achieve too little impact. The problem is that there are still too few constraints on demand for subsidised housing. Price is indeed a constraint on the demand for owner occupied housing particularly in the south; in the field of subsidised housing to rent, it is free for the least well off and rents have been cheap even for those clear of housing benefit. New policies on rents in the local authority sector will be slow to take effect, and except for new tenants of housing associations the shortage of housing in the South East is in no way reflected in the cost to those who are fortunate enough to obtain subsidised housing there. It is still too easy for people who are not even economically active to move to the South East, if they have family connections there. After an unpleasant period staying with friends or living in Bed and Breakfast, sooner or later they achieve a "free" home. We have discussed this in relation to the homelessness problem recently in E(LF).

14. The E(LF) discussion showed that colleagues were reluctant to accept the consequences of our present policies - that we needed to

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provide extra homes for homeless people in the stress areas. The analysis above shows the scale of the far greater problem of which homelessness is but the tip of the iceberg: a problem which is shortage of supply against largely unrestrained demand, mostly in one particular area of the country. At the same time we have 50,000 empty (and fit) council houses in Scotland, and about 20,000 in the North of England. It seems perverse to ignore this empty stock and at the same time to ask you for substantial resources to build more houses in an area where prices are high, land with planning permission is short, and congestion on roads and in schools is already chronic.

15. I would like to find different, and more cost-effective policies. If I fail, or if colleagues are not inclined to accept them, I will have to return to my bid. But I believe we must now contemplate a policy based on 3 elements.

1. A crash programme to bring all empty public stock into use in the stress areas;

2. Cash incentives to persuade people to vacate public rented stock in the stress areas, either:

a) to buy their own home elsewhere;

or b) to move to an area with surplus stock and rent at lower cost to themselves;

or c) to buy a home from the surplus public stock in the areas of the country where we have a surplus, on favourable terms.

3) To restrict homelessness acceptances to exclude those with no local connection and who are not economically active from the stress areas, and to house them in areas where we have surplus stock.

16. I have included in my bids the first of these elements - a package of targeted spending, mainly in 1990-91 and 1991-92, aimed at a once for all increase in the number of lettings we get from the existing stock. This would be done largely by bringing back into use empty local authority and housing association properties in need of repair in areas of housing stress. It would also include, for example, additional resources for cash incentive schemes, to allow better-off tenants to move out into owner occupation, so releasing rented accommodation for those in need. Altogether some 13,000 additional properties in 1990-91, 8,000 in 1991-92 and 1,000 in 1992-93 could be brought into use - and so provide help at a stage when the main Housing Corporation programme was still building up. In addition, of course, it makes very obvious economic sense to put properties back into use in areas of scarcity: such investment will allow the use of bed and breakfast (and other costly short-term) accommodation to be reduced, so producing savings in local authorities' current expenditure. Indeed, because bed and breakfast costs are so high, particularly in London, the pay-back period for a

good part of the capital expenditure I am proposing would be less than 2 years.

17. I have not, at this stage, worked up the last 2 elements of the approach set out in paragraph 15 above. Such new policies would have a public expenditure cost, but that would be considerably less than building new rented housing.

18. Renovation Since last year's Survey, the detailed results of the 1986 English House Condition Survey have become available. These confirm that the state of the public sector stock has remained broadly static since 1981; and that there has been only a modest improvement in the private sector. Although renovation commonly includes an element of improvement, without it we face increasing disrepair, leading to higher costs in due course and, potentially, to eventual unfitness. With an ageing housing stock - only about 1% is added each year compared with 3% at past peaks, and only 0.2% is demolished - rising expenditure is needed to hold conditions steady.

19. The need for public sector renovation is being reduced by the success of the right to buy, and by the disposal by some local authorities of all or part of their stocks to other landlords. We must assume, however, for the Survey period, a substantial number of dwellings remaining in local authority ownership. Moreover, disrepair jeopardizes sales, and reduces the sale price of disposals that local authorities do make.

20. So far as the local authority stock is concerned, our objective, I believe, should be to prevent any further deterioration. The EHCS indicates that a steady state can be maintained by renovating broadly the present proportion, 3%, of the stock each year. I want to continue giving priority to local authorities' worst housing estates, by building on the success of Estate Action. The better targetting produced by the new capital finance arrangements may avoid the need to make separate allocations of Supplementary Credit Approvals for every Estate Action scheme - but I shall want to demonstrate that, in total, sums on a similar scale to recent years are being directed to local authorities for Estate Action. For mainstream renovation the baseline, however, implies a reduction of 25% in unit output by 1992-93, compared with the forecast 11% fall in the size of the stock. My bids for additional credit approvals therefore include £150m, £177m and £115m - taking Estate Action and mainstream renovation together - to provide for constant real expenditure per dwelling. They are the minimum needed to avoid deterioration: the minimum because they take no account of rising unit costs as the better stock is sold (through right to buy, and large scale disposals by authorities such as Sevenoaks and Chiltern) and as the remaining stock ages.

21. The Local Government and Housing Bill introduces a new system of renovation grants with effect from 1990-91. The new system will target grant on properties that need urgent action - those that are unfit or most likely to become unfit - and limit help to people too poor to finance the work themselves. This means eliminating the deadweight that has been such a feature of the present home

improvement grant system. But it also means, as a conscious choice, increasing unit costs as we allow grants of up to 100% and concentrate on the properties where the cost of work needed will tend to be highest.

22. In terms of the condition of the private sector stock, much will depend on the take-up of these new grants, and also on the reaction of those owners no longer eligible for grants who, we hope, will nevertheless carry out the work that is needed, but finance it themselves. The baseline for expenditure in 1990-91 is 12% lower in real terms than for 1989-90. Given the predicted overhang of grants from the existing system into next year, and adding to that a fairly modest assumption about take-up under the new system, additional resources will be needed for renovation grants (which in future will mostly be mandatory) and group repair together. Thereafter, because of the uncertainties, I suggest, as a holding assumption, that spending on grants for private sector renovation continues at the same level as in 1990-91 in real terms. We shall then need to monitor the situation closely and, depending on the final shape of the means-test and early indications of take-up, consider the figures for later years in more detail in the 1990 Survey. The resulting increase for these purposes (taking Credit Approvals and specific grants together) would be £53m, £68m and £84m. An increase is also needed for slum clearance, mainly to reflect the increase in the size of home loss payments, and the proposal to pay market value compensation for all cleared properties. I must emphasise that, unless there is a substantial increase in privately financed spending, spending at these levels is likely to mean an increase in unfitness; a much larger bid would be needed to protect against that outcome.

23. Although considerable uncertainties remain about the pattern of spending on HATs, it is clear that the timetable has slipped as a result of the need for tenants' ballots. The profile of expenditure shown in the tables, including savings in 1990-91 and 1991-92, is my present best estimate of what may emerge.

24. The tables and supporting material also include details of a number of smaller housing bids, which I shall not explore in detail here, each of which is however of considerable importance in its own right. These include an increase in spending on defective housing in 1990-91, but with savings offered in subsequent years.

Housing current

25. The 1989 Survey takes account of the proposed new Housing Revenue Account Subsidy, under which housing subsidy and rent rebate subsidy come together in my programme. Two technical bids are required, one for the effect of former rate fund contributions (RFCs) to the HRA, and the other to meet the 3½% of rent rebate costs not presently met by DSS. These two amounts together come to £446m in 1990-91, £458m in 1991-92 and £469m in 1992-93. They do not represent an increase in total net public expenditure. However, because the amount allowed for RFCs does not take full account of those authorities where such contributions are on a rising trend, a

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further bid of £48m in 1990-91, £49m in 1991-92 and £50m in 1992-93 is required.

26. The size of the remaining substantive bids that are needed will depend on the assumptions we propose to make for 1990-91 for the increase in management and maintenance costs, the average rent increase, and any limit we set on guideline rent rises for individual local authorities. In the past two years our subsidy assumption has been for real rent rises of 5%, and matching increases in management and maintenance. Actual increases, however, were about 4%, and we have given assurances of a smooth transition to the new system, so that for the tenant the immediate effect should be indistinguishable from what would have happened had the current system remained in force.

27. In my view we could calculate subsidy on an assumed real rent increase of 5% in 1990-91 without breaching our assurances, provided that rent increases do not exceed £4 per week for any one authority. I would emphasise that this is as ambitious as we can reasonably be in the first year of the new regime because for those local authorities with rents below the national average a maximum rent increase of £4 per week would be an increase of over 20%. On these assumptions, even taking account of increases in the amount of rent rebate subsidy required, the subsidy total will be £100m less under the New Financial Regime than it would have been under the present system. On the other hand increasing rents by 6% real would bring in only £16m more in gross rent because of the £4 cut-off but the rent rebate subsidy requirement would increase by £11m - a net saving of only £5m. A 5% increase would therefore seem to be the optimum.

28. I am proposing an increase in management and maintenance allowances of 3% real. We know from a recent study that many tenants are willing to pay more in rents provided it is accompanied by better management and maintenance. The package I propose allows a real increase in M&M nationally together with real increases in gross rent over twice that needed to meet that increased expenditure. The difference represents the start we are making on moving rents away from historic costs. At the local level this package allows us to start redistributing the M&M allowances without imposing any reductions, which, in the first year, would be incompatible with our undertakings to ensure a smooth transition. In future years I shall wish to consider whether, from the evidence available to me under the new regime, management and maintenance allowances need to increase by more than inflation.

Countryside and recreation

29. I have scaled down, and, in the case of the Rural Development Commission eliminated entirely, the increases in funding sought by the countryside and recreation sponsored bodies in their corporate plans. The Tidy Britain Group's spending should revert over the PES period to their core activities. The Countryside Commission however need additional resources if progress is to be made with tree planting, the development of long-distance routes, and for their contribution to the successful Groundwork Foundation. The bid for the Nature Conservancy Council assumes that separate conservation agencies are to be established for Scotland and Wales. But my bids

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do not take account of any further reorganisation of those bodies that may be needed, on which we shall shortly be having a discussion in H.

30. The Sports Council bid is largely for contributions towards the revenue costs of the World Student Games, and for incentive funding schemes attracting private finance. In view of the uncertainties I have not at this stage entered a bid for the Football Membership Authority or expenditure on football ground licensing. As you know the latter is expected to cost at least £0.5m, and possibly more depending on Lord Justice Taylor's findings. We are considering the possibility also that licensing will be carried out by an NDPB rather than the Department. I must reserve my position on seeking additional resources later in the round when the position becomes clearer.

31. On environmental matters, we need to provide for the increased contribution to UNEP. Building on the impetus we have now achieved, we must also develop our environmental research capacity, in order to provide the scientific evidence needed for policy formulation at national, EC and international levels. The main requirement is for work on air pollution, including the proposed UK Climate Change Centre.

Heritage

32. A number of major projects are urgently needed at the occupied palaces; in addition, there is a backlog of essential maintenance work (including fire prevention). Without increased expenditure at the unoccupied palaces and Royal Parks - for example, a new visitor centre at Hampton Court - we shall not be able to make the most of their commercial possibilities and reduce the subsidy from the taxpayer. It is particularly important that we give the new Historic Royal Palaces agency adequate initial funding for commercial investment.

33. Undoubtedly, we need to provide for increased accommodation costs for the Historic Buildings and Monuments Commission as various leases run out, and in preparation for relocation outside London in the mid-1990s. Updating of and extensions to computer systems at the Royal Commission on Historical Monuments will improve the organisation's efficiency and should enable it to generate extra income by charging for the services it provides. The National Heritage Memorial Fund is pressing strongly for additional funding. I shall be discussing with Richard Luce the strategy we should adopt; we may need to bid subsequently for the last two years of the Survey.

Water

34. The bid for the National Rivers Authority incorporates the increases we anticipate will be necessary as a result of the recently announced proposal to fully fund LGSS pension funds from 1 April 1990, and the better estimates which are now available of the likely expenditure and income on the NRA's various activities. These increases have been offset, to some extent in 1990-91 and

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wholly thereafter, by savings which have resulted from decisions reached on the VAT status of various NRA functions since the last PES round.

35. The bid for the Water Services Office is a provisional one. It has been seen by the future Director General. He will let you know of any changes he wishes made to it, and will be primarily responsible for negotiation on the WSO's funding requirement.

36. Assuming that water privatisation proceeds are taken over 3 years, there will also be privatisation costs in 1990-91 and 1991-92. I hope it will be possible to agree these in advance of the main Survey discussions.

The Urban Block

37. I am not, at this stage, submitting a bid for LDDC. Your officials have only just written to mine about the proposed private funding vehicle for the Docklands Light Railway Eastern Extension; and the tenders for the Limehouse Link have only just been received by LDDC and are still being analysed. I shall write to you separately on LDDC's requirements for the Survey period when both these issues are resolved - hopefully by mid-June.

38. The second and third generation UDCs are now well into their stride. Several have identified opportunities to capitalise on private sector interest and lever in substantial amounts of private sector funds. Some of those schemes will be foregone if funding is not increased. While not envisaging meeting all UDCs' requests for additional funding, I think that there will be considerable merit in providing extra resources within the Survey period, particularly for Tyne and Wear and Teesside among the second generation UDCs, and for additional City Grant (for example in Manchester) and rephased land purchase (for example in Leeds) for the third generation.

39. Good City Grant applications are coming in at a far faster rate than we had assumed last year. Even at the levels of spending suggested, there will need to be some rationing of resources, and private investment and new jobs will be foregone.

40. The levels of spending on UP and DLG have been significantly reduced over the last few years. I should like to keep UP spending broadly constant in real terms at the 1989-90 level during the Survey period (at least until we have had a chance to look at its future in more detail); and, given the build up of good schemes and newly arising dereliction (for example from coalfield closures), to restore DLG to broadly its 1988-89 level in cash terms.

Local Environmental Services

41. Actual spending on LES capital has been well above provision in recent years as local authorities spend heavily from receipts. The scope for such receipts-financed spending will be considerably reduced as a result of the debt redemption provisions of the new capital finance regime. The bid is intended to ensure first that adequate provision is made to cope with particular problems now

identified, especially on waste disposal, and second to keep expenditure reductions that occur in the Survey period within sensible and defensible limits.

42. Local authorities definitely need to spend some money to prevent the dangerous build up of methane gas in landfill waste sites, and to upgrade and replace old municipal incinerators which must be brought up to new EC standards. Expenditure by local authorities on these priority areas will mean very substantial reductions in the remainder of local environmental services capital expenditure. Even with the bid, the real value of local environmental services capital expenditure in 1990-91 is likely to be around 40% less than in 1987-88, and a third less than expenditure in 1989-90. Nonetheless I would be prepared to defend such provision on the grounds that it maintained expenditure at the level of 1989-90 provision (after discounting the one-off provision for community charge), and that it met the most pressing requirements to spend on the environment and waste disposal, plus an allowance for general inflation.

43. Without the bid, the amount available in 1990-91 for basic LES allocations (credit approvals plus receipts taken into account) would be likely to be less than £150m. With such a low total, it would be impossible to provide adequately for genuine differences between authorities in their basic expenditure needs. This matters much more than in the past because the new capital finance system reduces the spending capacity not only of such receipts-rich authorities but also of low-receipts authorities which have until now been spending heavily from their limited receipts. It is important that as we enter the new system the control exercised over receipts should be seen to provide benefits in terms of credit approvals and that the new system is not discredited by a failure to ensure adequate resources for tightly pressed authorities.

44. Our assessment of the overall expenditure levels implied by the bid is that they would be around the minimum necessary to prevent the LES capital stock from deteriorating overall, while allowing local authorities to respond to certain key areas of pressure for increased capital expenditure.

Administration

45. The administration bid is based on the Department's increased manpower requirements, primarily for the Planning Inspectorate, and Environmental Protection, but also for work elsewhere to follow up legislation and to get back up to strength in areas where staff have been withdrawn in order to work in Water Privatisation. The manpower bid is a net bid, taking account of gross savings, of which the majority arise from Water privatisation (-77 each year) but a substantial number arise elsewhere from changes in work and from efficiency gains.

46. The bid for the Planning Inspectorate is large, but represents our best estimate of what will be needed to keep pace with the rising number of appeals. It takes account of improvements in Inspectors' productivity and of system changes which should also

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improve handling times in the later years. I am continuing to pursue further efficiency gains and to look at policy options which would reduce the number of appeals. But it would not be realistic to expect any radical new measures to be in place in time to affect the PES bid significantly. Unless additional resources are provided, delays will worsen and the planning system will hold back economic growth.

47. I attach the Department's management plan in support of the running cost bid. This plan sets out our proposals for efficiency improvements and the assumptions underlying the bid. The plans for each area of activity are identified separately.

48. I am copying this letter to the Prime Minister, John Moore, Peter Walker and Malcolm Rifkind.

Yours sincerely
N Ridley

pp NICHOLAS RIDLEY

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

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