REPORT TO:	**Finance and Management Committee**	**AGENDA ITEM: 10**
DATE OF MEETING:	**22nd October 2009**	**CATEGORY: DELEGATED**
REPORT FROM:	**Mark Alflat, Director of Community Services**	**OPEN:**
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SUBJECT:	**Proposed reform of Council Housing Finance**	**REF:**
WARD(S) AFFECTED:	**All**	**TERMS OF REFERENCE: HCSO1, FM01**

1. Recommendations

1.1 To agree the following response to government on their proposed reform of Council Housing finance

General comment:

1.1.1 South Derbyshire District Council very much welcomes the aim to fundamentally overhaul the current national Housing Revenue Account system. The current system is bad for local government in that very few authorities can project their housing accounts viably into the future with stock in a reasonable condition. It is also bad for tenants in that achieving a service commensurate with the price (rent) you pay is a principle long lost within the system. There is very little local autonomy or democracy in the current set up.

1.1.2 We also welcome the proposal that local HRAs should be self-funding. This will put real decision making back into the hands of tenants and their representatives.

1.1.3 Our position on reallocation of debt is that this has to be at clearly viable levels for each local HRA for the proposals to work nationally. The financial modelling work that we have done indicates that this may be a marginal issue for this authority and if others find themselves projecting the same kind of slender margins over 30 years, achieving national agreement on debt reallocation will be difficult. In this we urge the Government to only seek to redistribute the actual debt currently in the national system and not be tempted to build in amounts for funding other works. The more the government reallocates in debt the fewer the authorities will be willing to take it on whether voluntarily or imposed. If the fundamental principle behind the proposals is seen to be flawed it won't matter how much is proposed to be allocated to national capital account sinking funds i.e. if there is £19bn of current actual debt only that should be sought to be reallocated.

1.1.4 This Council sees merit in the proposals for central government to take on/write off the national HRA debt itself and thereby release the significant investment potential of the HRAs around the country and help stimulate growth and the economy generally. However this Council recognises that taking more debt to the centre in the current economic circumstance is going to be difficult.

1.1.5 If national debt is redistributed (i.e. actual current debt rather than an allocation of debt) and local LAs are then self financing any additional borrowing they seek to undertake could be controlled through existing mechanisms i.e. Corporate audit commission monitoring, TSA Housing inspections and external audit functions. There is no need to layer in another level of control. HM treasury colleagues may be concerned about a sudden rush of LA borrowing but the more likely scenario is that actual additional borrowing will be severely limited by the amount of debt each LA takes on. In this way those same treasury colleagues may advise loading in high debt reallocation at the start of the process to deter additional borrowing but if this is done the whole project may fall as a result. We realise the government has indicated that debt may be imposed through legislation but if a large number of LAs simple can't project the numbers viably then the amount of opposition to the proposal would make it untenable.

1.1.6 In a nutshell our general comment: We welcome your proposals but make sure it works for as many LAs as possible at the lowest possible level of debt redistribution otherwise as a whole the proposals will become mired in argument and delay.

1.2 In addition to the comment at 1.1 above to also include the detailed specific comments proposed in section 4 of this report.

1.3 That an advisory note be issued to all tenants to inform them that we will not make any decisions on progressing the stock option process until the government announce the outcome of their consultation in the spring of 2010.

1.4 To note that as the report has housing policy implications it was also due to be considered by the Housing and Community Services Committee on the 15th October. Any proposed additions or amendments to the report as a result of that meeting will be reported verbally.

2. Purpose of Report

2.1 To outline the Government's proposals in their consultation paper: Reform of council housing finance and seek members agreement to a response to be made to government by their stipulated closing date of 27th October

3. Executive Summary

3.1 The government published its wide-ranging consultation paper on the outcome of the Review of Council Housing Finance on 22nd July 2009. The review had been ongoing for the previous 18 months and followed a previous review which had lasted a year.

3.2 There is widespread acceptance that the current national housing system is broken and needs fixing and that any such fixing should be wholesale and that tinkering is not going to sort the problem.

3.3 The problem is that there isn't a ready-made solution. The current system entails more than 150 councils paying over proportions of their rent income into a national pool and 50+ other Councils taking money out of the pool on an annual basis. The system is aimed at helping those authorities with large debts on their Housing Revenue Accounts by effectively getting those with lower or no debts to help out. The way though that government calculates an authority's ability to pay into the system is based upon a series of allowances for major works, responsive repairs and management costs. Government also controls rent levels through this process and the combination of all of this effectively means that individual councils, and thereby their tenants, have very little say over what happens to their own rent and the connection of receiving a service commensurate with what people pay locally has long been lost.

3.4 Acceptance that the national system is broken is not a new phenomenon. In 2005 the Government's own quango, the Audit Commission, went public with a detailed report that said exactly that. Other reports since 2001 have said similar things.

3.5 This report summarises the 400+ pages of the proposals and proposes feedback on the specific questions posed for consultation. The main focus of attention the paper has received has been on the issue of debt redistribution. The paper though also accepts that the current funding mechanism doesn't reflect true costs and therefore if the current system is retained raises the prospect of a reduced contribution to the national pool. However this is contradicted by the general understanding that any changes would have to be cost neutral and the difficult general economic climate makes this seem more likely.

3.6 It is estimated that there is £19bn debt in the system that would need to be redistributed.

3.7 All responses need to be with government by the 27th October.

4. <u>Detail</u>

4.1 The consultation paper is broken down into five sections. The first describes the review process itself, the second the current system leaving three sections relating to proposed changes and the future. Looking at the current system first and then each of those relating to the future:

4.2 The current housing finance system

4.2.1 This section provides an overview of the current system for financing council housing, covering the ring-fenced landlord account (the Housing Revenue Account) and the system for redistributing income between councils (the Housing Revenue Account subsidy system). It describes the current distribution of housing debt within the system and the rules that apply to capital receipts and borrowing. It also provides an overview of the Decent Homes Standard and social rent policy.

4.2.2 The consultation paper states with regard to the ring-fence that:
"DoE circular 8/95 provides guidance on the operation of the ring fence but it…reflects the provision of housing and housing services 15-20 years ago. Many services and facilities on estates which were originally provided specifically for

council tenants are now available to the mixed tenure households living on the estates."

This suggests that the government believes that housing revenue accounts are currently being charged too high a proportion of the costs of providing services on mixed tenure estates and that these costs should be borne by the General Fund.

4.2.3 The consultation paper states with regard to rents and housing subsidy that:

"The notionality in the system also ensures that local choices about rents do not influence the amount of subsidy a council is eligible to receive. It is assumed that all councils will set rents in line with national policy. As with costs, a decision by a council to set rents above or below this amount will not increase or reduce its entitlement to subsidy."

This is a strange observation as rent restructuring has effectively removed local choices about rents while rent rebate subsidy limitation has ensured that where councils increase rents above the government's limits they are penalised through receiving lower levels of housing benefit subsidy. It also states:

"The evidence on rents is being published as part of the review. This consultation document is not however proposing any changes to rent policy. It will be necessary to establish long term rent policy in advance of implementing any changes to the system for financing council housing. But we expect to deal with future council rent policy separately, in the context of the HRA subsidy determination for 2010-11 and a future direction by the Secretary of State to the Tenant Services Authority on council rents."

The government is therefore deferring a decision on future rent policy until the publication of the housing subsidy determination for 2010/11 but as expected is linking this with the standards for rents that are being consulted on by the Tenant Services Authority.

4.2.4 The consultation paper summarises the problems with the current system as follows:

- 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 three-quarters of councils pay notional surpluses into the system, with only a quarter receiving subsidy
- The requirement for many authorities to contribute from their rent income back to central Government for redistribution to other areas is particularly unpopular especially now it is projected that the national system as a whole will begin to move back into surplus
- The annual nature of the process, and the volatility this brings, militates against longer term planning by councils. Currently there are annual changes in allowances, rents and borrowing allocations at short notice
- Pursuit of fairness within the system has led to increasing complexity and less transparency, with lots of subtle adjustments to reflect local circumstances. This has made the system hard to understand and its outcomes sometimes unpredictable. The assumptions it makes about rent levels are also highly complex
- Local responsibility and accountability is weak and the system adds a great deal of operational detail into what should be a strategic relationship between council landlords and central Government.

4.3 Costs and Standards of Council Housing in Future

4.3.1 This section covers the future costs and standards of council housing. It describes the allowances within the current system and the evidence gathered during the review about the need to spend in future. It proposes changes to the framework for allocating costs between the Housing Revenue Account and a local authority's general fund. It sets out a proposal for continuing the Decent Homes Standard in future and how we might address energy efficiency. It also proposes changes to the Housing Revenue Account which would allow sinking funds to be set up for works to leaseholders' homes.

4.3.2 The consultation paper states with regard to management and maintenance that:
"The research drew the following conclusions:

- *The need to spend on management and maintenance at a national level is about 5 per cent higher than current allowances. However, further work is needed to understand how this is distributed at a local authority level*
- *Around 40 per cent of management costs are spent on what were traditionally 'non-core' services e.g. initiatives to tackle anti-social behaviour or services to help tenants into work*
- *There is a lack of transparency in the treatment of the administration of the maintenance function within the allowance methodology. Even allowing for differential treatment between authorities it is estimated that expenditure on management exceeds allowances by about 8 per cent and on maintenance by about 3 per cent*
  "The Government has concluded that provision nationally for management and maintenance needs to increase by 5 per cent above current levels and that this level of need should be assumed in the financial provision for whichever model is taken forward. However, further work is needed to understand how this is distributed at the local level."

4.3.3 These conclusions are significant in that, unless rents are to be increased significantly, they would necessitate an increase in central government funding for council housing. However, the further work that is needed to understand how this is distributed at the local level suggests that a further dispute about the factors that drive expenditure on management and maintenance can be expected.

4.3.4 The consultation paper states with regard to the major repairs allowance that:
"The review commissioned Building Research Establishment (BRE)11 to update the estimates of the resources required to maintain the stock in a decent condition beyond 2010, looking forward on a 30 year planning basis to 2040, by revising the existing MRA model to bring it into line with Decent Homes. As a result:

- *Prices used in the model have been revised, with some significantly higher and some significantly lower*
- *A number of previously excluded elements (notably lifts, garages, CCTV, TV reception, alarms, play areas, external lighting, walls and fences, and grass and planted areas) have been included*
- *The assumed lifetime for some elements, including kitchens, bathrooms and roof coverings, were changed*

"BRE concluded that the MRA tackling newly arising need should be uplifted by an average of 24 per cent to £825 per unit per year over 30 years, made up of £734 for

the main home elements and £91 for lifts and common parts. The asset lifetimes used in this scenario were the most consistent with Decent Homes.
"Regional factors still need to be addressed, and the initial results reported here are subject to caveats and revisions."

4.3.5 Again this is significant in that the government are proposing putting additional resources into council housing. Again, the addressing of 'regional factors' will give scope for dispute between authorities in different regions about the factors that drive expenditure on major repairs.

4.3.6 The consultation paper states with regard to capital resources that:
"After 2010 there will, in addition, be a backlog that requires ongoing capital grant separate from the MRA. The backlog assessed in this report is the backlog of time-expired elements already in place and is estimated to be approximately £6bn.

"Separate analysis has estimated that the costs needed to deal with the non-decent backlog in 2010 will be between £1,400m to £2,900m based upon modelling from local authority predictions, English House Condition Survey (2006) data and Business Plan Statistical Appendix (2006) data.

"Our approach… will be based on combining a national formula (which may be revised) with some scope for local adjustments."

4.3.7 The government had previously stated that Supported Capital Expenditure would cease to be provided to housing revenue accounts after 2010 as this had been the target date for achieving the decent homes standard. Again, this is significant as the government is proposing increased resources for council housing and again the matter of determining a national formula and the scope for local adjustments is deferred.

4.3.8 The consultation paper finds that local authority landlords have been extending their activities beyond traditional core landlord functions into non-core functions and coreplus functions. The consultation paper therefore states:
"We would prefer to establish a series of principles to enable local authorities to decide whether the service should be paid for through the HRA or the general fund. These decisions should reflect changes to Circular 8/95 and the new role of the Tenant Services Authority.
"The principles we propose are that:

- *There should be a separate local authority landlord account that records all landlord income and expenditure (both capital and revenue) and the transfer of resources between the HRA and the general fund*
- *Housing services that a landlord is required to provide should be paid through the HRA*
- *Some defined services should be paid for from the general fund e.g. housing advisory services, administration of a common housing register and other strategic housing functions*
- *Any requirements placed on landlords should either arise as statutory obligations or through standards set by the TSA as cross-domain regulator of social housing or be directly funded. When TSA sets standards (whether or not it is the subject of a direction by the Secretary of State) it will need to take into account the consequences for tenants, for new supply and for public expenditure*

- *Standards should build in tenant choice and influence*
- *The costs of meeting TSA standards should fall on the HRA*

"Beyond these standards, if there is ambiguity as to whether a particular cost should fall on the HRA, the test should be 'who benefits?' If services are provided for everyone or as part of a general obligation, the costs should fall to the general fund. If the cost of a service can be seen to be of wider benefit than solely to tenants or leaseholders of properties within the HRA, that cost should be divided between the HRA and the general fund according to a local agreement."

4.3.9 These proposals would strengthen the housing revenue account ring fence and in some cases would shift costs from the housing revenue account to the general fund. The two questions posed on core and non-core services in the consultation paper are as follows along with a proposed response from this Council:

- *We propose that the HRA ring fence should continue and, if anything, be strengthened. Do you agree with the principles for the operation of the ring fence set out?*

SDDC comment: We welcome the concept behind this proposal of fairness in where charges should fall, the HRA or General Fund

- *Are there any particular ambiguities or detailed concerns about the consequences?*

SDDC comment: If such changes are adopted there would be a detrimental effect in the General Fund and the consultation paper indicates that this would be funded by Government. Greater clarity is needed on the actual mechanism proposed for this and if any of the resources do need to be found from each local General Fund, the option of phasing changes in over several years would help in easing the transition.

4.3.10 The consultation paper confirms the government's commitment to the decent homes standard and proposes that this be extended (and funded by government) to include items such as lifts and common areas. Again, this is a commitment to increased expenditure. It also suggests that councils could fund improvements in energy performance through private capital grants, energy savings or contributions from tenants.

4.3.11 The two questions posed on standards in the consultation paper are:

- *We propose funding the ongoing maintenance of lifts and common parts in addition to the Decent Homes Standard. Are there any particular issues about committing this additional funding for lifts and common parts, in particular around funding any backlog through capital grant and the ongoing maintenance through the HRA system (as reformed)?*

SDDC comment: The net effect of this change will be to shift the balance of resources towards more urban areas. As these areas will tend to be those that have their debts reduced or cleared under the proposed national redistribution is it fair to the less urbanised areas to also make additional allowances?

- *Is this the right direction of travel on standards and do you think the funding mechanisms will work or can you recommend other mechanisms that would be neutral to Government expenditure?*

SDDC comment: These proposals relate to a continuation of the current funding mechanisms. This Council believes that the system needs wholesale change and whilst those authorities with a significant number of lifts and common parts will welcome this proposal it is tinkering with a broken system.

4.3.12 The consultation paper favours sinking funds for leaseholders' service charges and poses the following question:

- *We propose allowing local authorities to set up sinking funds for works to leaseholders' stock and amending HRA rules to permit this. Will there be any barriers to local authorities taking this up voluntarily, or would we need to place an obligation on local authority landlords?*

SDDC comment: While most local authorities do not operate sinking funds in this way we are not aware of any reason why they should not do so under existing legislation. This authority will consider the implications of this proposal and may well decide to set up such a fund.

4.3.13 The section on costs and standards of council housing in the future is chiefly notable in that it proposes a significant increase in expenditure on council housing. This is apparently at odds with one of the original constraints on the study of council housing finance which was that there should be no change to existing government housing budgets. Securing government recognition of the inadequacy of current housing revenue account revenue budgets and capital programmes represents a significant achievement for the sector. However, achieving this will require additional resources either from central government or from significant increases in rents.

4.4 Options for Fundamental Reform of the System

4.4.1 This section describes the options for fundamental reform of the council housing finance system. It covers improvements to the current system which the government considers would reduce volatility and improve long term planning – in particular through multi-year subsidy determinations and/or debt allocation. It also sets out an option for a devolved system – self-financing – which would remove the need for redistribution of revenues in return for a one-off allocation of debt. It describes methods for assessing the level of debt each council would be required to support under self-financing and how this debt would be allocated. It also identifies some potential costs to the general fund from debt allocation and how these could be mitigated or funded.

4.4.2 In addition, this section sets out proposals for managing the amount of new borrowing councils might undertake under self-financing, so that this is consistent with overall public borrowing and spending policies. It considers risks arising from self-financing and how these could be managed. It also includes a proposal to end the pooling of capital receipts, subject to a condition that the currently pooled amounts are reinvested locally in housing.

4.4.3 Finally it describes the implications of the proposed changes on disabled adaptations, on transfer and arms-length management organisation policy and programmes and on local housing companies. It also invites views about any impact on equalities.

4.4.4 The consultation paper considers the scope for making improvements to the current system, in particular by introducing three to five year subsidy settlements. Reallocation of debt between authorities is considered. However, the government rejects the option of writing off debt, saying:

"It has been suggested that Government should pay off all the housing debt held by local authorities (currently in excess of some £18bn), leaving rents to support only the day to day running costs of the stock. This debt was incurred in building and maintaining council housing. It is therefore right that it should continue to be serviced from council rents. It would be unaffordable and unfair to ask the general taxpayer to support this debt in future."

4.4.5 The consultation paper states with regard to self-financing options that:
"Under self-financing, each local authority would keep the money raised locally from rents and use it to run their stock.

"Self-financing would require a one-off reallocation of housing debt in order to put all councils in a position where they could support their stock from their rental income in future. Without this reallocation of debt, some councils would either have to cut services or increase rents. But with this settlement on debt, the review found that rents set in line with current social rent policy would generate sufficient income to sustain the stock in all local authorities at the higher funding levels identified as necessary in Section 3.

"Under self-financing we will move to a sustainable funding model for council housing:

- *Councils will have enough money from the rental income from their stock to be able to service debt over time and to pay for ongoing maintenance at the Decent Homes Standard as well as works needed to maintain lifts and common parts*
- *Because of this certainty of funding councils will be able to plan ahead for works and procure them efficiently; and*
- *Councils will be better able to plan longer term for the management of their assets and manage them on a portfolio basis because they will be able to keep more of the capital receipts from Right to Buy sales and to reinvest this in replacement stock. There should be tangible improvements in service delivery and tenant engagement*

"Housing debt would be allocated to councils on the basis of each council's ability to service it, using the same updated figures for costs of management, maintenance, major repairs and income that would be used to calculate subsidy if we were to continue with a subsidy system.

"In principle, the total debt allocated to councils under self-financing could be higher or lower than the current level of debt in the system. This would depend on the value to the landlord of the stock, which in turn is determined by the assumptions made about future costs and rental income.

"The opening debt level would be one based on the tenanted market value of the stock. Under this option:

- *Each council would produce a 30 year business plan. The investment needs in the plan would be based on common service standards and evidence from the review about the costs of delivering those standards. Assumptions about income in the plan would be based on rent levels set in line with Government social rent policy*
- *The value of the stock would be calculated from the present value of the cash flows in the business plan*

- *Each council's housing debt would be adjusted to reflect the value of its stock, entailing either a capital payment to or from Government*

We envisage that the debt settlement would take the following form:

- *The value of the landlord business would be based on the present value of the cash flows in the business – excluding any existing housing debt*
- *If this value was lower than the current notional debt supported by subsidy (the subsidy capital financing requirement), a payment would be made by Government to the council sufficient to reduce the notional debt to the level of the valuation.*
- *If the value of the stock was higher than the current notional debt level, new debt would be imposed on the council to bring it up to the level of the valuation."*

4.4.6 This proposal follows closely the system that was modelled in the self financing pilots except that it is based on a higher level of expenditure than had previously been the case. Despite the observation in the consultation paper that 'the total debt allocated to councils under self-financing could be higher or lower than the current level of debt in the system' and the suggestion that total debt levels could increase by up to 40%, it is difficult to see how the increases in expenditure could be achieved unless levels of debt were lower and a significant write off of housing revenue account debt occurred. The assumptions that are made in the business plans will be critical as the self financing model will be able to deliver only the level of expenditure included in the business plan. Careful consideration will have to be given to how these assumptions will be arrived at. The assumptions that are made about rent increases will be especially important and the consultation paper is silent about these.

4.4.7 The consultation paper recognises that self financing could have a negative impact on the general fund and states that:

"The review has identified some potential administrative and transactional costs from this activity:

- *The debt attributable to housing is part of a council's overall debt portfolio. The council's general fund charges interest to the HRA at the consolidated rate of interest (CRI) on the amount of debt attributable to housing. New borrowing attributable to either the HRA or the general fund will therefore have an impact on the CRI and on charges to both the HRA and the general fund. A significant increase in debt attributable to the HRA as a result of reallocation of debt could have a positive or negative impact for the general fund, depending on whether the new borrowing is above or below the CRI*
- *There might be premia payable for early repayment of loans*
- *There could be extra debt management expenses incurred in borrowing and managing additional amounts of debt, particularly in councils which are currently debt free*

"Our intention would be to identify any additional costs which would fall on either the HRA or the general fund as a result of the debt reallocation and to provide a settlement that funds these."

4.4.8 The consultation paper suggests some ways in which these costs could be met.

4.4.9 The consultation paper suggests that there should be a mechanism to reopen the debt settlement in the event of major policy changes.

4.4.10 The consultation paper also recognises that there are detailed accounting and treasury management issues to be worked through if self financing was implemented.

4.4.11 The four questions posed by the consultation paper on self-financing are:

- *We propose calculating opening debt in accordance with the principles set out (above)... What circumstances could lead to this level of debt not being supportable from the landlord business at the national level?*

SDDC comment:

- As stated in our opening general comment if the level of debt reallocated is increased to aid the setting of a national capital account or sinking fund such additions are likely to make the principle of debt allocation unviable. Each LA needs to have a business plan where it can pay back opening debt over the standard 30-year term of its business plan. Although the government have stated their intention to impose debt allocation, if it cannot be achieved voluntarily, it is difficult to see how it could be imposed if individual plans are not viable as a result.
- *Are there particular circumstances that could affect this conclusion about the broad level of debt at district level?*

SDDC comment: Please see comment immediately above.

- *We identified premia for repayment and market debt as issues that would need to be potentially adjusted for in opening debt. How would these technical issues need to be reflected in the opening debt? Are there any others? Are there other ways that these issues could be addressed?*

SDDC comment: We agree these issues do need addressing in the opening opening debt settlement but a pragmatic approach should be taken to each outstanding debt to ensure that additional premia are not unnecessarily loaded into the debt allocation process. If necessary actual debts could be held at the centre to avoid such payments.

- *We propose that a mechanism similar to the Item 8 determination that allows interest for service borrowing to be paid from the HRA to the general fund should continue to be the mechanism for supporting interest payments. Are there any technical issues with this?*

SDDC comment: If the new borrowing is not entirely and clearly ring-fenced to the HRA by whatever means, the current CRI mechanism could have an indirect impact (either way) on the General Fund, with interest on this debt falling on the general council taxpayer. It appears that this is contrary to the Government's principle of wanting to strengthen the ring-fence.

4.4.12 The consultation paper considers that ending the current subsidy system and moving to a self-financing model without constraints could enable a significant increase in prudential borrowing and that if this was not controlled I would be of serious concern to government. The consultation paper states that:

"Allowing unlimited prudential borrowing would be inconsistent with the Government's overall fiscal and macroeconomic policy. The department would therefore need to ration or limit in some way any additional borrowing over what was implied by the notional initial business plan and would have to adjust its expenditure on other housing programmes to accommodate this.

"The Government is considering how to ensure that the overall fiscal position for itself is not undermined under self financing and the consequences for controls on

additional borrowing over the debt profile associated with the original business plan."

4.4.13 The two questions posed by the consultation paper on borrowing under self financing are:

- *Do you agree the principles over debt levels associated with implementing the original business plan and their link to borrowing?*

SDDC comment: If national debt is redistributed (i.e. actual current debt rather than an allocation of debt) and local LAs are then self financing any additional borrowing they seek to undertake could be controlled through existing mechanisms i.e. Corporate audit commission monitoring, TSA Housing inspections and external audit functions. There is no need to layer in another level of control. HM treasury colleagues may be concerned about a sudden rush of LA borrowing but the more likely scenario is that actual additional borrowing will be severely limited by the amount of debt each LA takes on. In this way those same treasury colleagues may advise loading in high debt reallocation at the start of the process to deter additional borrowing but if this is done the whole project may fall as a result. We realise the government has indicated that debt may be imposed through legislation but if a large number of LAs simple can't project the numbers viably then the amount of opposition to the proposal would make it untenable.

- *In addition to the spending associated with the original business plan, what uncommitted income might be generated and how might councils want to use this?*

SDDC comment: The may be some scope for generating additional income but it is likely to be at the margins. Although some urban areas may have a number of items they can charge separately for outside of rent (e.g. service charges) the majority of landlords have limited scope in this regard.

4.4.14 The government clearly does not want the freedoms and flexibilities offered by self-financing to extend to authorities using efficiency gains to fund additional prudential borrowing to improve housing beyond the standards envisaged when the original business plans were prepared and debt transfers made. This position is not unexpected but is inconsistent with the principles of 'prudential borrowing' and the stated objective of creating a 'level playing field' between local authorities and housing associations. Housing associations have no constraints placed on their borrowing other than the need to remain financially viable.

4.4.15 The consultation paper notes that self-financing would increase the exposure of local authorities to risk – including the risk of increased interest rates. It is envisaged that the Tenant Services Authority would provide the framework for managing these risks.

4.4.16 The consultation paper proposes that local authorities should retain all their capital receipts. However, this would have the implication that Communities & Local Government would have to reduce their capital budgets for other programmes. Consequently, the consultation paper suggests that Councils would be required to invest a proportion of their receipts in new supply or regeneration. There would be a requirement for 75% of receipts to be reinvested in housing.

4.4.17 The three questions posed by the consultation paper on capital receipts are:

- *We have set out our general approach to capital receipts. The intention is to enable asset management and replacement of stock lost through Right to Buy. Are there any risks in leaving this resource with landlords (rather than pooling some of it as at present)?*

SDDC comment: No.

- *Should there be any particular policy about the balance of investment brought about by capital receipts between new supply and existing stock?*

SDDC comment: No. The principle of self-funding is that decisions are being taken more locally to reflect local needs and demands.

- *Are there concerns about central Government giving up receipts which it currently pools to allow their allocation to the areas of greatest need?*

SDDC comment: No.

4.4.18 The consultation paper suggests that this would result in local authorities being able to fund more disabled adaptations in both the Housing Revenue Account and General Fund but no new resources are offered.

4.4.19 There is a suggestion that funding available for stock transfer will be less advantageous than in the past. The consultation paper states:

"We will only fund transfers at standards materially the same as those proposed for self-financing."

4.4.20 The government sees a strong future for Arms Length Management Organisations. They consider that under self-financing they should have the financial flexibility and resources to plan ahead and prosper and should be able to utilise their experience and local knowledge to broaden and enhance their role.

4.4.21 The government will work with the Homes and Communities Agency to explore opportunities to make progress across the pilot programme of Local Housing Companies whose plans for new development have been adversely affected by the recession.

4.4.22 With regard to equality impact assessment, the consultation paper asks the following questions:

- *Would any of our proposed changes have a disproportionate effect on particular groups of people in terms of their gender or gender identity, race, disability, age, sexual orientation, religion or (non-political) belief and human rights?*
- *What would be the direction (positive or negative) and scale of these effects and what evidence is there to support this assessment?*
- *What would be necessary to assemble the evidence required?*

SDDC comment: No comment on this section.

4.5 Implementing Reforms

4.5.1 This section covers implementation of reforms. It describes the measures being taken immediately on new council homes in order to remove disincentives to council house building, the powers which would be required to implement self-financing across all councils and stock, and an indicative timetable for implementing the revenue and capital reforms.

4.5.2 The government wishes to move swiftly to have a self financing option up and running. They have already moved to create a self-financing mechanism for local authority new build properties using powers contained in the Housing and Regeneration Act 2008 and secondary legislation.

4.5.3 The Housing and Regeneration Act 2008 also provides for individually negotiated agreements between local authorities and central government to exclude specified stock from the subsidy system. This could be used to introduce voluntary self-financing through the following:

- An agreement about the costs of running the stock at the local level
- An understanding about the operational practicalities of the Housing Revenue Account ring fence in the context of self-financing
- Any significant transaction costs from taking on or writing off debt to be reflected in the proposed debt settlement

4.5.4 The government considers that it would be possible to set out the terms of such an offer by the spring of 2010. However, they do not propose to negotiate with each authority individually and consider that this option would only be possible if all local authorities accepted the terms offered. The Local Government Association is expected to attempt to achieve agreement on this among local authorities but it is unclear whether they will be successful unless authorities believed that an earlier voluntary settlement could be financially more advantageous than a later compulsory settlement.

4.5.5 The government states that if unanimity is not achieved following their offer in spring 2010 primary legislation would be required. The government considers that, subject to parliamentary time, a self-financing system could be legislated for and be in operation from 2012/13.

5. Reactions to the Consultation Paper

5.1 Grant Shapps MP, Conservative Shadow Minister of Housing, was quoted in ‘Inside Housing’ as saying:
“Everyone agrees that housing finance is urgently in need of reform and we strongly support the principle of the level playing field with councils being able to get the benefits of managing their own housing funds… I will, however, await the detailed proposals and we will be on our guard for hitherto efficient councils being forced to adopt high levels of debt.”

5.2 This suggests that some form of self-financing could be introduced whether or not there is a change of government in 2009 or 2010. However, it suggests that the Conservatives would be reluctant to redistribute significant amounts of debt.
Ruth Lucas, Policy Consultant at the Local Government Association, was quoted in ‘Inside Housing’ as saying:
“There are negotiations to be had… and I need to negotiate with my membership. But we are concerned that this paper does not address the issue of any debt cancellation.”

6. Financial Implications for SDDC

6.1 There are no immediate, direct financial consequences as a result of the consultation paper, and consequently, this report. It is after all a consultation exercise. However the whole of the report is about the future of HRA finance.

6.2 The consultation proposes increased allowances for maintenance and major works and if the current national subsidy system is maintained these proposals are welcomed.

6.3 Such additional allowances are proposed to be built into the proposed major change option which is the debt reallocation proposal. This again is welcome.

6.4 However through its membership of ARCH (Association of Retained Council Housing) South Derbyshire has been the subject of a case study where our stock investment needs and all our other costs have been modelled into a debt reallocation model by a leading financial expert. This work has indicated that the minimum opening debt in a debt redistribution model could be around £47m, a more likely level is around £55m and two other scenarios of even more. Clearly moving from a debt free position to take on such a debt would be a major step change. The prospect would be though that at least the debt would be gradually paid off. A continuation of the current negative subsidy systems for the next 30 years would see us contribute over £150m to the national pool.

6.5 The scale of the numbers involved in the allocation of debt proposal are scary and will make lay people jolt and react to reject them. However the two critical factors in any debt apportionment to South Derbyshire are: can we make our business plan stack up for 30 years (we currently can't) and will the interest payment on the opening debt be lower that the current level of negative subsidy payment?

6.6 On the first of these points it appears that our business plan may well be viable at the lower levels of debt proposed (but only just) and will be dependent on us increasing rents reasonably quickly towards the government's target rents to increase income. At higher levels of debt allocation though our business plan may not be viable hence the call in our proposed opening general comment at 1.1.3 to government for the allocation to be kept as low as possible and limited to the actual debt in the national system. On the second point it is estimated that the interest payment on a debt of £55m would be around £2.5m

Findings from the Case Study

6.7 In the case study, 4 options were modelled, based on various debt settlements being proposed in the consultation paper. The amount of debt allocated was based on the Tenanted Market Value (TMV) of stock adjusted as follows:

- **Option 1** – the base position, plus planned uplifts in current repairs, management and maintenance allowances as set out in current national settlements.

- **Option 2** – with no uplifts, i.e. based on a continuation of the current subsidy system. It is considered that this is the worst option for the sector overall and provides a higher level of debt settlement.

- **Option 3** – with an increase in allowances as identified in the review to sustain spending and meet commitments for repairs and maintenance in line with that calculated nationally. This is the best option for the sector as it provides lower debt settlements to take account of the additional resources required. In addition, total debt settlements would equal the total debt currently in the system at a national level. This is considered the most equitable basis.

- **Option 4** – taking account of inflation and applying a discount rate in future years. This is a more technical calculation and is considered unfair as it increases debt settlements nationally by over 60%, compared to the current level of debt. This is because it widens the gap between future rents and allowances in the TMV calculation.

6.8 The modelling assumes other factors in the Council's current financial projection for its HRA remaining the same, although it assumes rent convergence by 2017. The options also build in additional borrowing required to meet spending commitments over the next 10 years as identified in the 2009 Stock Condition Survey (SCS 09)

6.9 The aim of the modelling was to determine under each option whether the debt could be funded and sustained within the industry standard **30-year** business-planning period. The results are summarised in table 1.

Table 1

Option	Debt Settlement (£m)	Debt to meet SCS (£m)	Total Debt (£m)	Repaid By
1	55	15	70	Year 28
2	63	15	78	Year 30
3	48	15	63	Year 23
4	80	15	95	Year 33

6.10 As previously highlighted, this shows that under options 1 and 2, the debt level is just about sustainable. Clearly, Option 3 with uplift in resources and which equals the national debt situation is the best scenario for South Derbyshire.

6.11 The case study points out that a significant factor for the Council compared to a lot of other authorities is the current average rent. This is 14% below the formula rent and provides headroom in the form of additional resources when factored into the calculation.

6.12 Within a self-financing model, the Council would have access to this additional income in the future, assuming rents continue to be set in accordance with national guidelines.

6.13 Clearly, an important issue for the Council is how the cost of taking on a share of the national housing debt compares to the amount it currently pays in negative subsidy.

6.14 Based on the debt figures calculated in the case study, further analysis has been undertaken to ascertain the amounts involved based on the current cost of borrowing over 30 years (4.2%). This is summarised in the following table.

Table 2

Option	Cost of Debt over 30 years (£m)	Current Subsidy Payments (£m)	Difference (£m)	Average per Year (£'000)
1	115	150	-35	-1,167
2	130	150	-20	-667
3	105	150	-45	-1,500
4	155	150	+5	+167

6.15 This analysis reflects the case study exercise. Whilst options 1 and 2 show the HRA better off compared to current subsidy payments, option 3 is the most beneficial. Option 4 is effectively out of scope.

6.16 As the case study highlighted, the key issue for the Council is that currently average rents are well below formula rents. As rents converge, self-financing brings the benefit of increased headroom compared to the average authority in the subsidy system.

6.17 Potentially therefore, additional resources could be available for further investment, to repay debt earlier and/or to ensure that the HRA operates in balance well into the future.

Assumptions and Risks

6.18 Any analysis of this magnitude has to make various assumptions. It has been highlighted that the key factor for the Council is future rents, but there are other issues and these are considered below.

Rents

6.19 This will depend on future rent policy nationally and the affordability at a local level. The Government are due to consider this separately but it is outside this review. Although these proposals may lead to self-financing, rent setting could still be determined nationally outside of the Council's control.

6.20 The timing of convergence could also change projected figures. Bringing it forward will increase the debt settlement by increasing the TMV basis. However, this is not considered as critical; convergence would only add between £2m and £5m in total to options 1 to 3, which would still be someway below current subsidy payments.

Borrowing

6.21 The Government have still to decide the mechanism of how the debt, once calculated and agreed will be passed over to individual councils. It has been assumed that in these calculations in **Table 2,** the Council will be free to borrow money within the limit allocated by the Government, taking into account local circumstances and treasury management guidelines.

6.22 However, this could create problems nationally with numerous authorities accessing money markets at the same time and some form of control may be required.

6.23 In addition, councils will need to access additional money to meet spending identified in their stock condition surveys. The Government may wish to control the amount of borrowing depending on macro-economic policy.

6.24 However in South Derbyshire's case, given the headroom in the projected figures, the Council may not need to borrow to meet this in any case.

Interest Payable and Interest Rates

6.25 It is also not clear, whether existing debt will be passed over with pre-determined interest rates. The calculations in **Table 2**, assume the prevailing fixed interest rate on money borrowed from the Public Works Loan Board for 30-years, i.e. 4.21% with principal being repaid in equal instalments each year.

6.26 Under current accounting regulations, interest on debt is charged to a council's General Fund. The amount applicable to the HRA is passed across the ring-fence through a formula designed to ensure that the HRA is charged with the proportion of debt outstanding that relates to council housing.

6.27 However, this can vary each year due to the rate that is used to calculate the interest. This does not entirely reflect the cost of borrowing locally, but is influenced by a national rate used by the Government and notified to councils annually. It is not fixed.

6.28 This is known as the Consolidated Rate of Interest (CRI). The Council's current CRI (as at 31st March 2009) is 4.6%. The national average is 6.4%, the Council's rate being lower as it only has a small amount of debt outstanding.

6.29 To test the sensitivity of rates, applying 6.4% to the 4 debt options, still shows options 1 and 3 sustainable, although option 2 would fall out of scope at this rate of interest. Option 3 would cost approximately £20m more over the 30-years, although still sustainable and better compared to the current subsidy payment.

Possible Effect on the General Fund

6.30 If the new borrowing is not entirely and clearly ring-fenced to the HRA by whatever means, the current CRI mechanism could have an indirect impact (either way) on the General Fund, with interest on this debt falling on the general council taxpayer.

6.31 It appears that this is contrary to the Government's principle of wanting to strengthen the ring-fence. Therefore, the response to the question in paragraph 4.4.11 reflects this.

Timing of Implementation

6.32 The calculations in the case study and the comparison of debt repayments to subsidy are based on current figures. The longer a self-financing model takes to be implemented, the greater the debt settlement, as TMV would increase in any model.

6.33 Implementation may not take place until 2012/13. It is estimated that this could increase debt settlement figures by upto 8% at that time.

6.34 If this was the case, Options 1 to 3 will still be sustainable, but option 2 would be more marginal.

7. Corporate Implications

7.1 The government's consultation exercise, although about the HRA, also proposes changes to the relationship between the HRA and General Fund and these are highlighted in the report.

8. Community Implications

8.1 Tenants would, inevitably, be significantly affected by these proposals if they come to fruition. Whether that be by changes to the current system with increased allowances and the prospect of less than currently projected contributions to the national pool; the taking on of a significant debt into the HRA business or; by effectively changing the option of potential stock transfer given that a high level of capital debt may make it less viable.

8.2 In the stock options process completed April 2009 it was stated to tenants that we would await the outcome of the HRA review before deciding the next step in the process. The government have said that they will consider the response to their paper and announce their proposed way forward in the Spring of 2010.

8.3 Therefore the current situation is that we have a series of proposals which may or may not come to fruition. Some of these will help the viability of our local HRA others may make it worse. Until we know definitively which route the government is proposing it is difficult to recommend a definitive course of action to the tenants.

8.4 It is therefore proposed that an information update be sent to all tenants outlining the current situation.

9. Conclusions

9.1 The aim of fundamentally overhauling the current national Housing Revenue Account system is a good one. The consultation paper proposes the introduction of self-financing on the basis of increased funding for housing revenue accounts. This increased funding will be aimed at management costs, maintenance costs, major repairs and continuing to meet the decent homes standard.

9.2 The proposed mechanism is a one-off redistribution of housing revenue account debt. This would be done by assessing each authority's capacity to raise income and its need to spend and therefore its capacity to fund debt. On the whole, negative subsidy authorities with low (or no) debt would find their debt increased; while positive subsidy authorities with high debt would find their debt reduced. There is also a proposal to introduce capital grants to fund investment.

9.3 It had earlier been believed that total housing revenue account debt would remain the same, but the consultation paper states that it is uncertain whether total debt would increase or reduce. The government's debt paper table shows an increase in total housing revenue account debt at the point of redistribution of £7million (40%). However, it is difficult to see how self-financing could be achieved at the proposed levels of expenditure without a significant reduction in total housing revenue account debt and/or significant increases in rents.

9.4 There are a large number of complex technical matters to address not least of which is how the increased levels of expenditure are to be calculated at an individual authority level. This could have a significant effect on the geographical distribution of debt and resources following self-financing. The government's proposals for controlling local authority borrowing after self-financing will also require close examination as this implies a departure from the principles of 'prudential borrowing'.

9.5 The consultation paper does not address the question of social rent policy but this is clearly an important part of the picture for local authorities and their tenants. With self-financing any increases in rents would be retained locally so policy on social rents becomes even more important to local authorities.

9.6 With implementation planned for 2012/13 it is certain that a general election will intervene. This consultation paper is clearly part of the government's 'offer' to local authorities and their tenants at that general election. The Conservative Party, however, also appears supportive of self-financing but with some reservations about increasing the debt of low debt, negative subsidy authorities. This suggests that they may consider implementing self-financing but with a more limited redistribution of debt.

9.7 The implementation of self-financing will also take place in the context of the Comprehensive Spending Review of 2010. It is generally accepted that, whatever party is in power in the autumn of 2010, they will have to make difficult decisions about making significant reductions in expenditure and/or increases in taxation. Whether a significant increase in expenditure in the housing revenue account or a write-off of housing revenue account debt could be contemplated at that time is open to doubt.

10. Background Papers

10.1 Reform of council housing finance: Consultation. Department for Communities and Local Government: July 2009.

10.2 HRA Reform: the really big issues. Chartered Institute of Housing briefing: September 2009.

10.3 Reform of Council Housing Finance. Briefing paper from AWICS Independent Consultancy services: July 2009.