Leeds
CITY COUNCIL

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Joint Report of the Director of Environment and Neighbourhoods and the Director of Resources

Executive Board

Date: 22nd June 2010

Subject: Government Review of Council Housing Finance – The Council's response to the consultation paper "Council housing: a real future"

Electoral Wards Affected:	**Specific Implications For:**
	Equality and Diversity ☐
	Community Cohesion ☐
☐ Ward Members consulted (referred to in report)	Narrowing the Gap ☐

Eligible for Call In ☐

Not Eligible for Call In (Details contained in the report) √

EXECUTIVE SUMMARY

On 24th March 2010 the last Government published its consultation paper, "Council housing: a real future". This set out proposals for dismantling the current Housing Revenue Account (HRA) subsidy system and replacing it with a devolved system of funding and responsibility, subject to a one off allocation of debt between local and central government. In order to respond to the consultation paper, the Government's debt settlement figure for Leeds has been modelled into its HRA Business Plan. This modelling demonstrated that over the life of the 30 year Business Plan the Council would be substantially better off compared to remaining in the subsidy system, although the majority of the additional resources generated would not be realised until the later years of this period.

This report sets out a brief context to the main issues the paper is seeking views on, together with the Council's proposed response. The new government has yet to indicate whether it supports the proposals but has not withdrawn the consultation.

In summary, the Council supports the review of council housing finance and the principles upon which it is based. The self-financing model should offer more certainty in terms of funding which could allow more robust planning of works and facilitate more efficient procurement. However, there are a number of concerns surrounding the methodology in the consultation paper which need to be clarified by Government before the Council can support the proposals in full.

1 Purpose of this Report

1.1 To inform Executive Board of the Council's proposed response to the Government's consultation paper, " Council housing :a real future"

2 Background information

2.1 The current housing finance system

2.1.1 The current housing finance system has been in place for 20 years. Under the 1989 Local Government and Housing Act, each Local Authority is required to keep a Housing Revenue Account (HRA) and is subject to annual Housing Subsidy determinations.

2.1.2 The current system works on the basis of a "notional" HRA, informed by stock data provided by each Local Authority. This means that the Government, based on its own assumptions, makes an assessment of each council's need to spend, levels of rental income receivable and repayment of historical debt.

2.1.3 Based on the Government assumptions above, in 2010/11 Leeds would need to pay back to the Government over £46m of its rental income. However, taking into account the Major Repairs Allowance (MRA), which the Council receives to cover its long term maintenance costs, plus the ALMO allowances that Leeds receives to fund the debt associated with the Decent Homes programme, and the grant payable for PFI schemes Leeds will receive resources of over £29m.

2.2 Council Housing Finance Reform

2.2.1 A previous consultation paper issued by the Government in July 2009 set out the intention to dismantle the Housing Subsidy system and replace it with a devolved system of responsibility and funding after a one off allocation of housing debt. In October 2009 Executive Board agreed the Council's response to this paper. In summary, the Council welcomed the proposals to reform council housing finance and the principles upon which these were based, whilst acknowledging that the lack of detail contained in the Government's paper made it very difficult to assess the impact of the proposals on the Council.

2.2.2 In March 2010 the Government issued a further consultation paper "Council housing: a real future" (with the sub title Prospectus) in which it sets out further details of its proposals for the reform of the HRA. These are briefly outlined in **Section 3** below.

2.2.3 The Prospectus sets out 6 specific questions that the Government is seeking views on. These are attached at Appendix A. **Section 4** below deals with each question in turn. It sets out where necessary, a brief context to each issue, followed by the Council's proposed response ***(shown in italics)***. In formulating the proposed response, the Council has assessed/modelled the impact of the proposals on the HRA Business Plan and the ability of the Council to fund its capital investment requirement.

2.2.4 The closing date for responses to the consultation is 6th July 2010. Given this deadline, there is insufficient time for Call In processes to be concluded and hence this report is not eligible for Call In.

3 Summary of Key Issues

3.1 **Self - financing Housing Revenue Account** - The consultation paper sets out the Government's "vision for self financing" in which each council will retain its rental

income to fund the delivery of housing services and maintain its stock **subject** to a one-off distribution of debt between councils. The debt that each council can support has been calculated by the Government based on notional income and expenditure assumptions over 30 years.

3.2 **Housing Rents** - Under the proposals councils will still be required to follow the Government's social rent policy. There is currently no fixed date for convergence of social rents, although for the purposes of calculating each council's debt allocation, the Government's modelling has assumed a convergence date of 2015/16. In order to achieve this, real annual rent increases of 2.2% in 2011 and 2.1% in each of the following four years will be required.

3.3 **PFI** - For Housing PFI schemes that are signed e.g. Swarcliffe, or will be signed before the implementation of the proposed reform e.g. Beeston & Holbeck and Little London, the annual PFI grant payable from Government has been included in the calculation of the debt settlement figure. In respect of PFI schemes to be signed after implementation e.g. Lifetime Homes, then the Government will pay PFI subsidy separately via a grant.

3.4 **Capital investment /New Build** - It is the Government's view that each council's debt settlement figure provides sufficient capacity and flexibility for a council to put in place and fund an asset management strategy and to build new homes without the need to increase their borrowing above the opening debt settlement figure. Other spending pressures, notably adaptations for disabled local authority tenants, asbestos removal and the Housing Health and Safety Rating system have not been taken into account and funding for these will be considered as part of the next spending review.

3.5 **Retention of Capital Receipts** – Currently, councils have to pay over 75% of all capital receipts generated to the Government. Under the new proposals councils will be allowed to retain 100% of their housing receipts from houses and land provided that 75% is used for affordable housing and regeneration projects. The remaining 25% may be used for any capital purpose.

3.6 **Financial, Accounting and Regulatory Framework** - The Government's proposal is that the HRA should have a separate balance sheet - currently it is all consolidated into the General Fund balance sheet. In addition, the Government wishes to see a clear separation between HRA and General Fund debt and proposes options for doing so. However it does recognise that treasury management efficiencies generated through dealing with all loans consolidated together should not be lost.

3.7 **Retention of the HRA ringfence** - It is a legal requirement for councils to maintain a ringfenced HRA with only income and expenditure relating to the council's housing stock being charged there. The Government's view is that the ring fence still needs to apply and they propose a series of principles that will enable local authorities to decide whether the service should be paid for through the HRA or the General Fund.

4 Response to Consultation Questions

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

4.1.1 General comments

The Council welcomes the principle of self financing. It would however, have preferred the debt settlement figure to have been based more closely on actual rather than

notional figures but recognises the difficulties inherent in doing this on a national scale.

Given the notional basis of the calculation, the Council acknowledges the uplifts in both the Management & Maintenance Allowance and the Major Repairs Allowance (MRA) of 11.2% and 30.2% respectively which have been factored into the modelling to determine the debt settlement figure for Leeds. Whilst recognising that these uplifts are above the national averages of 10% and 27%, the Council would question whether these increases are sufficient, particularly given that it has been previously reported that MRA needs to increase by an average of 40% and the Government has acknowledged that the HRA will be funding increasing costs of non core services such as anti social behaviour and alarm systems together with any requirements arising from the Tenant Services Agency (TSA).

The debt settlement modelling makes a number of assumptions around inflation and interest rates. This leaves the risk of any change in these solely with the Council e.g. if interest rates rise the HRA will have to bear the cost with no support from Government.

4.1.2 Specific areas of concern

Following a detailed consideration of the prospectus and the model used by the Government to calculate the opening debt for Leeds there are a number of specific issues the Council wishes to challenge. These are detailed below:

PFI

The prospectus indicates that all PFI schemes signed prior to self-financing have been included in the debt allocation and the PFI allowances currently received will no longer be available. Whilst the calculation includes the allowance for the Swarcliffe PFI scheme it does not reflect accurately the subsidy/stock units for the Little London, Beeston Hill & Holbeck scheme.

The discount rates applied to the PFI allowances Leeds currently receives for the Swarcliffe PFI scheme and is due to receive for the Little London, Beeston & Holbeck scheme are, particularly in the case of the latter, significantly different to the 6.5% and 7% used in the Government's model to calculate the debt settlement figure and seriously disadvantage the Council over the life of the projects

The Council's preferred option is for all PFI allowances to be excluded from the modelling of the debt settlement and for us to continue to receive PFI subsidy in the form of a grant. This, in our view, would be more transparent and consistent with the way in which PFI schemes due to start after self - financing is introduced will be funded.

Rental income

The Council notes that there is no proposal to change the rent convergence policy or to allow councils to determine their own rent increases. This effectively means the Government will retain control over rents, with the Council's income stream potentially not being any more predictable than under the subsidy system. For Leeds, with rental income of £170m per annum a 1% swing in any "guideline" annual rent increase/decrease would generate a gain /loss in income of £1.7m. Within the context of the lack of a certain timeframe for convergence, this uncertainty over our key source of income could have a major impact on long term planning and poses the significant risk of the HRA becoming financial unsustainable in the future.

The Council would like reassurance that either there will be no changes to the timescales for convergence or that councils will be compensated if any changes have a detrimental impact on their HRA Business Plans.

The consultation paper indicates that the debt settlement figure includes an estimate of forgone income from councils who are affected by the limit on annual increases in individual rents. It is very unclear how this has been calculated and the Council is concerned that the method used may not accurately reflect the true position for Leeds as it is likely to have been based on averages, rather than on an individual dwelling basis. For 2009/10 Leeds received £4.6m in compensation for complying with the Government's rent policy and therefore any miscalculation in the Government's model could impact very significantly on our HRA Business Plan projections.

Again the Council would prefer to see this stripped out of the debt settlement model and allow councils to apply for a grant equal to any compensation due in the future.

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

4.2.1 The HRA ringfence

The Council welcomes the continuation of the HRA ringfence and supports the principle of "the need to be fair to both tenants and council tax payers" with the test being "who benefits". It supports the approach of local flexibility in the allocation of costs between the HRA and the General Fund.

4.2.2 Housing Balance sheet

The Council recognises the need to be transparent in relation to costs associated with housing and accepts that a separate housing balance sheet would contribute towards this transparency.

4.2.3 Unpooling of housing debt

Leeds' current £1.4bn loan maturity profile, set within the prudential framework, has been established to ensure that it matures in a manageable fashion and that there are no unusual maturity peaks that present undue interest refinance risk. The consultation paper proposes to separate out these portfolios so that there is a clear separation between general fund debt and HRA debt. This provides for effects of decisions being taken in one area being self contained unlike in the present system.

However there would be increased costs of administration without any direct improvement in the management of the separated loan portfolios. Indeed opportunities may be seized at the expense of the other loan portfolio, where at present both areas benefit. The number of opportunities may also be reduced in the remaining portfolio. There are also concerns over how, when and on what basis the loan portfolio will be split between HRA and General fund.

The current proposals would result in the repayment of circa. £400m PWLB loans, which would incur a penalty for repayment of circa. £50m. It is important that this penalty does not fall on the Council. The consultation does not appear to welcome the repayment of market loans, even if possible. Any repayment would require the current treasury strategy to be re-written as a number of prudential indicators will be breeched. It may also be the case that two strategies may need to be developed to cover the two loans funds and may also require the practical separation of daily

management of the authority's cash flow. The authority would then need to manage two loan book backs to an acceptable level of risk maturity over a period of time.

As a minimum the Council would expect that any proposals to separate general fund and HRA debt will not result in a negative impact on the Council's General Fund in terms of additional costs falling upon the Council tax payer.

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

In modelling the debt settlement figure, the Government have used a discount rate of 7% to value the business and not 6.5% usually involved in housing stock transfers. This should, in the Government's opinion allow councils headroom to deliver a sustainable new build programme without increasing borrowing above the opening debt allocated.

Using a discount factor of 7%(rather than 6.5%) in the Government's model reduces the Council's opening debt settlement figure by @ £20m.Based on this figure it is estimated the Council could build 160-170 new homes per year based on the current average cost of a new build, land at nil cost and no Social Housing Grant.

Increasing the number of new homes is one of the Council's strategic priorities, however, any decision to build new homes would need to be taken within the context of other strategic priorities such as the need to maintain decent homes and the wider investment needs as outlined in the Council's Asset Management Strategy.

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

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

The Council agrees that the current HRA subsidy system is complex, hard to understand and lacks transparency. The annual nature of the process also means that long term planning is difficult, because it is problematic to project the impact of future subsidy determinations on the HRA Business Plan.

The Council welcomes the move towards a self-financing model, as in principle it should offer more certainty in terms of funding which will allow for better planning of works, facilitate more efficient procurement which will facilitate more robust asset management strategies.

There are however still, a number of key issues which would need to be addressed and clarified before the Council would wish to implement self financing. These concerns are specifically outlined in responses to the consultation questions 1, 3, and 6.

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

4.5.1 Restrictions on borrowing retention of capital receipts

In formulating the Council's view the current indicative debt settlement figure provided by the Government for Leeds (£403m) has been modelled into our 30 year HRA

Business Plan. This has then been compared against the position if the current system of housing subsidy were to continue. In addition, these respective positions, and any additional headroom generated from the proposals have been compared against the housing capital investment requirement for the thirty year period.

Whilst the self financing settlement will deliver additional resources over the 30 year period, our modelling shows that less than 10% of these resources will be realised in the first 15 years of our Business Plan. The Council would prefer to see a mechanism which spread the benefit of additional resources more evenly enabling a more consistent approach to meeting investment needs in line with our Asset Management Strategy.

The Council welcomes the proposal that councils will be able to retain 100% of their housing capital receipts, but would prefer there to be greater flexibility in respect of local discretion as to how these are used. Given this proposal does not require any primary legislation, the Council would ask the Government to amend the Capital Financing Regulations in order that it could be implemented as soon as possible.

Whilst recognising the Government's wish to control public sector debt borrowing, the Council does not support the proposal that councils will not be able to take on additional borrowing above the opening debt allocated as part of the self-financing settlement. This proposal to limit "additional" borrowing; seems in conflict with the benefits of the proposed reforms particularly in relation to the ability to plan long term, local flexibility and accountability. It would be our preference to continue the application of the Prudential Code in respect of housing borrowing, in the same way it is applied to General Fund borrowing.

4.5.2 Risk

In our view, all the risks of implementing the self-financing system as detailed in the consultation appear to transfer to the Council. These include the risk that assumptions used in the Government's modelling turn out to be unrealistic over the life of the Business Plan e.g. inflation, interest rates, compensation for rents. In addition there are risks that may arise due to future statutory or regulatory changes over which the Council has no control.

The consultation paper states that the self-financing settlement is "full and final" with no transfer back or Government support should any council agreeing to implement the proposals be unable to cope in the future. .

The Council would urge the Government to consider the option of a "safety net" for council's should this be required.

4.5.3 Funding of adaptations

The proposal that resourcing of adaptations, asbestos removal and works arising from the Housing Health and Safety Rating system will be considered as part of the Spending Review is of concern, particularly given the constraints which are due to be implemented in respect of public sector expenditure. Specifically there are significant pressures to continue to increase expenditure on aids and adaptations in Council properties and as there is no guarantee that there will be sufficient funding allocated for these, this will almost certainly place additional pressure on Council resources with little means of increasing these through additional borrowing or rental increases.

5 Implications for Council Policy and Governance

5.1 There are no specific implications for Council policy and governance at present given that the Government are seeking views on proposals. As more details emerge the implications for the Council will be considered. The Government's stated aim of increasing the number of new homes is consistent with the council's strategic objectives.

6 Legal and Resource Implications

6.1 Specific legal and resource implications are covered in Section 4 of this report.

7 Conclusions

7.1 The Council agrees that the current HRA subsidy system is complex, hard to understand, lacks transparency and makes long term planning difficult.

7.2 The Council supports the review of council housing finance and the principles upon which it is based. The introduction of a self - financing regime should be more transparent and easier to explain to tenants and other stakeholders, whilst offering more certainty in terms of funding, which in turn should allow better planning of works, more efficient procurement and facilitate more robust asset management strategies.

7.3 The proposals contained with in the consultation paper "Council housing: a real future" have been considered in the context of the benefits it would bring in not having the annual subsidy determination. In addition the Government's debt settlement figure for Leeds has been modelled into the HRA Business Plan.

7.4 This modelling demonstrated that over the life of the 30 year Business Plan the Council would be substantially better off compared to remaining in the subsidy system. However for the first 10 years there is arguably little difference with a potential reduction in flexibility due to the restriction in borrowing

7.5 Whilst not opposed in principle to a self-financing system there are, however, still a number of key issues which would need to be addressed and clarified by the Government before the Council would wish to consider implementation. These are covered in Section 4 of the report.

8 Recommendations

8.1 That Executive Board agree the proposed response to the Government's consultation paper "Council housing: a real future".

Reference documents

(a) Council housing : a real future - Prospectus - Department for Communities and Local Government - March 2010

(b) Council housing : a real future - Impact Assessment - Department for Communities and Local Government - March 2010

(c) Housing Finance Reform: An Initial Briefing Note - CIPFA - 31 March 2010CLG HRA Finance Reform Paper – SECTOR – 16th September 2009

(d) Council Housing Finance Reform “Prospectus”- the main issues - Trowers & Hamlins - April 2010

(e) Council housing : a real future – SIGOMA Briefing - April 2010

Appendix A

Consultation questions

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?

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 for council housing or the continuation of a nationally redistributive system?

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

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