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PORTFOLIO – HOSPITAL

CABINET – 5 JULY 2010

HOUSING REVENUE ACCOUNT REFORM

1 INTRODUCTION

1.1 In July 2009 the Government issued a long awaited paper on the reform of council housing finance. Reports detailing the proposals were presented to the Review Panel in September 2009 and to the Cabinet in October 2009. New Forest District Council responded to this consultation in October 2009.

1.2 The Government then issued a Prospectus titled "Council Housing: A Real Future" in March 2010 setting out their proposals to bring council house funding up to date. This paper sets out their proposals for the self financing of council housing and has asked a number of questions. The proposal is set out as a "once and for all settlement between central and local government".

1.3 Consultation responses are required by the closing date of 6 July 2010.

2 BACKGROUND

2.1 The current housing finance system stems from a requirement of the Housing Act 1935 which requires local authorities to keep a separate Housing Revenue Account (HRA). The HRA is a separate record of revenue expenditure and income relating to an Authority's own housing stock.

2.2 The HRA is a ring-fenced account within the general fund and is operated within government guidance and professional accountancy protocols. One purpose of introducing the HRA ring fence policy in 1989 was to create a more coherent "landlord account". It ensures that rent levels cannot be subsidised by increases in council tax and that rents cannot be increased to keep council tax levels down.

3 THE HRA SUBSIDY SYSTEM

3.1 The HRA subsidy system is the system through which the Government determines the amounts local authorities need to spend on their council housing and whether subsidy is required to support this. Of the 205 local authorities in the HRA subsidy system in 2008/2009, 153 were in surplus and therefore making a contribution into the system (negative subsidy) and 52 in deficit and receiving subsidy from the system (positive subsidy). New Forest District Council is in negative subsidy and makes a contribution of nearly £9m per annum to the Government. This effectively means that nearly 40% of the rent that any tenant pays goes to Government and brings no benefit to the District.

3.2 The Government considers that there is a clear rationale for the distribution of income between landlords. They argue that Councils have different spending needs and different capacities to raise income. Without redistribution, some Councils would have to charge higher rents or deliver lower quality services.

3.3 The factors that determine whether a council is in a deficit or surplus under the current subsidy system are complex. The three main factors are:-

- Assumptions made about the need to spend on management, maintenance and major repairs;

- Assumptions made about rental income; and

- The amount of housing debt a council is assumed to hold

3.4 An important driver of subsidy redistribution is the cost of servicing housing debt. The subsidy system supports an amount of **notional** debt in each council, based on **assumptions** about what councils should have borrowed and repaid over time. The average debt is equivalent to around £7,000 per property, but about a quarter of Authorities are debt free and others have debt of up to £30,000 per property. New Forest District Council is debt free.

3.5 Any Capital expenditure which an Authority wishes to spend on housing is outside the constraints of the HRA. The exception is the Major Repairs Allowance (MRA) which is held in a separate reserve account and can only be used for capital expenditure on the housing stock.

3.6 Government policy is that all social landlords (local authorities and housing associations) should offer similar rents for similar properties, whilst maintaining substantial discounts to market rents. The HRA subsidy system requires the Government to make assumptions about the rental income of every council landlord. This has led to extremely complex calculations within the subsidy system relating to an individual council's progress with the rent restructuring process (the aim being to equalise council and housing association rents).

4 PROBLEMS WITH THE CURRENT SYSTEM

4.1 The review of the HRA carried out by the Government has identified a number of problems in operating a national system for redistributing rental income between landlords. These are:-

- The fairness of the system depends on the accuracy of the assumptions it makes about spending needs in over 200 councils. It is difficult to manage this information nationally.

- Over time, the balance of deficit and surplus Authorities has changed. The system is now roughly in balance nationally, but 75% of councils pay notional surpluses into the system, with only 25% receiving subsidy.

- The requirement for many Authorities to contribute to a central pot from their tenants' rental income is deeply unpopular with tenants.

- The annual nature of the process mitigates against longer term planning by councils.

- The Government's pursuit of fairness within the system has led to increasingly complex calculations and less transparency.

- Local accountability and responsibility is weak.

5 PROPOSALS

5.1 In principle the current Government consultation invites local authorities to agree to the proposals in the paper. This would give full control of the HRA to councils and gain independence from the housing subsidy system. The main impact of this would be:-

Positive:

- No longer a need to pay annual negative subsidies to Government (£8.9m in 2010/11 – trend rising by approximately £500k per annum until rent restructuring has been achieved and subsequently at a slower rate)
- Retention of full right to buy receipts rather than the need to hand over 75% of any receipts to Government.

Negative:

- Acceptance of an additional loan of £132m (with 2 alternative models also under discussion which would either increase or decrease this level by about £7m – see section on New Built proposals)

5.2 The consultation also invites a response to 6 specific questions:

1. What are your views on the proposed methodology for assessing income and spending needs...?
2. What are your views on the proposals for the financial, regulatory and accounting framework for self financing?
3. How much new supply could this settlement enable you to deliver, if combined with social housing grant?
4. Do you favour a self-financing system or the continuation of a nationally redistributive system?
5. Would you wish to proceed to early voluntary implementation of self financing?
6. If you favour self financing but do not wish to proceed at the moment, what are the reasons?

5.3 A key test of the impact of the new system compared to the current system is a comparison of the cash impact of the proposed change based on the assumed subsidy situation for 2011/12.

5.4 Based on recent trends the assumed negative subsidy for New Forest for 2011/12 is likely to be in the region of £9.4m to £9.5m. In contrast the cost of taking on £132m of new debt will be interest charges of approximately £8.6m (at 6.5%). The Chartered Institute of Housing (CIH) is pointing out that the real cost is potentially lower as it should be possible to negotiate deals at below 6.5% in the current economic climate.

5.5 Given this situation the CIH is of the view that the proposed deal is *'better than could have been expected and gives substantial extra spending power in a self financing HRA that would not be available in a continued national system'*.

5.6 However the ‘deal’ is based on financial models which make assumptions and once an Authority has gained full independence for the HRA it will have to take on the risks that those assumptions will change over time with potentially either a beneficial or negative impact on the HRA. Specific sensitivities and risks are addressed below in addressing the individual consultation questions.

6 SUGGESTED RESPONSE TO THE CONSULTATION QUESTIONS

6.1 Consultation Question 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?

One may not necessarily applaud a methodology which requires the Council to take on new debt of £132m, but the annual cost is likely to be lower than the one resulting from the continuation of the current subsidy system. In addition, as long as some repayment of the debt takes place the annual cost of servicing the debt should decrease, whilst the cost of the subsidy system is likely to continue to increase and it is also a cost which is less predictable, as changes are outside the jurisdiction of local authorities.

However, whilst the bottom line impact of the change is positive this will only be the case if interest rates do not exceed the model rate and if one assumes continued rent increases of 0.5% above inflation.

Rent increases of 0.5% above inflation (following successful rent restructuring in 2015) may not necessarily at first sight be supported by tenants, but they are in, the longer term, probably easier to accept than Government-imposed rent increases above that level, particularly if they are coupled with the knowledge that any surpluses will benefit the local HRA. On the other hand Government have in the past been keen to directly influence rent policy and local authorities will need to be reassured that this will not happen in the future to the detriment of HRA sustainability. This is equally of importance in terms of the Government’s future approach to rent rebates and subsidy limitation where rents exceed set limits. Clarification of the framework regarding those issues is essential.

6.2 Consultation Question 2: What are your views on the proposals for the financial, regulatory and accounting framework for self-financing?

This area does not present any potential deal breaker issues, but it will be necessary to review the arrangements with regard to maximum debt levels over time in order to ensure that any legal framework is adapted to reflect experience with the implementation of the new system to give local authorities maximum freedom whilst guarding against the risk of an 'Icelandic' crisis.

For local authorities some of the additional expertise necessary in financial and treasury management and business planning as a result of the increased responsibilities are likely to result in slightly increased annual costs and in particular, in the short term the advice of specialist treasury/financial consultants is essential to deal with the complexities emerging from taking on £132m of new debt. The council will also need to consider carefully the approach to the repayment of the debt and the long term implications of the phasing of the debt in order to avoid some of the following scenarios:

- A policy of not repaying debt may appear pain free during the life of a long term loan, but could be disastrous if replacement funds could not be arranged at the end of the term (or only at greatly increased rates)

- A debt maturing all at once could similarly put the Council in a very difficult situation if the market conditions at maturity were detrimental

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

One of the models put forward by the government uses a greater discount rate of 7%, which it is considering applying subject to local authorities using the headroom for investment into new housing. For NFDC this model would reduce debt by £7m and would immediately create headroom for using the £7m as an investment into new stock. Rather than owing £7m to Government, the likely best utilisation of resources for the Council is to use the full amount and invest it into new housing (together with any Social Housing Grant) and in order to secure the 'additional funds' it may be in the best interest of the Council to give Government a commitment that these will be utilised for new housing stock, subject to available housing and continued sustainability of the HRA (with a format for reporting and control to be agreed). There should be further benefits from the additional rent income (net of costs) which need to be assessed in terms of the long term impact on the HRA business plan and/or the additional scope for new stock investment.

In terms of the numbers of new homes that might be able to be provided, it is anticipated that this could be around 100 new units. (If the £7m were combined with an equal amount of Social Housing Grant).

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

Given the history of the redistributive system (i.e. the current subsidy system) and its ever increasing costs to this Council it would probably not be in the best interests of the Authority to now argue in favour of its retention as long as the financial framework for a successful independent future of the HRA can be agreed.

6.5 Consultation Questions 5 & 6: 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 time do you think is required to prepare for implementation? If you favour self-financing but do not wish to proceed on the basis of the proposals in this document, what are the reasons?

The opportunity to move to a self-financing system on a voluntary basis has the benefit of allowing the Council to potentially make best use of historically low interest rates rather than be forced at a later stage to have to accept a legally imposed self-financing system in a less favourable financial environment. At this stage it is therefore probably advisable to give a principal commitment to move ahead on a voluntary basis subject to:

- ability to take on debt at rates not higher than 6.5%
- satisfactory conclusion to issues emerging from consultation
- no detrimental impact of later enforced self-financing system (i.e. being a 'volunteer' must not lead to a situation which is worse than not having proceeded on a voluntary basis)
- full business plan development after initial consultation phase is over with a more detailed assessment of scope to invest into new stock as a result of RTB receipts and HRA surpluses.

6.6 Other Considerations:

From the Authority's view the proposals appear to give a clear indication that self-financing is the better option in terms of increased control of the Council over the destiny of the HRA and for simply financial reasons. But this goes hand in hand with the increased level of responsibility and there will be a need to still review the current costs of the HRA. At the moment it is in a deficit situation, which is going to worsen in the next year as negative subsidy increases. In this situation the reduced costs from servicing the debt taken on as part of self-financing may be welcome in helping to balance the books – but this would be to the cost of long term sustainability and it is therefore essential that a long term business plan looks as much at HRA management and maintenance costs as at the cost/benefit of replacing negative subsidy with the cost of new debt.

Particular sensitivities that must be reflected in a detailed business/asset management plan are:

- Progress of rent restructuring/rent increases
- Future management and maintenance costs
- Inflation and interest rates
- Future RTB receipts assumptions and their use (HRA/GF)
- Application of stock improvement and investment
- Policy on debt repayment (or re-borrow and only interest financed)
- Long term asset management

7 FINANCIAL IMPLICATIONS

7.1 The proposals set out by the Government in the consultation paper will have a significant impact upon the future financing of the HRA. A detailed review of the HRA Business Plan will be necessary to fully understand the impact and conclusions, but the broad consequences have been set out in section 6 above.

8 ENVIRONMENTAL IMPLICATIONS

8.1 There are no environmental implications arising from this report.

9 CRIME AND DISORDER IMPLICATIONS

9.1 There are no crime and disorder implications arising from this report.

10 EQUALITY AND DIVERSITY IMPLICATIONS

10.1 There are no equality and diversity implications arising from this report.

11 TENANTS' COMMENTS

11.1 The Tenant Representatives expressed the view that there were many risks to the proposal. They felt that it was very unfair that the Council had not been able to use all of the monies it received from housing rental income in the first instance. They also had concerns regarding the level of debt which would be taken on by the Council who had proved to be a caring, responsible landlord.

12. HOUSING REVIEW PANEL COMMENTS

12.1 The Review Panel were happy with the proposed consultation responses but felt that it was necessary to highlight some specific concerns in a covering letter for the Governments serious consideration.

13 HOUSING PORTFOLIO HOLDER'S COMMENTS

13.1 "The review of the HRA has been long awaited by stock retaining Authorities. I fully support the review but do have reservations over the significant debt that the government expect us to take on. However, on balance it would mean that our tenants will no longer have to pay a significant proportion of their rent to government. This could mean greater investment in our own stock and the real chance of a sustained building programme of new council housing, particularly in the longer term once the debt has been repaid.

13.2 I support the suggested responses to the consultation questions with the proviso that any proposals subsequently received from government are subject to a detailed analysis and the preparation of a new HRA Business Plan".

14 RECOMMENDATION

14.1 (a) That the proposed responses to the consultation as set out in Report E to the Cabinet be agreed; and

(b) That the following points raised by the Housing Review Panel be included in a covering letter accompanying the consultation response: -

(i) That the Council has concerns regarding the complexities of how the Government has calculated the debt this Council would have to incur and the fact that these calculations do not come with any guarantees or safeguards from the Government regarding the long term stability of the Council's finances;

(ii) That the Council feels frustration at being penalised by having to take on a significant debt when it has proved itself to be a debt free responsible landlord;

(iii) That the unfairness of the system needs to be addressed as authorities in the south of the Country have to take on significant debts despite being debt free, to off set debts accrued by northern authorities.

For Further Information Contact:

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Background Papers:

Consultation Paper: Council Housing: A real Future – March 2010