**POLICY FINANCE & ADMINISTRATION COMMITTEE**

**29 JUNE 2010**

**JOINT REPORT OF HEAD OF FINANCIAL SERVICES & HEAD OF SOCIAL & ECONOMIC DEVELOPMENT**

# COUNCIL HOUSING FINANCE REVIEW – HRA REFORM PROSPECTUS

## 1 PURPOSE OF REPORT

1.1 To inform Members of the issues arising from the Government's prospectus on the Council Housing review

## 2.0 RECOMMENDATIONS

2.1 ***It is recommended that***:

(i) ***The Committee consider the suggested response at Appendix B and approve the final submission to the prospectus entitled 'Council Housing: a Real Future' as issued by Communities & Local Government in March 2010, as informed by CSA;***

(ii) ***The depreciation charged to the HRA is earmarked specifically for the HRA with the use being determined as part of the annual Treasury Management strategy and HRA budget;***

(iii) ***To ring-fence 100% of Right to Buy receipts to the HRA to ensure the ongoing stability of the Business Plan.***

## 3. KEY ISSUES

### 3.1 Background

The current Housing Subsidy system pools rents and redistributes them nationally on the basis of an assessed need, which takes into account Management, Maintenance and Major Repairs Allowances as well as interest on historic debt. It also pools Right to Buy (RTB) receipts with 75% of receipts going to the Government.

The key problems with this current system are;

- The difficulties associated with making the right assumptions about resources,
- The majority of Councils are in negative subsidy resulting in an overall surplus of around £100m in 2009/10 which is passed to Central Government,
- It is unpopular as there are no perceived 'winners',
- The volatility of the settlements which are increasingly complex and are not transparent,
- The possibility of massive future surpluses in the system which would benefit central government at the expense of local rent payers.

In December 2007 a review of Council Housing Finance was announced and subsequently launched in March 2008. In July 2009 a consultation paper was issued to which Melton Borough Council responded following consultation with Members. In March 2010 the prospectus ‘Council Housing: a Real Future’ was issued to Councils with the consultation period ending on 6 July 2010 (Appendix A).

3.2 **The vision for Self Financing**

The prospectus aims to replace the current centralised, redistributive system with a new system that devolves financing and accountability to local authorities to give Councils more flexibility to respond to the needs of local people and more ability to plan long term, driving services and improving efficiency.

The new system will be created by a once and for all new settlement between central and local government, in exchange for a one-off allocation of debt. Central Government will stop the annual redistribution of rental income.

The consultation proposes to:

- Dismantle the current HRA subsidy system
- Issue a one-off allocation of Housing debt
- Rents will be retained locally with the current rent restructuring policy to be continued, so central government will still constrain rent increases as with Registered Social Landlords
- 100% of RTB receipts to be retained locally
- Strengthened and more transparent guidance on the ring fence to be issued
- A 30 year business plan with assumed rents and expenditure to be used to set the debt allocation
- Be nationally neutral between central and local government

This prospectus is a voluntary ‘offer’ with a proposed start date of 1 April 2011 in lieu of legalised settlement and utilising provisions in the Housing & Regeneration Act; as such there is a call for agreement by all authorities across the sector. It is not clear what the situation would be if a minority of authorities are unwilling or unable to accept the proposals on a voluntary basis and whether if the process was legislated for, the financial terms of the settlement would be worse.

The new government has expressed its interest in this review and is committed to the principles contained therein, however it is not yet clear whether they will commission a further consultation following receipt of responses and amend this offer. A response by government is expected in September 2010.

**3.3 What the settlement means for Melton Borough Council**

Debt Allocation

The allocation of debt makes an assumption about rental income and assumed expenditure over a 30 year period. The assumption for rental income is based on the Council reaching rental convergence to formula rent in 2015/16 in line with social rent policy. The assumed expenditure is based on the Management & Maintenance allowance in the 2010/11 subsidy determination plus an uplift of 2.7% and the Major Repairs Allowance (MRA) in the 2010/11 determination plus an uplift of 28.7%. This is then discounted to reflect the time-value of money over 30 years.

The discount factor used in the prospectus is 7% rather than the 6.5% typically used in housing transfers. This has the effect of reducing the Council’s debt allocation with the expectation that we will use this headroom to deliver new housing.

Using the assumed annual inflation percentages used in the prospectus until 2015/16 and the PWC modelled example the debt allocation for Melton Borough Council at the 7% discount rate would be £29,269,000. This would be reduced by the HRA Subsidy Capital Financing Requirement (SCFR) of £5,931,000 to £23,338,000. At 6.5% the allocation would be £30,631,000 reduced to £24,700,000, so we would be expected to finance new housing from the interest saved on the difference of £1,362,000. It is not clear whether Council's who do not set out their willingness & ability to deliver this new housing would be allocated debt at the 6.5% or 7% discount factor. As this element of the proposal is not certain the Council would be prudent at this stage to allow for the higher level of debt which is the amount included in the Business Plan.

The SCFR is the amount used as the assumed HRA debt levels as at the 2010/11 subsidy determination. The actual amount of HRA debt (the Capital Financing Requirement (CFR)) is forecast to be £4,296,356 at 31 March 2011. The prospectus does state that we would retain the headroom we currently have and will not penalise us for using our own resources in the past to reduce our debt.

Under self financing, local authorities who need to borrow to make the debt allocation to the Government will all face similar funding decisions for this new borrowing, the rates charged to the HRA on this borrowing will vary according to the loans and on the policies which apply to how charges are calculated. For Melton the apportionment of Treasury Management charges between the HRA and the General Fund will increase for the HRA, however this will form a part of the Central Establishment Charges (CEC) exercise at budget setting and will be managed in order to maintain a neutral impact on the General Fund.

The prospectus promotes the clear separation of debt pools between the HRA and the General Fund. This would limit the effect decisions in one area have on the other and provides the opportunity to eliminate the complexities in existing rules for calculating the HRA's share of debt charges.

<u>Depreciation & Debt Repayment</u>

The principle of self financing extends to the management of assets and liabilities, including making sound long term provision for maintaining and replacing the time-limited elements of homes such as windows, heating systems, kitchens and bathrooms.

Local Authorities are required to make a charge for depreciation of the dwelling stock and other property within the HRA which complies with 'the Code of Practice on Local Authority Accounting in the United Kingdom'. Under self financing it is proposed that an approach to depreciation is based on accounting and financial principles and is rooted in prudent local management. As such if sufficient resources are to be available to support future maintenance commitments and maintain the value of stock then such depreciation should be cash backed or debt repaid to create headroom for funding future maintenance from borrowing. The ideal position will depend on sound treasury management decisions depending on prevailing market conditions. Under this framework it will be for local authorities to balance investment in major repairs and repayment of Council Housing debt. Local authorities would have a long term incentive to reduce debt but no obligation to do so.

<u>Borrowing by Self-Financing Landlords</u>

There are a number of constraints over the amount of new prudential borrowing that self financing authorities might undertake:

- The new debt allocated in the self financing settlement will restrict the amount of income available to support further prudential borrowing as well as introduce a cap on the overall debt level

- Local authorities will need to satisfy their chief finance officer that extra borrowing is affordable within the prudential borrowing rules
- HRA ring fence will continue under self financing to ensure that borrowing for HRA assets is charged to the HRA and HRA income can only be used to finance borrowing for housing purposes
- The amount of income that authorities can raise to support borrowing will be limited by social rent policy
- In addition, the proposal is to cap borrowing at the self financing debt level.

<u>New Homes</u>

By increasing the discount factor on the debt allocation amount it is expected that local authorities will use this extra capacity to build new homes. The prospectus requests an indication of what size of new supply programme we could deliver when answering this consultation.

On the basis of a 5% interest rate on borrowing applied to the difference in borrowing requirement MBC could deliver up to 4 new homes per year over a 5 year period assuming no cost to land, ie building the new homes on the land of the current proposed garage demolition sites.

<u>RTB Receipts</u>

The proposal ends the pooling of capital receipts as part of the self financing settlement, subject to some conditions. It would allow us to retain all our housing receipts from houses and land which fall within the HRA, provided 75% of these receipts will be or have been used for affordable housing and regeneration projects, in addition to ensuring that a relative amount of the asset lost to sale is set aside to repay the debt on that asset.

If the Council receives over £125,000 of housing receipts in any one year it must submit a return to its auditor indicating that 75% of its housing receipts has either been spent on eligible expenditure or has been irrevocably committed to be spent on eligible expenditure.

This change represents a transfer of funds from central to local government and so would reduce the resources available for centrally funded housing programmes. A proportion of local authority expenditure which is currently supported by capital grant would instead be financed by a local authorities own housing receipts. MBC currently does not receive any such capital grant.

The Council's current policy is to transfer up to £130k per annum to the General Fund to support General Fund housing projects, although in practice this amount has not been achieved for some time due to declining council house sales.

<u>A Housing Balance Sheet</u>

The self financing settlement is largely concerned with replacing the housing revenue support system. However it is essential that local authorities develop a longer term full asset management strategy that brings together revenue and capital streams of funding. The government therefore proposes that all Council landlords should maintain a housing balance sheet to support the HRA.

<u>Related Housing Matters</u>

The funding for Aids and Adaptations and disabled facilities is outside of the business plan and no Grants for MBC are expected under self-financing. From the assumptions used on the Business Plan the expectation is that if the current subsidy arrangements were maintained the Council's contribution to the subsidy system would increase year on year at amounts above inflation, when compared to self-financing this plan shows a relative surplus on the HRA each year which can then be used to support these capital costs.

There is a managed backlog of maintenance which has been addressed by planning works in a programmed approach. Some of the service improvements and efficiencies expected from the re-tendering of the Housing repairs contract will over the longer term move to a more proactive approach to maintenance.

Capital programme spending and investment into the housing stock is shown to be higher under the self financing proposals than under the current subsidy system as per Appendix C, as current spending assumptions are based in line with current resources.

## 4.0 POLICY AND CORPORATE IMPLICATIONS

4.1 There are no further policy and corporate implications arising from this report.

## 5.0 FINANCIAL AND OTHER RESOURCE IMPLICATIONS

5.1 Financial implications have been addresses in the main in section 3 above.

5.2 Whilst the incoming Government have shown a commitment to the principles of these self financing proposals it is expected that a further consultation will result with the possibility of a different offer. In order to assess the current proposals a 30 year business plan has been constructed and based on these assumptions shows that under the present subsidy system the HRA at MBC may not be viable and we would need to explore alternative options which may include stock transfer, ALMO etc. The current offer proposed is viable and maintains a working balance on the HRA in line with the £250k agreed at this committee on 3 December 2009.

5.3 The outcome of the stock condition survey which is currently being undertaken will have an effect on the figures used and mixed with possible changes to the details of the offer by the new government, could change the whole look of the business plan. At Appendix C is a table showing the first 10 years of the business plan and compares the effects of the proposed changes to the expectations of an unchanged subsidy system based on the current proposals and the existing condition survey.

## 6.0 LEGAL IMPLICATIONS/POWERS

6.1 There are no other legal implications directly arising from this report.

## 7.0 COMMUNITY SAFETY

7.1 There are no direct links to community safety arising from this report.

## 8.0 EQUALITIES

8.1 An initial equalities impact assessment has been completed and the Council's Equalities Group will assess this. The group's findings will be verbally presented to this committee at the meeting.

## 9.0 RISKS

9.1 The risks are considered in the table below:

**Probability**

| | | | | |
|---|---|---|---|---|
| Very High A | | 2 | | |
| High B | | | | |
| Significant C | 5 | | 3 | |
| Low D | | 6 | 4,7,9 | |
| Very Low E | | | 1,8 | |
| Almost Impossible F | | | | |
| | IV Neg-ligible | III Marg-inal | II Critical | I Catast-rophic |

**Impact**

| Risk No. | Description |
|---|---|
| 1 | Interest Rate Fluctuation on short and long term borrowing undermines the business plan |
| 2 | Rents will not reach full convergence in line with Social Rent policy due to caps & limits imposed |
| 3 | Proportion of RTB receipts not retained within the HRA due to pressures on other funds |
| 4 | Long term ability to fund stock to ensure kept within the decent homes standard |
| 5 | Impact of the inability to borrow beyond the self financing cap to fund capital repairs |
| 6 | Inability to deliver new housing |
| 7 | Maintenance of stock within budget constraints |
| 8 | Robustness of stock condition survey |
| 9 | Details of the revised offer do not support the business plan |

9.2 In recent years there has been a problem regarding the Repairs and Maintenance budget and so it is imperative that the Council has certainty in the early years of this self financing settlement by ensuring that resources are kept within the HRA to mitigate this risk.

## 10.0 CLIMATE CHANGE

10.1 There are no climate change issues directly arising from this report.

## 11.0 CONSULTATIONS

11.1 TFEC members were informed of the initial proposals in October 2009 and at the meeting held on 7 June 2010 were advised that they would receive a copy of our response. A meeting was held to consult lead members and officers on 25 June 2010.

## 12.0 WARDS AFFECTED

12.1 All wards are affected.

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| Contact Officer: | Carol King |
| Date: | 24 June 2010 |
| Appendices: | Appendix A – Council Housing: A Real Future<br>Appendix B – Questions & Suggested Responses<br>Appendix C – 10 Year Business Plan<br>Appendix D – Presentation |
| Background Papers: | Council Housing: A Real Future |
| Reference: | X: Committees/PFA/290610/DG - HRA Reform Proposals |