CABINET
15 JUNE 2010

ITEM NO. ....

REFORM OF COUNCIL HOUSING FINANCING

Responsible Cabinet Member - Councillor Bill Dixon, Neighbourhood Services and Community Safety Portfolio

Responsible Director - Cliff Brown, Director of Community Services

SUMMARY REPORT

Purpose of the Report

1. To inform Members of a consultation paper issued by the previous Government setting out proposals for the reform of the Housing Revenue Account (HRA) finance system.

Summary

2. The reform of Housing Revenue Account Subsidy System (HRASS) consultation is ongoing and responses are due by 6 July 2010. This consultation would normally be the last step in the HRA review process. However, the status of this consultation is no longer clear bearing in mind the change of Government although the Coalition Government's programme for Government does say that they will "review the unfair Housing Revenue Account." At this stage, therefore, in the absence of any further information, it is proposed to continue to respond by the consultation deadline.

3. It is difficult to assess the full financial impact over time as there are uncertainties around rent increase levels, inflation and interest rates in particular. However, some of the initial benefits of the proposals would be:-

   (a) Opportunity for increased investment of around £6.3m.
   (b) Opportunity to bid for a further £2.5m of investment.
   (c) Ability to retain future capital receipts.
   (d) Savings from procuring longer term contracts.
   (e) Ability to charge higher rents on new build and re-modelled properties.

Recommendation

4. It is recommended that:-

   (a) The proposals for the reform of the Council Housing Finance are noted.

   (b) Approval is given to the draft response to the consultation as attached at **Appendix 1** subject to the addition of any further points that may be of benefit to the Council (with the approval of the relevant Portfolio holder).

Reasons

5. The recommendations are supported by the following reasons :-

   (a) The HRA Subsidy system is outdated and no longer fit for purpose.

   (b) The proposals for becoming self-financing will give us greater flexibility and improve our financial position.

Cliff Brown
Director of Community Services

Background Papers

No Background papers were used in the preparation of this report.

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CLD

S17 Crime and Disorder	There are no implications in relation to crime and disorder.
Health and Well Being	There are no direct benefits in terms of Health and Well Being.
Sustainability	Subject to the outcome of the consultation and the final decision of government additional resources will assist in making communities on Council housing estates more sustainable.
Diversity	There are no diversity issues.
Wards Affected	All Wards with Council Housing could potentially be affected.
Groups Affected	All Council tenants could potentially benefit.
Budget and Policy Framework	At this stage there are no policy changes required but there is the potential for an improved budgetary position for the Council.
Key Decision	No key decisions are required at this stage of the consultation process.
Urgent Decision	This is not an urgent decision.
One Darlington: Perfectly Placed	By being better off financially we will be in a better position to contribute to the Sustainability Strategy.
Efficiency	If the Council were to become self financing we would be in a stronger financial position and be able to make efficiency savings through longer term contracts.

Information and Analysis

Background

6. On 25 March 2010 the previous Minister for Housing announced the detail behind the move to dismantle the current Housing Revenue Account (HRA) subsidy system and replace it with a devolved "self-financing" system.

7. The detailed proposals are set out in a prospectus document entitled "Council housing: a real future". The plan and the prospectus are accompanied and supported by a number of technical documents and financial models and has cross-party support.

8. The proposals follow a consultation exercise by Communities and Local Government (CLG) in July to October last year which itself was preceded by more than two years of discussions with tenants, professionals and other stakeholders on how best to improve the notoriously complicated and inefficient system and give local authorities more resources and more independence. Darlington was selected as one of six local authorities to be part of this self financing work.

9. This consultation would normally be the last step in the HRA review process. Responses to the proposals in the consultation paper have been requested to be submitted by 6 July 2010. However, the status of this consultation is no longer clear bearing in mind the change of Government although the coalition's programme for Government does say that they will "review the unfair Housing Revenue Account." At this stage, therefore, in the absence of any further information, it is proposed to continue to respond by the consultation deadline.

The Current HRA Subsidy System

10. The current housing finance system basically works as follows

    (a) Every council that owns and manages council homes is required to maintain a separate account of council housing income and expenditure, a Housing Revenue Account (HRA).

    (b) The 'Housing Revenue Account Subsidy System' (HRASS) was designed in the 1980's to provide grant support for council housing. It is based on a 'notional' HRA containing calculations from management, maintenance, debt servicing costs and rent, none of which bear any relationship to actual income and expenditure for council housing. The calculation includes four different 'rent' figures, all of them quite different to the actual rents paid by tenants. The calculations are set out in a Statutory Instrument and approved annually by Parliament

    (c) If the 'notional' HRA shows a deficit then Government pays that amount of 'positive' subsidy as grant to the housing authority. If, on the other hand and in the case of Darlington, the notional account shows a credit then this is paid as a 'negative' subsidy to Government. In 2011/12 it is estimated we will pay back £1.8m.

    (d) When the HRASS started, no council had to pay money to Government. Now, out of 206 housing authorities, 156 pay 'negative' subsidy to the Treasury.

The Self-Financing Proposal

11. The consultation paper proposes a number of radical changes to the financing system for council housing which if implemented would have a significant impact on the Council's HRA Business Plan and its stock retention strategy. It constitutes an "offer" to councils to abolish the current national housing subsidy system and replace it with a system of self-financing in exchange for a one off settlement of debt allowing council's to retain locally 100% of all future rental income and capital receipts.

12. The Main Proposals:

(a) **Creation of a New Self-Financing System**

Creation of a new system of housing finance by a once and for all settlement between central and local Government under which in exchange for a one off reallocation of debt between local authorities and central Government, the present annual redistribution of rental income would cease.

(b) **Retention of a Ring Fenced HRA**

The Prospectus confirms that the HRA ring-fence is to be strengthened, with an annex setting out draft new guidance. They reflect modern social landlord practice, by recognising that such landlords are concerned with a great deal more than 'bricks and mortar' and that accordingly there need to be rules about which services should be funded from rents and those which should not.

The rules also reflect the need, implicit in the self financing exercise, that a landlord account be established to record landlord income and expenditure as well as the use of both HRA and General Fund money.

(c) **Retention of National Rent Policy**

Under self-financing local authority landlords will still be required to follow National Rent Policy and the self-financing model assumes adherence to this policy and rent "convergence" to the national formula rents by 2015/16.

The previous Government envisaged the Tenant Services Authority (TSA) playing a key role in securing compliance with its rent policy and otherwise ensuring that local authorities deliver the performance expected of them under self-financing.

(d) **Ending the Current Redistributive System for Financing Council Housing in Return for "One Off" Settlement of Debt**

A fundamental reform of the housing finance system, which is based around a devolved system of self-financing, would remove the present redistributive subsidy system in return for a one-off re-allocation of debt. Under this new self-financing system, the Council will keep all of the rent it collects from council housing in Darlington instead of paying an increasing proportion in "negative subsidy" to central Government. Councils will have predictable income streams, their own rents, which they can use to maintain their own stock.

(e) **Right to Retain all Capital Receipts**

The Council would also retain all capital receipts from the sale of housing and land that fall within the HRA, providing that at least 75% of those receipts are used for affordable housing and regeneration projects. The remaining 25% can be used for any capital purposes.

(f) **A Self-Financing Settlement Model and Investment in New Council Housing**

A self-financing settlement is calculated based on a model to calculate the income and spending needs and the calculation of a sustainable level of debt for each Council using a proposed model. The calculations in the model include significant uplifts to the existing Management and Maintenance Allowances and Major Repairs Allowances giving every council a guaranteed 10% more money than they have under the current system. In addition the discount rate used in valuing the present net value of the business is proposed to be 7% rather than the 6.5% discount rate typically used in housing transfer. This will reduce the net receipt that the Government will receive from self-financing by around £1.2 billion and in return it was expected for Councils to use this additional financial headroom to deliver up to 10,000 new council homes each year by 2014 when combined with access to Social Housing Grant through the Homes and Communities Agency.

The self-financing model will indicate a sustainable level of opening debt for each local authority and measures this against the current Supported Capital Financing Requirement (The SCFR is the level of debt that the subsidy system currently supports). If the opening debt level generated by the model is higher than SCFR the local authority would pay the Government the difference between the two figures to buy themselves out of the subsidy system and the otherwise ongoing 'negative subsidy'.

(g) **A New Financial, Accounting and Regulatory Framework**

There are proposals to "un-pool" housing debt from other local authority debt for local authority accounting purposes and the creation of a council housing balance sheet to clearly set out the assets and liabilities that support the HRA. The Council housing balance sheet would be held as a memorandum balance sheet within the local authority's accounts.

A cap on borrowing will be introduced at the self-financing debt level although local authorities who have elected to hold housing debt at a lower figure than the SCFR will retain the borrowing headroom they currently have and over time the capacity of self-financing landlords to borrow to invest in the stock is likely to increase.

Implementation Timetable

13. The responses to the July 2009 consultation paper confirmed strong support for the principles of self-financing however self-financing is a major task and all aspects of the proposals need to be fully worked through and considered by central and local government prior to implementation.

14. If there is a consensus agreement the proposal is to work towards a voluntary implementation from 2011/12 subject to confirmation at the next Comprehensive Spending Review. This would be achieved through existing powers in the Local Government and Housing Act 1989 (inserted by section 313 of the Housing and Regeneration Act 2009) which allow for individual agreements between local authorities and Government to exclude specified housing stock from the HRA subsidy system. The previous Government made it clear that it would not be possible to enter into bespoke agreements based on individual negotiations with individual local authorities

15. Alternatively, they indicated they would seek to implement self-financing through new primary legislation and subject to parliamentary time this could be as early as 2012/13.

Financial Implications

16. The proposal to dismantle the current HRA subsidy system of funding council housing involves an overall uplift in major repairs allowance and management and maintenance allowances and claims to guarantee minimum 10% more money in every council for maintaining and managing their homes.

17. Research was undertaken in the HRA review which has resulted in adjustments to the calculations of the allowances. For the Management and Maintenance (M&M) this is resulted in greater resources allocated towards medium and high rise flats. For Darlington the proposals mean an uplift of 1.3%, estimated to be £116k which is low due to Darlington having minimal medium/high rise flats.

18. The Major Repairs Allowance (MRA) has resulted in greater resources allocated to houses rather than flats. For Darlington the proposal means an uplift of 21.5%, which is estimated to be £824k. Again, this is relatively low compared to other local authorities because Darlington’s stock is made up of 42% of low rise flats.

19. All local authorities are to receive a minimum 10% increase across all the allowances, this has given Darlington a combined allowance uplift of 10%. Without the minimum guarantee the increase would have been 7.3%, which would equate to £355k extra funding.

20. The offer is linked to a commitment sought by the Government from local authorities to use some of the new funding capacity to build over 10,000 new council homes a year.

21. Under this new self-financing system the Council would also keep 100% of the rent collected from tenants locally, ending the current negative subsidy arrangements, and keeping 100% of Right to Buy receipts.

22. Due to the economic downturn, in common with other local authorities across the county, Right to Buy receipts are at an all time low. In the financial year 2009/10 we sold only 5 properties realising a capital receipt of £263k, (currently we would retain £65k), we are anticipating similar levels for the foreseeable future.

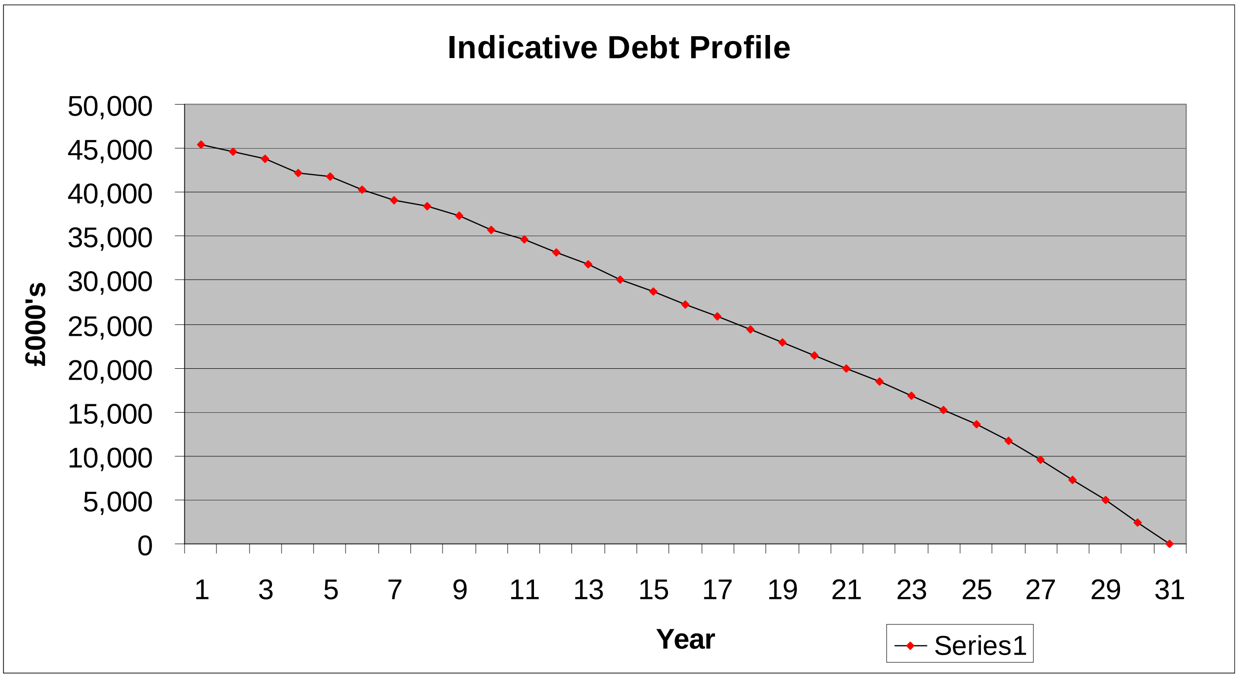
23. The total debt in the current HRA system is £21.5bn. CLG have projected that the total debt to come out of the HRA subsidy system is £25.1bn. This proposal is asking local authorities to accept a share of the additional £3.6bn debt. For Darlington this is projected to be £12.7m.

24. The headroom that this would attract due to the higher net present value of 7% as apposed to 6.5%, which would normally be used for valuing the business, provides Darlington with a one off £2.5m from 2011/12 to re-invest in the existing stock, improve services or build new homes or any such combination as determined locally.

25. Apart from the right to keep 100% of capital receipts there will be no new capital grants to Councils to cover any future investment and no borrowing over and above the opening debt settlement figure of £45.4m. Essentially it retains capital control through a cap on borrowing but appears to give revenue freedom.

26. The current HRA subsidy system attributes a debt of £32.7m to Darlington, which was fixed by CLG at a set date in the 1990's. The actual HRA debt for Darlington is £26.4m which would give additional 'headroom' of £6.3m.

27. In order to assess the impact of the proposed offer of self-financing a new 30 year business plan has been developed. In calculating this business plan we have estimated that if no additional borrowing is undertaken, after the initial proposals as outline above, then we would be debt free by year 31 as shown in the table below. A more robust business plan would need to be established to plan for future housing needs. It should be noted that we also have flexibility over the length of time over which we borrow.



Risk

28. It is currently expected that there will be no adverse financial implications for the General Fund. Officers will continue to monitor the potential impact as proposals are developed by the Government.

29. The report makes clear that local authorities will have to address various risks in their business plans, including the costs deriving from future statutory or regulatory changes, the possibility that future rents will not increase at a rate over inflation and cost increases above inflation and interest rate risk on borrowing requirements.

30. In the absence of a decision being made on the way forward our ability to plan within our current business model in the short term is more difficult.

Conclusion

31. The principle of the proposed reforms included an option for a devolved system of self-financing that would remove the present redistributive national housing subsidy system in return for a ‘one off reallocation of debt’.

32. This proposal would remove the complex annual round of cross-subsidy Central Government determinations, making the funding system clearer and fairer. It also devolves from the funding, management and standards of council housing in future to elected local councils although rents would remain regulated at national level and regulation by the Council's will be regulated by the new Tenant Services Authority will continue. Rather than coping with annual uncertainty about subsidy arrangements and rent policy assumptions, local authorities will have long term certainty about their income and wider financial position. This provides new opportunities for local authorities, working with their tenants, to support the local authority’s strategic housing role.

33. It will help local authorities to set and work towards medium and long term local priorities for housing within a clear financial framework as well as manage their homes better and improve the quality of services.

34. It is very difficult to summarise the benefits to the Council in the short term of the proposal. Taking a reasonable projection of rent income and borrowing commitments, we feel that this will produce an additional £1m per annum for investment over the first five years and £0.5m per annum thereafter, while keeping the level of debt constant. This is in addition to the one-off £2.5m identified in paragraph 23.

Outcome of Consultation

35. The Tenants Board have been aware for some time of the potential for the HRA Subsidy System to be replaced with a self-financing system and have remained supportive throughout.