PRIME MINISTER

PAPERS ON HOUSING FINANCE AND LOCAL AUTHORITY CAPITAL CONTROL SYSTEM

Mr. Ridley has issued a large weight of paper on these inter-related issues. Some of the papers are for discussion at E(LF) next Thursday, others he hopes to clear in correspondence. But I think you will want to consider them all as a package.

At Flag A is a summary minute by Mr. Ridley in which he seeks to pull together the different elements and "put them in a wider political context".

At Flag B is the detailed E(LF) paper on a new financial regime for local authority housing, for discussion at next Thursday's meeting. But rather than going through this paper in detail, you may prefer to concentrate on the Cabinet Office brief at Flag C which very helpfully pulls out the main issues and relates the latest proposals back to Mr. Ridley's earlier ideas.

At Flag D is a draft consultation paper Mr. Ridley wishes to issue on the new general local authority capital control system agreed in E(LF) last year.

At Flags E and F are two further papers for discussion at Thursday's meeting, following up earlier exchanges on the disposal of local authority housing stocks. These concern points of greater detail, which you may feel you only need to glance at.

Most of this can be taken forward at Thursday's E(LF) meeting. But, meantime, do you want to offer any comments on the draft consultation paper at Flag D?

Yes – but it is a point of substance. I feel that surplus funds should be capable of being spent to bring schools up to standard and to provide them with facilities like swimming pools, music rooms, technology centres – and to do something to help the old folk not

Amanda Ross

pp Paul Gray

Duty Clerk

18 March

JA1BSS

[redacted]

Original on Housing file

SECRETARY OF STATE FOR THE ENVIRONMENT

Prime Minister

NEW HOUSING FINANCE REGIME AND CAPITAL CONTROL SYSTEM

At the E(LF) meeting on 24 March we are due to discuss my proposals to reform the arrangements for regulating the finances of local authority housing (E(LF)(88)3). I have also recently circulated for clearance by correspondence a draft consultation document on the general capital control system.

Both of these are major issues and will have important political overtones as much for our own supporters as for the opposition. It may be helpful for you and for colleagues to put them in a wider political context.

Our present capital control system for local authorities is outdated. We are ostensibly trying to control the net capital expenditure by local authorities and to allocate spending approvals where they are most needed. But in practice net expenditure has in almost all years diverged markedly from provision. Authorities, above all our own supporters, have built up very large stocks of capital receipts, and we have had to incur political unpopularity with them to prevent these resources from being used for further capital spending too quickly.

The system is also much too complex, with far too many loopholes and exemptions. The most irresponsible authorities in the control of our political opponents have been building up severe problems for the future by creative accounting devices of various sorts. These devices, and the allowance that must be made for the use of accumulated capital receipts, have increasingly restricted the scope which we have to distribute resources through allocations in accordance with the real needs for capital spending.

There is a clear gain to be achieved by introducing a sensible capital control system which will control what needs to be controlled, and will leave authorities reasonable flexibility to plan their own programmes over a number of years within our overall constraints. The central part of our proposals is to move from an expenditure control to a control on borrowing by local authorities. This is what many authorities have been asking for, and it should be widely welcomed. It is generally recognised and accepted that the level of borrowing by the public sector and by local authorities is something that needs to be controlled; and it will be difficult for anyone to mount an effective criticism of a control on borrowing as such. It still leaves us with an expenditure problem.

In principle moving our control on to borrowing means that authorities should be free to achieve additional capital spending by raising finance by selling other assets. One key change in our new proposals is that authorities will be able to finance additional capital spending directly from revenue if they are prepared to raise the community charge to pay for it. This should give an additional freedom and flexibility to local authorities, and at the same time an increase in accountability to the local electorate. – Depends how many are on 0-20%.

Local authorities will also be free to spend a proportion of their capital receipts on additional capital expenditure either immediately or over time. The freedom to spend the prescribed proportion of receipts when they wish will be very welcome to authorities, and will overcome a lot of the criticism we have received about the artificial constraints of annuality.

We must recognise however that the other aspect of our proposals on capital receipts will be less popular - namely that the non-prescribed proportion of receipts should be put towards reducing debt or towards approved financial investments rather than towards new capital expenditure. We shall have to take this criticism head on. The fact is that local authorities have very large accumulations of land and property at present, and our objective is to reduce this total. Our objective would be totally frustrated if every time an authority sold one asset they were immediately able to spend the proceeds on acquiring another one.

We are moving towards smaller leaner local authorities with smaller stocks of housing and other physical assets, operating more as enablers than as providers. We shall have to sell this message vigorously, particularly to our own friends and supporters in the shires and on our backbenches who think that authorities should be free to use all the proceeds of asset sales to acquire new assets, especially since we have at various times in the past given public assurance that authorities would be able to use all their capital receipts over time.

On the housing side, the issue is much more acute. Rented housing represents potentially the biggest asset that district councils have, and the great prize of our new housing policies is to realise these assets, and transfer them into private ownership. The right to buy has already secured the transfer of over 1 million dwellings, but there are still 4.5 million to go. We now need to promote larger block transfers of local authority housing to other owners. But not to allow more to be built

We have been encouraging voluntary piecemeal disposal of council housing empires - Wandsworth has shown what can be done in this direction, and what a dramatic effect such a policy can have on the local economy and on the local political scene. This has developed into the new and most exciting initiative which I have already described to you - local authorities seeking to get out of the landlord business altogether, and transfer their stock to independent landlords. We are all agreed that so long as we can be sure that councils are genuinely relinquishing control, and the new landlords are truly independent, we must do everything we can to assist these changes.

Every transfer of this kind brings a receipt, which is potentially available to reduce the PSBR. A cautious estimate of the aggregate tenanted value of the local authority stock in England is of the order of £20bn. It is clearly vital for our broader economic strategy that potential resources of this magnitude are kept under effective control. It is impossible to leave them with local authorities to spend at will.

SECRETARY OF STATE FOR THE ENVIRONMENT

The scale of these potential receipts on the housing side is so great that we shall have to continue to apply to housing receipts rules which are significantly more stringent than those we can afford to apply to other local authority receipts. We cannot rely on debt reduction to soak them up, even if we insisted on councils applying them 100% to that purpose. In some cases, the value of housing assets exceeds housing debt by many £m. Such authorities would be capable of extinguishing all debt and funding all their reasonable requirements for new investment for decades ahead. This will tend to be the case in the southern shire districts, where our supporters will be in the forefront of the move towards voluntary privatisation.

The housing proposals therefore have to strike a careful balance between our two major policy objectives - getting maximum privatisation, and preventing the proceeds being spent in a spending spree. I am proposing some very restrictive rules on authorities' free use of housing receipts, including not only the requirement to devote a high proportion to debt reduction, but also a block on spending the substantial surpluses which might remain even after 100% redemption. There is no doubt that these restrictions will be seen as oppressive by our supporters in local government, and by some of our backbenchers. We are all too depressingly familiar with the parrot cry that we should allow authorities to spend "their own" money. Our new proposals do not meet that demand. But there are two new factors. First, the sheer scale of some of these receipts is so great that it will be clear that they cannot just be spent. Second, an important difference between the present control system and the one proposed is that councils will in future hold in their own hands the key to unlock some of the restraints on them. Under the proposals, surplus spending power will be sterilised 90% up to the point that the council concerned disposes of its stock. When it finally closes down its Housing Revenue Account at least a proportion of the surpluses will be released. The existence of this incentive will, I believe, enable us to shift the argument onto a different plane, and to get our supporters to give priority to the big political prize of large scale privatisation of council housing.

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The proposals for the revenue side of councils' housing operations also have some features which will need careful presentation. The proposal to end local authorities' ability to make contributions from the rate fund to the housing revenue account (with the benefit of RSG subsidy from the central taxpayer!) is likely to annoy only those local councillors who have a deliberate policy of keeping rents at uneconomic levels. We shall not be preventing authorities from continuing to make transfers the other way, thereby giving their community charge payers the benefits of efficiency savings. The proposal to specify the minimum surpluses to be transferred will, however, be controversial, particularly when the equivalent sums will be abated from other central government subsidies to the authority. This aspect is nevertheless an essential part of the package. Without an effective mechanism for requiring reasonable surpluses to be generated, there would be no spur to efficiency, and our other policies of promoting competition with independent landlords through Tenants' Choice could be frustrated by councils deliberately reducing rents in order to compete unfairly with the private sector.

Unless we can apply continuing firm pressure on the housing revenue accounts, we shall not sustain the impetus towards large scale privatisations of council housing.

I am copying this letter to the members of E(LF) and Sir Robin Butler.

Robin Wright

P.P. N R

18 March 1988

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