



Report to the Executive for Decision 12 October 2009

Portfolio:	Policy, Strategy and Finance
Subject:	Reform of Council Housing Finance
Report of:	Acting Chief Finance Officer
Strategy/Policy:	
Corporate Objective:	To promote the economic success of the Borough

Purpose:

The Minister for Housing and Planning has issued a consultation paper entitled "Reform of Council Housing Finance". The purpose of this report is to provide an overview of the proposals and to indicate their impact for Fareham. Also to enable a response to be sent to the Department for Communities and Local Government (DCLG) on the consultation paper.

Executive summary:

The Government's proposals are for the Housing Revenue Account subsidy system to be dismantled and replaced with a devolved system of responsibility and funding.

The intention is to implement new arrangements that will provide more flexibility in housing finances and more transparency in the operation of the system. Control would be devolved from central to local government increasing local responsibility and accountability for long term planning, asset management and for meeting the housing needs of local people.

A devolved self-financing alternative to the current system is proposed that will remove the need to redistribute revenue nationally, while continuing to ensure that all councils have sufficient resources to finance their council housing services from their own rents and revenues.

Councils would retain the negative subsidy that is currently redistributed by the Government in exchange for a one-off allocation of housing debt that will be serviced by Councils through their Housing Revenue Account (HRA).

The Government's intention is that this once-and-for-all settlement will create a new starting point for local authorities currently in the HRA subsidy system, from which it is hoped that each will be able to sustain and maintain their homes on an equitable basis.

Councils should be able to plan long term and improve the management of their homes, secure greater efficiencies and improve the quality of service to their tenants.

Consultation responses are due by 27 October 2009. Following consultation, further details will be published in Spring 2010, and the Minister anticipates changes in place from 2012/13.

Recommendation:

The Executive is asked to note the report and to approve the draft response to DCLG as set out in paragraphs 34 - 36.

Reason:

To inform the Executive of proposals to reform council housing finance and to respond to the consultation paper issued by DCLG.

Cost of proposals:

Not available until the detailed proposals have been finalised.

Appendix A: Risk Assessment

Background papers:

DCLG Consultation Paper - Reform of Council Housing Finance - July 2009

Tribal - Fareham Borough Council - Review of Self Financing Proposals - September 2009



FAREHAM BOROUGH
COUNCIL

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Executive Briefing Paper

Date: 12 October 2009

Subject: Reform of Council Housing Finance

Briefing by: Acting Chief Finance Officer

Portfolio: Policy, Strategy and Finance

INTRODUCTION

1. This consultation is the result of a detailed investigation into the operation of the council housing finance system, aimed to find a long term, sustainable solution to improve or replace the current Housing Revenue Account subsidy system in England that would be fair to both tenant and taxpayer and fit with wider housing policy.
2. The Government has signalled that its preferred option would be to dismantle the current Housing Revenue Account subsidy system and replace it with a devolved system of self-financing for all English local housing authorities. This will depend on a one-off allocation of housing debt, after which councils will be able to keep all their rental income. The alternative option would be to retain but improve the current system.
3. While the review has focused on council housing finance, its considerations are relevant to all social landlords.

THE CURRENT ARRANGEMENTS

Housing Revenue Account (HRA)

4. The HRA is a ring-fenced account within the general fund; credits and debits are governed by statute and the ring-fence 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 the council tax and that rents cannot be increased in order to keep council tax levels down.
5. Although it is a ring-fenced account within the general fund, there are certain prescribed circumstances when transfers into and out of the HRA are permitted. DoE Circular 8/95 provides guidance on the operation of the ring fence but it is not intended to be an exhaustive list of every item or new initiative. It enables local authorities to exercise their own judgement on what is reasonable and justifiable to charge to the HRA.

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xps-091012-r11-awa

The HRA Subsidy System

6. The HRA subsidy system allows the Government to determine the amounts that local authorities need to spend on their council housing, and whether subsidy is required to support this. The Government makes notional calculations of how much income and expenditure each authority should have. If assumed spending is greater than assumed income, Government pays HRA subsidy to make up the deficit; where it is less, the local authority pays the surplus to the Government. While the calculations are notional, they are based on actual data such as stock numbers, interest rates and deprivation indices, all of which are adjusted annually.
7. Of the 205 local authorities in the HRA subsidy system in 2008/09, 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). In 2009/10 it is estimated that Fareham will pay £2.4 million in negative subsidy to the Government.
8. There is a clear rationale for redistribution of income between landlords. 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. By redistributing resources, all councils should be able to deliver a similar level of service while charging a similar level of rent.
9. However, the factors that determine whether a council is in deficit or surplus under the current subsidy system are complex, reflecting a number of different elements which impact on income and spending needs. The three main factors that drive subsidies 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.
10. The notional elements in the current system mean that the subsidy position is not influenced by the relative efficiency of different landlords. The subsidy system makes assumptions about spending needs based on standard costs for delivering services; a council may spend more or less than this amount on delivering a service, but this will not change the amount of subsidy which it is eligible to receive.
11. These notional elements also mean 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.

Capital Expenditure and Receipts

12. The HRA controls revenue expenditure, but local authorities are also responsible for significant capital investment programmes, often funded directly or indirectly by central Government. Unlike revenue transactions, capital transactions are not subject to the separation of housing and non-housing expenditure. Apart from rules which allow local authorities to retain a greater share of receipts if they spend them on affordable housing, authorities are free to spend their usable receipts on whatever capital purpose they wish.
13. The one element of capital directly related to the HRA is the major repairs allowance which is held in a separate account and it can only be used for capital expenditure. All other housing capital expenditure and capital receipts are accounted for outside the HRA.

Rents

14. Government policy is that all social landlords should offer similar rents for similar properties whilst maintain discounts to market rents. The rent formula was established to gradually bring about this policy, with actual rents moving towards a national formula rent.
15. The original objective was that actual rents would converge to within 5% of formula rents by 2012 by applying annual rent increases above or below the annual increase in formula rents, but subject to a maximum annual increase in actual rent of RPI + 0.5% + £2 per week.
16. This has led to complex calculations within the subsidy system and additional mechanisms have been introduced to compensate landlords if moving to the formula rent would breach aspects of the over-arching rent policy.
17. However, the consultation paper does not propose changes to rent policy although it would be necessary to establish long term rent policy in advance of any changes to the system for financing council housing.

Management and Maintenance

18. Research has been carried out about the future need to spend on the management and maintenance of council housing based on the existing level of allowances and actual spending.
19. The conclusions drawn from the research are that at a national level management allowances need to increase by 8% and maintenance allowances by 3%.
20. The Government has accepted this and the consultation paper confirms that this level of need will be assumed in any new arrangements that are introduced.

PROBLEMS WITH THE CURRENT ARRANGEMENTS

21. The review has identified a number of problems in operating a national system for redistributing rental income between landlords:
- 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, inhibits 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.

OPTIONS FOR FUNDAMENTAL REFORM

22. The DCLG published a consultation paper on 21 July, which provides information on a potential self-financing option for local authorities. The consultation lays out two options for future HRA funding. Under both of them, authorities would:
- Manage their stock according to their 30year business plan;
 - Observe a more rigorous HRA ring fence, which applies to capital as well as revenue items;
 - Maintain a new account, which will record all transfers between the HRA and General Fund;

- Retain 100% of the proceeds from Right-to-Buy sales, with 75% of such receipts ring fenced for reinvestment in housing (it is not clear from the consultation document whether this provision applies just to the self financing option or whether it would apply if the subsidy system was retained);
 - Account to the Tenant Services Authority for the value for money and efficiency secured for local tenants; and
 - Be able to borrow prudentially to provide local housing investment, within acceptable limits set by HM Treasury.
23. The review has examined a range of options for reform within two broad models for financing council housing in the future:
- improvements to the current system for funding council housing in which revenues continue to flow between local and central Government as a result of on-going assumptions made by Government about landlord costs and income
 - a self-financing, devolved system in which rents are retained by councils to spend on their own services, in exchange for a one-off reallocation of debt.
24. The first of the HRA funding options is a modified version of the current subsidy system with changes that provide greater long term stability than at present. The changes include a move to longer determination periods of between three and five years, a 5% national increase in management & maintenance allowances, and a 24% national increase in major repairs allowances, along with additional grants for backlog works. It is unclear if they also include retention by authorities of 100% of capital receipts from right to buy.
25. The second option, self financing, is more radical and appears to be the Government's preferred option. It requires restructuring of local authority housing debt which would include an end to the current subsidy system, redistribution of debt to stock owning housing authorities, based on the value of their housing stock, and authorities retaining any surpluses made on their HRA, for reinvestment in local housing. That is, each local authority would retain all rent and other income within the HRA and use it to manage and maintain the council housing stock.
26. The Council commissioned Tribal group to carry out a review of the DCLG's proposals for Fareham.
27. Tribal's report compares the HRA position under the current system with its position under the proposed options.

TRIBAL'S FINDINGS

28. Following the consultation process the government will take a view on the mechanics of distribution and this may result in an outcome for Fareham which differs from the range of projections prepared by Tribal. However, the modelling Tribal has done is consistent with the consultation document and incorporates the changes to allowances contained in the final 2009/10 amended subsidy determination, which feed into the TMV (tenanted market value of the stock) using future subsidy cash flows over 30 years.
29. Tribal has modelled estimated debt figures for Fareham under three scenarios; two are TMVs based on subsidy cash flows, using 7% and 6% discount rates, and a third uses Fareham's actual HRA Business Plan cash flows with a 6% discount rate. Where the valuation is higher than the existing notional debt as would be the case for Fareham new debt would be imposed on the council to bring it up to the level of the valuation.
30. The following table summarises Tribal's findings.

	Debt taken on from other authorities	HRA surplus / deficit (-) 30 years cumulative	Major repairs reserve 30 years cumulative	Total revenue and capital resources accumulated / shortfall(-)
	£m	£m	£m	£m
No change, current system remains	0.0	-23.4	-19.2	-42.6
Current system enhanced, capital receipts currently pooled used for HRA	0.0	1.0	41.2	42.2
Current system scrapped, debt shared between authorities:				
Debt shared on basis of current subsidy cash flow, 7% discount rate	38.4	95.8	41.2	137.0
Debt shared on basis of current subsidy cash flow, 6% discount rate	43.9	75.0	41.2	116.2
Debt shared on basis of cash flow indicated by business plan	47.9	59.8	41.2	101.0

IMPLEMENTATION OF THE REFORMS

31. Primary legislation would be required to achieve a national settlement and, subject to parliamentary time, the Government anticipates that a self financing system could be in operation from 2012/13.
32. The Government has already created a self-financing mechanism for local authority new build properties. This allows councils to keep the operating profit from newly built stock (rather than losing it through the subsidy system), to retain the receipts from new build properties that are sold and councils are now able to bid for grant from the Homes and Communities Agency to finance new build.

RISK ASSESSMENT

33. An assessment of the risks and opportunities associated with this decision is attached at Appendix A.

RESPONSE TO CONSULTATION

34. It is suggested that officers respond to the Government's consultation in favour of ending the current subsidy system, and making the following points:
35. The Council believes that ideally the Government should take over the debt outstanding nationally when the current system ends, but recognises this may be unaffordable, especially in the current economic climate. In the event that the outstanding debt is allocated to authorities a higher discount rate should be used to calculate the allocation.
36. Should the Government choose to continue the current system it should be with the enhancements described in the consultation paper, including the use by each authority of the proportion of their right to buy capital receipts which is currently pooled. Continuing the current system with the other enhancements but without the use of the capital receipts would still be preferable to continuing the current system as it is.

CONCLUSION

37. If the current subsidy system were to continue, without the increases to allowances and freedom to use right to buy receipts proposed in the Government's consultation paper, Fareham's HRA revenue balances would be exhausted and there would be a shortfall of capital resource shortfalls before the end of the 30 year business plan.
38. Both the two main proposals contained in the consultation paper significantly improve the position for Fareham's HRA. If the current subsidy system continues, with the enhancements referred to in the consultation paper, the HRA is projected to remain just in surplus throughout the 30 year term of the business plan and unused capital resources, totalling £41.2m, will accumulate by 2038/39. Replacing the current subsidy system with a self financing system will further improve the position.

39. If the current subsidy system is replaced from 2012/13 with a self financing system projections show the Council would be able to repay all its HRA debt by 2030/31 and will accumulate revenue and capital resources totalling approximately £116m by 2038/39.
40. The suggested response to the consultation is in favour of those proposals which would put Fareham in the most advantageous position.
41. Until the government announces the outcome of the consultation process and its intentions for council housing finance, there will be uncertainty about the projections for Fareham's HRA. The factors used in the projections may change, as a result of government policy or economic conditions.

Reference Papers: None

APPENDIX A

RISK ASSESSMENT

Impact	Description	Potential Risks	Comments	Potential Opportunities	Comments
CORPORATE OBJECTIVES	Implications in relation to: <ul style="list-style-type: none"> • achieving Corporate Objectives and Priorities • Corporate Governance Responsibilities 	No significant risks.		Opportunities to better meet the housing needs of local people may result from the changes	
PARTNERSHIPS	Implications for any existing partnership arrangements Risks or opportunities for new partnerships	No significant risks.		No significant opportunities.	
FINANCE AND RESOURCES	Implications in relation to: <ul style="list-style-type: none"> • Budget Constraints • Funding • Contractual Obligations or Penalties • Use of Land or Assets 	The financial implications for both the HRA and General Fund are not yet clear		No significant opportunities.	
LEGAL	Implications in relation to: <ul style="list-style-type: none"> • Statutory or discretionary powers • National Legislation (e.g. Human Rights, Data protection etc) • Failing to comply with legislative requirements of service • Potential litigation action 	No significant risks.		No significant opportunities.	

Impact	Description	Potential Risks	Comments	Potential Opportunities	Comments
PERSONNEL	Implications in relation to: <ul style="list-style-type: none"> • Organisational change • Employee policies and conditions • Skill availability • Training and Development 	No significant risks.		No significant opportunities.	
SERVICE	Implications in relation to: <ul style="list-style-type: none"> • performance targets • the operation of the service • the need for Change Management • Competitive advantage of the service • Technological impacts • Innovation • The needs of residents, businesses or visitors to the Borough 	No significant risks.		No significant opportunities.	
HEALTH & SAFETY	Implications for the Health & Safety of the Public, Employees or Members	No significant risks.		No significant opportunities.	
CRIME & DISORDER	Implications in relation to: <ul style="list-style-type: none"> • Council's Section 17 Obligations • Community Safety • Anti-fraud and corruption 	No significant risks.		No significant opportunities.	
ENVIRONMENTAL	Implications in relation to: <ul style="list-style-type: none"> • Sustainability • Public Health • Physical risks 	No significant risks.		No significant opportunities.	

Impact	Description	Potential Risks	Comments	Potential Opportunities	Comments
<p>EQUALITY AND DIVERSITY</p>	<p>Implications in relation to:</p> <ul style="list-style-type: none"> • Inclusion • Equality of access and opportunity • Cohesion • Diversity 	<p>No significant risks.</p>		<p>No significant opportunities.</p>	