



Cabinet

30th June 2010

Item
10(i)

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|-----------------------|-----------------------------------------------------------------|---------------|-----------------------------------------------------|
| Report of | Head of Strategic Policy and Regeneration | Author | Lindsay Barker Darren Brown ☎ 282253 |
| Title | Consultation on a Self-Financing Housing Revenue Account | | |
| Wards affected | All | | |

This report concerns the proposal to leave the current national Housing Revenue Account (HRA) Subsidy System and adopt a Self-Financing HRA.

1. Decision(s) Required

- 1.1 To approve the Councils response to the Governments proposal to leave the present HRA subsidy system and adopt a self-financing housing revenue account, shown at Appendix A.

2. Reasons for Decision(s)

- 2.1 The Government are consulting on proposals to reform the current housing finance system and this report provides the opportunity to give our views.

3. Alternative Options

- 3.1 To not approve the Councils response to the consultation paper, however this is not being recommended for the reasons set out below. Alternatively, the option exists to not respond.

4. Supporting Information

The Current System/Background:

- 4.1 Council Housing finance is supported through the Housing Revenue Account (HRA) Subsidy system. This is a national system which provides deficit funding to local authorities, to enable them to meet the interest costs that are incurred from holding housing debt. It is a redistributive system based on a notional HRA for each authority and has been in operation in its present form for more than 20 years. Under the subsidy system, income from tenants' rents and Right To Buy sales is collected centrally, and in return Councils are paid allowances for Management, Maintenance and Major Repairs. In principle, this redistributes funds to Councils that would be unable to meet interest payments on their debt, and other costs through rental income. However, over time these allowances have not kept pace with increases in rental income, which has led to a steady withdrawal of resources from the national housing system. So much so, that it is now acknowledged that the national HRA subsidy system is in surplus which represents a real redirection of resources from local authorities into central Government and hence a reform of the present housing subsidy system has long been called for by local authorities and leading housing professionals.

- 4.2 There has long been the belief that there are insufficient resources within the current subsidy system to deliver long-term investment in services to tenants and provide a sustainable housing stock. Furthermore, the current system is seen as being both unfair and unpopular. Not only is the system complex, it lacks transparency and provides little local accountability. It is highly volatile and can change at short-notice, creating difficulty in planning in the medium to long-term.
- 4.3 As a consequence, there have been a number of documents produced in recent years, setting out the intention firstly that high-performing ALMO's would be able to take advantage of "freedoms and flexibilities" in the current system, then developing into a Self-Financing pilot project consisting of 6 case-study local authorities who investigated the possibility of an alternative approach to the subsidy system which could be implemented for all local authorities. It was the findings of this pilot project which led the Government at the time to commission an HRA review, which resulted in a consultation paper on HRA reform being issued in July 2009 to which we responded. The results of this exercise have now been considered by the Government, which has resulted in a further consultation paper being produced in March 2010 setting out a "Voluntary offer" to local authorities to dismantle the current subsidy system, which is the subject of this report.

5. Proposals

- 5.1 On the 25th March 2010, the Department for Communities and Local Government (DCLG) issued the consultation paper entitled "Council Housing: A Real Future (Prospectus)". The proposals contained within the paper in summary are as follows;
- The current national HRA Subsidy system would be dismantled,
 - It would be replaced with a devolved, self-financing system in which Councils would be able to retain all tenants' rental income and capital receipts including those from Right To Buy (RTB) sales, within their Housing Revenue Account,
 - There would be a one-off adjustment of housing debt to local authorities,
 - There would be a strengthened (more transparent) HRA ring-fence guidance,
 - It would be nationally neutral between central and local Government.
- 5.2 The detail of how self-financing would work is becoming clearer, but there are still a number of technical questions that need to be answered before we are in a position to know absolutely the impact locally. The Department for Communities and Local Government (DCLG) are working with leading housing finance professionals, CIPFA and the Treasury to establish how some of these areas may be dealt with, which primarily revolve around the treatment and accounting for the debt reallocation.

- 5.3 The consultation paper is asking local authorities 6 questions. These are not specifically asking for an agreement at this point in time, but are in essence asking for our views on the proposals, whether or not we would favour moving to a self-financing environment for our HRA and voluntarily in 2011/12, and what reasons we may have for not wanting to move forward based on the proposal being made. It should also be noted that all of the figures included within the proposals are subject to confirmation by the Government at the next Comprehensive Spending Review, and should be viewed on the basis that they were proposed by the Government prior to the General Election, and the new incoming Government has indicated its intention to look at all areas of public expenditure.
- 5.4 The new Government has recently confirmed its intention to reform council housing finance. They have stated in their Coalition document that “We will... review the unfair Housing Revenue Account..”, however it is not yet clear whether the review will be in the same form as that proposed by the previous Government. Nevertheless, the consultation process is being continued. Furthermore, the Housing Minister made an announcement on 8th June, stating the he wants “to see a new devolved system that puts Councils firmly in control and gives them the financial freedom they need to make the best long term decisions about their housing”.

6. Housing Subsidy and The Debt Settlement

- 6.1 The Government appointed Price Waterhouse Coopers (PWC) to undertake the work around the level of debt that is to be redistributed amongst authorities, along with determining the most appropriate method of allocation. PWC have come up with a model which makes an assessment of each authority’s ability to service an amount of debt, based on an assumed level of spending required and rental income over the next 30 years. These expenditure assumptions are based on uplifted allowances within the current subsidy system as identified as part of the HRA review.
- 6.2 There is currently around £21billion of national housing debt which is serviced by all housing stock-retaining Councils, through the housing subsidy system. There are a number of authorities who have a high level of historic debt, along with a number of authorities who have little or no debt. Accordingly, there is a large number of authorities who pay negative subsidy to the Government under the current system, and there are a few authorities who actually receive subsidy from the Government. In essence, there is a strong relationship between those authorities who have high levels of debt and are receiving housing subsidy, with those with little or no debt that are paying housing subsidy to the Government.
- 6.3 The housing subsidy system takes funding from those authorities who notionally have enough resources to meet the costs of managing, maintaining and servicing the debt on their housing stock, and gives it to those authorities who have insufficient funding. Therefore for local authorities to become self-financing will require the national housing debt to be shared amongst Councils.
- 6.4 Naturally, there is a resistance from some authorities, especially those that are debt free, to taking on any new debt. They feel that they are being penalised for good financial management in the past which has seen them become debt free. However, due to the way the housing subsidy system operates, if an authority has little or no debt, then it is required to pay more in negative subsidy to the Government to support the debt of others. An example to demonstrate this is shown in the following table:

| | Authority A (with No Debt) | Authority B (with Debt) |
|----------------------------------|----------------------------|-------------------------|
| Management Allowance | £5m | £7m |
| Maintenance Allowance | £8m | £10m |
| Major Repairs Allowance | £4m | £6m |
| Total Expenditure | £17m | £23m |
| Rental Income | (£22m) | (£28m) |
| Notional Housing Surplus | (£5m) | (£5m) |
| Debt Charges | £0 | £9m |
| Subsidy Received from Government | - | (£4m) |
| Subsidy Paid to Government | £5m | - |

- 6.5 In the example above, Authority A which has no debt is paying £5 million to the Government in negative subsidy, which then in turn will use these funds to pay subsidy to those Councils like Authority B who need support in meeting their debt payments. This in effect means that authorities are already servicing the cost of debt through their negative subsidy payments to the Government, it just isn't necessarily their own debt. By reallocating the national debt, some authorities would be required to take on additional debt, whilst some authorities would actually see their level of debt reduce. The logic behind this being that once the housing subsidy system no longer exists as a means by which resources are redistributed between authorities to service debt, then each authority has an appropriate amount of opening debt that it can support and service into the future.
- 6.6 At Colchester, we are in a similar position to Authority A in the above example, i.e. we are paying negative subsidy to the Government. Our negative subsidy payments are forecast to increase annually in the future, to the extent that it is anticipated that we will pay around £25million over the next 5 years, and in excess of over £65million over the next 10 years. This is the factor that makes self-financing affordable for local authorities. We will be taking on additional debt, but will be saving future negative housing subsidy payments. Over the next 30 years this is forecast to generate a substantial level of additional resources. Therefore, the key point to understand when taking on debt is that although this will increase our level of debt held at the outset, we would no longer be required to pay the current and ever increasing subsidy payments to the Government in the future, thereby freeing up additional resources. We would be able to use these future resources to service the borrowing costs of the new debt taken on and provide for its repayment, and also fund the much needed improvements to our stock and services in the future. This is the underlying principle behind self-financing.

6.7 The review of Housing Finance not only identified a shortfall in funding of Management & Maintenance and Major Repairs Allowances compared to assumed levels of need, but also that there was £6 billion of investment needed for additional improvements/outstanding backlogs of works, and up to £5 billion needed on health and safety and disabled facilities expenditure. Some of the shortfall in allowances is being covered as part of the debt settlement calculation, whilst the remainder will be covered through a system of capital grants to be established after the settlement – for which authorities will be able to apply, through a process yet to be determined.

7. How will self-financing work

7.1 As previously mentioned, for it to be possible for Councils to be able to run their HRA's on a self-financing basis, it will be necessary to allocate centrally managed debt to local authorities. This will be distributed on the basis of the ability to service and repay this debt over a 30 year period. Therefore, some authorities will find their debt levels reducing, whilst others will find their debt levels increasing. As stated above, Colchester falls in to the latter category, which means we will be required to take on additional debt. Under the voluntary offer received from CLG, this amounts to £59.1million. This additional borrowing would then be paid to the Government to “buy” ourselves out of the system. If agreed and implemented, this would increase our HRA debt to a total of £110million at the start of the new system. There is a proviso within the offer that we could take-on a lower debt allocation of £52.8million, on the basis that we used the £6.3million reduction to deliver new affordable housing. However, the terms of this are currently unclear and therefore for the basis of this report, it has been assumed we would take-on the higher level of debt.

7.2 The amount of debt that authorities will be required to take on has been calculated on the basis of a formula developed centrally. A debt adjustment will be implemented which would move the current level of supported debt (i.e. in the current subsidy system) to the new level of the debt settlement. The review proposed a mechanism based on a tenanted market value, in other words a Net Present Value cashflow forecast based on future subsidy guideline rents, less uplifted Management & Maintenance and Major Repairs Allowances. Furthermore, it is being proposed that there will be a cap on borrowing, so as to limit the level of national debt. For Colchester, this cap would be approximately £125million.

7.3 Once Councils have left the current subsidy system, they will be able to retain all rental income and capital receipts, and invest in those areas where there is insufficient funding currently. However, along with these freedoms there will be a number of new risks which the Council will need to manage. The current system protects authorities to a certain extent from the effects of interest rate changes, for example if interest rates rise, then the HRA pays a higher financing cost but this is reimbursed through the subsidy formula. However, in a self-financing system housing subsidy would no longer exist and therefore this increased cost would have to be met from elsewhere within the HRA. Conversely, any reductions in interest rates are currently not benefitted from as the saving to the HRA is matched by an increase in subsidy payable. Under self-financing this would provide extra resources to the HRA, for either improvements in services, additional stock investment or repayment of debt which would save future financing costs. Whilst this has been identified as a potential risk, it in fact only puts the HRA on the same footing as the Council's General Fund which currently operates in this environment, and therefore we are familiar with and already have experience of operating in this way.

- 7.4 The Council has been developing a Business Plan which forecasts the Housing Revenue Account for each of the next 30 years, both under the current subsidy system and in a self-financing environment. The model takes into account the financing costs of the additional debt we would take-on, the negative subsidy payments no longer payable and the investment requirements of the stock indicated by our stock condition survey. The Business Plan shows that under current assumptions, we would be able to take on the additional amount of debt referred to above, deliver the investment requirements of the stock and in fact repay all of our debt within the life of the 30 year Business Plan. This needs to be compared to the alternative position, whereby we retain the current housing subsidy system and continue to make increasing negative subsidy payments to the Government, alongside not being to deliver the capital investment needs of our stock, and have no ability to reduce our current level of debt.
- 7.5 The modelling undertaken by officers indicates that if the current system remains, we will deliver around £51million of capital investment to our housing stock over the next 10 years (compared to around £94million under self-financing). However, by this time, the HRA balance is projected to go into a negative balance, meaning even this lower level of investment could not be sustained without making reductions in expenditure elsewhere. Even then, this would not deliver the required level of investment needed over the next 30 years.
- 7.6 Whilst the figures contained within this report reflect the Business Plan modelling undertaken as part of the assessment of the self-financing offer from CLG, it is intended that the HRA Business Plan process will be adopted in the future, and become a part of the ongoing financial management of the Council's Housing Revenue Account. Therefore, the assumptions that have been made will be able to be changed in future years, reflecting the Council's changing priorities and local circumstances.

8. Benefits/Risks

- 8.1 There are a number of Benefits and Risks that have currently been identified as part of the proposals. Whilst there will always be risks associated with change, they should be viewed in the context of the substantial benefits self-financing is expected to bring, especially when compared to the current subsidy system. The risks and benefits have been summarised as follows;
- 8.2 Benefits of Self-Financing:
- All future rental income would be retained locally with the continued policy of rent restructuring to safeguard the increase to tenants' rents;
 - 100% of Right To Buy receipts to be retained locally, with discretion retained for 25% as at present;
 - Increased capital investment in the Council's housing stock and services, enabling the Decent Homes standard to be maintained in the long-term,
 - Additional resources / Borrowing headroom for new affordable housing,
 - More certainty in long-term planning,
 - Ability to repay debt over the life of the business plan,
 - Greater local accountability.

8.3 Risks of Self-Financing:

- We would be approximately doubling the amount of debt we hold on our balance sheet from day one of the start of the new regime, although our modelling demonstrates that this could be reduced and indeed repaid over the life of the Business Plan.
- There is likely to be a reduction in Social Housing Grant in the future, as the Government would have less resources for centrally funded programmes, although the expectation is that authorities would be able to use the additional resources generated locally to replace this.
- Under the current capital financing rules, there could be an impact upon the Councils General Fund through the take-on of additional debt, although this depends on how the extra debt is treated and recharged to the HRA.

8.4 It is recognised that the potential impact of borrowing costs upon the General Fund is a concern and has been raised as part of the review. CLG have stated that they do not anticipate any negative impact upon Councils' General Funds as a result of implementing HRA reform. However, this is a technical area where further work will be required, and it is understood that CLG are working with CIPFA and the Audit Commission to resolve any issues that may arise in this area. Therefore whilst it is currently not possible to quantify whether there would be any impact in this area, it has been included as a risk nevertheless. We will however be urging the Government to mitigate any negative impact upon the General Fund in our response to the consultation.

9. Risks

9.1 The risks that revolve around self-financing primarily fall into 2 areas. Firstly, there are the risks relating to treasury management and the take-on of additional borrowing. Given that the current housing subsidy system predominantly protects local authorities from variations in interest rates, if the system is abolished then the HRA will be exposed to the impact of fluctuations in interest rates in the future. These could be positive or negative, dependant on the circumstances at the time. However, this risk can be mitigated by the Council's treasury management policies and indeed can be viewed as a positive, as the Council is incentivised to achieve treasury management efficiencies which it would be able to retain within the business plan, as opposed to being offset by housing subsidy. Furthermore, the abolition of subsidy would simply put the HRA on a similar footing to the General Fund in terms of exposure to treasury management variations.

9.2 The other main risk revolves around the possibility that future Governments may decide to open the settlement. The consultation paper refers to this settlement as "a once and for all settlement between central and local Government". However, the paper also refers to the fact that it cannot be guaranteed that future Governments will not make changes to policies that will impact upon the amount of rental income that can be raised or the costs of meeting standards or other obligations. However, it does state that self-financing business plans should be robust enough to withstand a range of movements in assumptions moving forward. It is expected that local authority landlords should be able to plan for and manage these normal business risks without recourse to Government.

10. Strategic Plan References

10.1 These proposals link in to the Homes for All priority.

11. Consultation

11.1 Briefing sessions on the proposals have been undertaken and have included representation from Colchester Borough Homes along with tenant representatives from their Board. Further consultation will be undertaken should we be asked to formally agree to the proposals in the future.

12. Publicity Considerations

12.1 Given the complex nature of this subject, we will ensure it is communicated clearly. Once the Government provides further information on their proposals, we will communicate this to the appropriate target audiences.

13. Financial implications

Financial Modelling of the “Offer”

13.1 Officers of the Council have been working with the Housing Quality Network (HQN) and the Chartered Institute of Housing (CIH) on developing a 30 year business plan to model the Council's HRA under both the current subsidy system and a self-financing one. Regardless of the outcome of the self-financing proposals, this is a key piece of work and will enable the Council to understand what the HRA looks like in the future from a financial point of view. It is therefore intended to regularly update the business plan model and include it as part of the HRA and Housing Investment Programme budget setting process which is agreed by Cabinet each year.

13.2 The business plan starts with the Council's current HRA budget, and in effect produces an HRA budget for each of the next 30 years (this builds on the current HRA Medium Term Financial Forecast (MTFF) which is produced as part of the current budget process and is reported to Cabinet in January each year). It includes a large amount of financial information, and makes assumptions on a wide variety of issues, such as inflation, interest rates, rents policy, financing options etc. As a result, the further the business plan looks ahead into the future, the more it becomes a guide rather than definitive as it is impossible to accurately predict some of these issues up to 30 years ahead. However, it does enable the Council to understand the future and also to undertake sensitivity analysis within the plan, to determine what the overall impact would be of changes in inflation, costs, income and interest rates etc.

13.3 The business plan will be a key document especially if self-financing goes ahead, because as previously stated, the Council will be taking on additional borrowing of around £59million and it will need to ensure it is able to meet the costs of servicing its debt, along with the potential to reduce or indeed repay it over the life of the plan. In addition, if constraints are applied to future borrowing, the plan will inform the Council of spending levels in future years, which will in turn feed into the delivery of the asset management strategy.

13.4 Colchester Borough Council and Colchester Borough Homes are jointly working on producing an asset management strategy for the Councils housing stock, which will amongst other things indicate the likely level of capital and revenue investment needed over the next 30 years. The strategy is being put together using core information from Codeman, which is the Councils IT asset management planning system and is populated with stock condition data which is gathered as properties are surveyed and average component costs which have been externally verified. This system therefore indicates when elements, such as kitchens, bathrooms, roofs etc require replacing in the future based on assumed lives of components, and puts a cost to these. This therefore enables high level planning on a year by year basis of capital and revenue requirements.

13.5 Clearly this is a planning tool and actual programmes of work each year would be on the basis of actual need, given some components would last longer or shorter than the industry norm, dependant on local circumstances such as usage. However, it does provide the data for the Council to model its business plan and is a necessity for authorities to understand what the current subsidy system and the proposal of self-financing means in the long-term.

14. Equality, Diversity and Human Rights implications

14.1 An Equality Impact Assessment (EIA) will be carried out at the point we are asked to formally commit to the proposals.

15. Community Safety Implications

15.1 There are no particular references to community safety implications.

16. Health and Safety Implications

16.1 There are no particular references to Health and Safety implications

17. Risk Management Implications

17.1 The risks currently identified have been included in the main body of the report.