SOUTH CAMBRIDGESHIRE DISTRICT COUNCIL

REPORT TO:	Housing Portfolio Holder	19 May 2010
AUTHOR/S:	Senior Management Team	

HOUSING REVENUE ACCOUNT (HRA) REFORM CONSULTATION

Purpose

1. To seek the recommendation of the Portfolio Holder for the draft response to the Government's consultation proposals on council housing finance to be referred to Council on 27 May 2010.

2. This is a key decision because

- It is likely to result in the Council incurring expenditure which is, or the making of savings which are, significant having regard to the Council's budget for the service or function to which the decision relates.

Recommendations and Reasons

3. That the Portfolio Holder for Housing recommends to Council that:

   (i) Council accepts in principle the proposal by the Department for Communities and Local Government (CLG) to proceed to voluntary implementation of self-financing for council housing but urges further consideration of this authority's special circumstances
   (ii) Council endorses the full response to the consultation prospectus as set out in Appendix A

Background

4. The Government began the review of council housing finance in 2007. The first phase of the consultation was reported to the Portfolio Holder for Housing on 16 September 2009 and the Cabinet on 8 October 2009.

5. The Government's reform proposals seek to replace the current Housing Revenue Account (HRA) subsidy system with a new self-financing regime. In 2010/11 the HRA subsidy system requires the Council to pay back to central Government almost £12 m of the £22 m rent it expects to collect from tenants. As rent levels increase to target guidelines in future years, this proportion will increase.

6. The Government is proposing that the removal of the HRA subsidy system and the establishment of a new self financing regime can be achieved by reallocating national housing debt of £25 billion between all 177 stock owning local authorities.

7. It was reported to Cabinet in October 2009 that the initial consultation document had indicated that South Cambridgeshire District Council may be required to take on a debt of around £30,000 per dwelling amounting to around £164M in total.

8. The Cabinet agreed the authority's response to the consultation and this was submitted to the CLG in October 2009.

9. In March 2010, the CLG responded to the initial consultation phase with a consultation prospectus, ‘Council Housing : a real future’, which sets out in more detail the settlement for each local authority and seek the views of all local authorities on whether they wish to proceed with the proposed settlement.

10. The Government states its preference for voluntary agreement with local authorities, with the new self-financing arrangements being introduced from April 2011. Primary legislation would be required to introduce the changes for those councils that do not agree voluntarily, and that would not be possible before April 2012 at the earliest.

Considerations

11. The consultation prospectus shows the portion of the national housing debt to be borne by South Cambridgeshire as between £188M and £197M depending upon the discount rate that is applied. This represents a per property debt of £36,000, higher than that anticipated in the October 2009 consultation, and the second highest in the country.

12. The CLG were assisted in the preparation of the consultation prospectus by the consultants Price Waterhouse Coopers (PWC). PWC have modelled for South Cambridgeshire the likely negative subsidy payments if the current HRA Subsidy system were to be retained and compared this with the impact of the self-financing proposal. PWC’s modelling provides the following indicative figures:

- If the HRA subsidy system were unchanged, the annual negative subsidy payment to Government would rise from £11.8M in 2010/11 to £17.2M by 2020/21.
- The total negative subsidy payable over 30 years would be £642.7M
- If the self-financing model is implemented, based on an opening debt of £197M and assuming an interest rate of 5.5% the annual interest payments would be around £10.8M.
- Over a 30 year period the interest payable would equate to £325.1M
- Overall the self-financing settlement over a 30-year period would benefit the Council by around £317.6M.

13. The Council has also modelled the impact of the proposal using actual spend figures. This shows that compared to the current HRA subsidy system the Council would be able to meet most of its Major Repairs Allowance expenditure, would be able to maintain a working balance at the current levels of around £2M and would be in a position to start repaying debt within 10 years. By contrast the current HRA system is unviable after the next five years.

14. This position is based upon assumed interest rates of 5.5% with an opening debt of £188m. If higher interest rates are applied then the self-financing proposal is less sustainable.

15. The Government has modelled the settlement on two discount rates (6.5% and 7%). The higher rate produces a lower opening debt figure. The Government envisages that some of this financial headroom created for councils will in time allow for the development of new council homes across the country. Within South Cambridgeshire this could amount to as many as 300 properties, mainly in the later years of the business plan but with the possibility of two or three new homes a year being built after the first five years.

16. The CLG proposals also include the ending of the capital pooling requirements which would mean that the Council would also benefit by retaining all of the money it receives from Right to Buy sales and other land and property sales. Since 2004, the Council has had to return to Government 75% of its house sale receipts – approximately £9.6 m over 6 years.

17. There are a number of technical matters included within the consultation and these are dealt with in Appendix A.

Options

18. The Council has the option to respond negatively to the self-financing proposals. The Government indicated that if a voluntary settlement cannot be achieved with local authorities then it would seek to introduce primary legislation to implement the changes.

19. The Council also has the option to support in principle the move to self-financing but to make that support conditional upon a number of key factors.

20. Finally, the Council can choose to support the move to self-financing without qualification.

Implications

21.

Financial	Debt of £188M to £197M to be taken on. The proposal provides more resources to fund the revenue and capital requirements of the housing service than the existing subsidy regime, but does not provide sufficient resources to meet the full investment requirement e.g. disabled adaptations and environmental works within the Council's housing stock. The HRA ring fence would still apply and housing would continue to be separately accounted for.
Legal	Consideration will need to be given to governance arrangements for self-financing. The 30 year business plan will be the Council's to manage, and will impose new challenges for elected members.
Staffing	Additional specialist treasury management staff and a potential increase in accountancy support required. New skills and capacity required in long term asset management within the Housing Service. Some allowance is made for these costs in the Government's proposed model.

Risk Management	Exposure to interest rate fluctuations offers opportunity, for example, if the Council can borrow at lower interest rates and therefore create the headroom to increase investment in its housing, but also risk in the event of higher interest rates, which would have to be managed through reductions in spend on housing services. Future governments may introduce policy changes that impact on the council's housing account.
Equal Opportunities	Disabled adaptations are not currently included with the Government's calculation of the Major Repairs Allowance. The non-inclusion of disabled adaptations in the prospectus could have significant implications for disabled tenants in the district and is a missed opportunity to address these needs.
Climate Change	The potential for extra resources may enhance the Council's ability to improve energy efficiency within its housing stock.

Consultations

22. The Tenant Participation Group has been consulted on their response to the proposals at a meeting on 10 May 2010. Their key concerns are:

(a) The proposal to allocate such a large debt to the Council is fundamentally unfair.
(b) There may be further changes in the future, which would end up penalising the Council.
(c) Due regard has not been given in the proposal to how disabled adaptations will be funded.

Conclusions / Summary

23. The proposal has significant implications for the Council. If the reforms go ahead the Council is likely to have to be required to take on over £180M of debt that has been accrued by other local authorities.

24. The self-financing regime does however offer the Council, in time, a better financial settlement with which to manage its council homes.

Background Papers: the following background papers were used in the preparation of this report:

Report to Housing Portfolio Holder - Reform of Council House Finance – consultation, 19 September 2009
Report to Cabinet –Reform of Council Housing Finance – consultation, 8 October 2009
CLG, Council Housing: A real future – Prospectus, March 2010

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APPENDIX A

HRA Reform Consultation – response to detailed questions

The Consultation questions set by the CLG are indicated in bold followed by the proposed Council response. The deadline for response is 6 July 2010.

1. What are your views on the proposed methodology for assessing income and spending needs under self –financing and for valuing each council's business?

1.1 The Council welcomes the proposal to unpool rents and service charges and create greater transparency.

1.2 The proposed uplift to the Management and Maintenance (M&M) allowance of 0.1% is disappointing. The impact of this on calculating the potential for debt transfer is compounded by the use of a notional rental income figure which is higher than that actually charged by the Council. This proposed uplift does not take account of the particular challenges faced by this Council with regard to providing services to a dispersed rural housing stock or the older age profile of our tenants.

1.3 Whilst the proposed uplift to the Major Repairs Allowance (MRA) of 50.4% is welcome, the low starting base of the MRA for South Cambridgeshire means that this figure does not reflect the true cost of maintaining our homes. With the uplift the MRA would be approximately £5M pa set against a spending need of £12M pa identified by the most recent stock condition survey.

1.4 Whilst the Council is still on course to meet the Decent Homes Standard before the end of 2010, there remains a backlog of essential works totalling £16M.

1.5 The Council is particularly concerned about the exclusion of disabled adaptations from the proposed financial model. South Cambridgeshire has a particularly high demand for disabled adaptations and in the STATUS tenant survey as well as a more recent survey of tenants it is reported that 40 - 50% of all households contain a member with a disability. The exclusion of disabled adaptations and spending on environmental works from the Government's calculations provides a false picture of the resources available to meet debt repayments.

1.6 By basing the reform proposal on the notional assumptions used for the subsidy regime the disadvantages for South Cambridgeshire have been carried forward. The Council accepts the need for a formula that properly reflects the differences in stock condition and management challenges across the country. It is felt however that these reasonable underlying assumptions produce an extreme outcome for South Cambridgeshire and that a limit to the percentage of total income that is allocated to debt should be set.

1.7 The Council welcomes the proposal to cease pooling of capital receipts. The Council has lost £9.5m over the past 6 years of house sale receipts to Government, and as a consequence has not been able to spend that money on maintaining and improving its housing stock.

2. What are your views on the proposals for the financial, regulatory and accounting framework for self-financing?

2.1 The proposal that local authorities maintain a separate balance sheet clearly setting out assets and liabilities is accepted as sensible accounting practice.

2.2 The rationale for a separate loan pool for housing is understood but the Council has concerns that this may limit its ability to use its finances flexibly to achieve overall best value for the Council. The Council seeks the power to invest, on commercial terms, its general fund investment pool in the HRA so minimising transaction costs and reducing credit risk overall.

2.3 The Council welcomes the flexibility to balance investment needs against debt reduction. With the high level of the proposed opening debt, this flexibility is essential to ensure the viability of the HRA in the first few years of a self-financing regime.

2.4 The proposed cap on borrowing at the opening self-financing level would not be problematic for the Council. It should be noted, however, that in the modelled debt curve provided with the prospectus, South Cambridgeshire is shown as having an increasing debt over the first four years as projected income is insufficient to meet the initial interest rate charges.

2.5 The Council has tested the proposed model using a range of assumptions and our actual spending figures. This shows that provided there is no requirement to repay any principal in the first few years and interest rates remain at the current low levels, then the HRA should be sustainable and there should be sufficient funding to maintain the decent homes standard. However, if interest rates were higher (say 6.5%) then, for the first few years, investment would fall below the level that the latest stock condition information shows is required.

2.6 Whilst the spend profile pattern at South Cambridgeshire District Council does follow that identified by the BRE, there is a significant discrepancy between the investment assumptions contained within notional model and the investment figures identified by the Council's stock condition survey. The impact of this is demonstrated in the modelling work shown above.

2.7 It is recognised that the Government needs to retain control over public sector borrowing and the Council accepts the need for the continued use of 'Item 8 determinations' to achieve this.

2.8 The Council's proposed business plan for stock transfer put to the tenants in June 2009 provided a capital sum to the Council and allowed a fully funded capital programme of around £12m per annum, a 15% uplift on revenue spending, and a peak debt of £80M. The self-financing proposal provides tenants with a considerably less favourable option. The proposed requirement to meet the self-financing sum of £188M if stock transfer were undertaken ahead of the scheme coming into operation would render a transfer of the Council's homes unviable.

2.9 The greater clarity offered on accounting for HRA and General Fund activity is welcome. The Council believes that it already meets this level of demarcation.

2.10 The Council accepts that the establishment of a self-financing system would mean the end of the ‘safety net’ of the HRA subsidy system. It is also appropriate that the housing regulator, the Tenant Services Authority (TSA), should play an important role in ensuring that landlords do not fail in their obligations to tenants.

2.11 Housing associations benefit from the TSA’s regulatory framework and also have a range of options open to them such as mergers, to protect their service delivery obligations. These safeguards and options will not be in place for local authorities yet the HRA ring fence means that they are essentially stand alone businesses. It is not clear at present how the role of the Audit Commission or Government Office can be extended to incorporate these dimensions. If the sustainability of a self-funding regime is to be protected these issues will need to be addressed and the Council would welcome some clarification of these issues.

2.12 The Council welcomes the announcement that future guidance will be forthcoming on the issue of leaseholder sinking funds.

3. How much new supply could this settlement enable you to deliver, if combined with social housing grant?

3.1 The lack of headroom in the early years and the potential for an increasing backlog of investment spending will limit the number of new homes that could be completed in the first 5 years. New supply is likely to occur in small incremental additions that arise out of remodelling opportunities.

3.2 The Council welcomes the opportunity that a 7% discount rate in the model provides to create headroom for the construction of new council housing. Later in the 30 year programme it may be possible to produce some new homes and over 30 years this could support up to 300 new homes, mainly in years 15 to 30 of the plan but with the possibility of two or three homes a year being built after year 5.

3.3 The local land supply is however very limited. The Council currently makes good use of S106 opportunities and rural exception sites to produce around 300 new affordable homes each year in partnership with local housing associations. It is not immediately obvious how the Council could improve upon this performance or offer better value for money by building homes itself particularly if this were reliant upon Homes & Communities Agency (HCA) grant funding.

4. Do you favour a self-financing system for council housing or the continuation of a nationally redistributive subsidy system?

4.1 The Council supports in principle the move to a self-financing system.

4.2 While this Council supports in principle the move to a self-financing system for council housing, it strongly opposes the imposition of such a significant debt on the Council as the price to be paid for that settlement. This Council paid off its debt in the early 1990’s through the application of prudent financial planning and management and since that time it has been subject to capital receipts pooling which has reduced considerably its ability to fund the required capital programme to maintain and improve its housing stock. In taking over half of tenants' rents, the housing subsidy system has also had the effect of starving the Council’s revenue funded management and maintenance services. The Council has brought this unfair taxation of its tenants to the Government’s attention on a number of occasions.

4.3 In order to offer tenants an alternative means of securing future investment in the Council’s housing stock, the Council made a stock transfer offer and this was rejected, meaning that self financing offers the only prospect at this time of increasing the resources available for the Council’s housing stock.

4.4 Given the Council’s experience above, it is concerned that future nationally determined changes may result in the self financing rules being amended at a later date and changing the basis upon which the Council is taking on self financing responsibilities.

5. Would you wish to proceed to early voluntary implementation of self-financing on the basis of the methodology and principles proposed in this document? Would you be ready to implement self-financing in 2011/12? If not, how much more time do you think is required to prepare for implementation?

5.1 The Council wishes to proceed to an early voluntary implementation and would able to do so in 2011/12.

5.2 The Council would however wish to have some certainty form the CLG on the interest rates to be applied

5.3 The time period between the Council agreeing to the voluntary implementation of self financing and the date of the Government’s confirmation would pose a critical period of exposure to interest rate movements. The Council, therefore, seeks a mechanism that provides some certainty of the rates to be applied on the settlement date.

6. If you favour self financing but do not wish to proceed on the basis of the proposals in this document, what are the reasons?

6.1 Not applicable