

## **CABINET – 1ST OCTOBER 2009**

### **Report of the Chief Executive**

Item 14 Reform of Council House Financing - Charnwood Borough Council's response to the CLG consultation document

#### Purpose of Report

To consider and approve the council's response to the Communities and Local Government (CLG) consultation document "Reform of council house finance".

#### Recommendations

1. To approve the proposed response to the "Reform of council house finance" consultation document.
2. To authorise the Acting Chief Executive in consultation with the Lead Members for Finance and Housing to alter the response following discussions with other affected councils on 2 October 2009.

#### Reasons

1. To ensure that CLG receive a considered response from the council for these important changes to local authority housing finance.
2. To amend the council's response, if necessary, in the light of a meeting scheduled for 2 October 2009 between affected Councils from across England.

#### Policy Context

This report supports the council's decent homes policy.

#### Background

In July 2009, Communities and Local Government (CLG) published its consultation document "Reform of council house finance". This is a fundamental review of the Housing Revenue Account (HRA) and details the replacement of the national housing subsidy system with self-financing of council housing at council level. This report

#### Summary of the proposals

Local authorities are required to maintain a Housing Revenue Account, which is a ring fenced account, in which the income and expenditure of the council's housing stock is dealt with as a "landlord account". A large component of the HRA is Housing Subsidy which is calculated via a system administered by the CLG on a national basis. CLG makes notional calculations of income and expenditure, and any deficits or surpluses on the account are taken from, or added to the national pot (in 2009/10 this equates to a notional £7.7m for Charnwood which is paid back into the national pot for redistribution).

In 2007, CLG began a review of housing finance taking into account:

- costs and standards for social housing
- rents and service charges
- rules governing the HRA and capital
- mechanisms for delivering funding

The reviews findings uncovered the following problems with the existing system:

- the fairness of the system depends on the accuracy of assumptions which is difficult to calculate nationally;
- over time, the balance of deficit and surplus authorities has changed. Whilst the system is roughly in balance nationally, three quarters of councils pay notional surpluses into the system (including Charnwood), with only a quarter receiving subsidy;
- medium and long term planning is difficult as subsidy allowances are set annually,
- the system is hard to understand and complex, particularly rents;
- local responsibility and accountability is weak as it is run nationally.

## **The Consultation**

The consultation document is available at:

<http://www.communities.gov.uk/publications/housing/councilhousingconsultation>

## **Summary of the proposals**

### **Costs and standards of council housing in the future**

Housing Subsidy includes allowances for Management, Maintenance and the Major Repairs Allowance.

The consultation paper recognises that the council housing functions are not fully funded through the current subsidy system. Both Management and Maintenance costs are under funded by around 5% nationally although more work is required to understand how this is distributed at a local level. The Major Repairs Allowance, which funds capital works towards the Decent Homes standard, is under funded by 24%.

The review acknowledges around 40% of management costs are now funding “non-core services” such as services to deal with antisocial behaviour. The consultation paper takes the view that core services should be funded from the HRA, as well as any services which are developed to meet the standard required by the new Regulator for affordable housing, the Tenants Services Authority (TSA). The general test of the HRA should be “Who benefits?” and if the answer is tenants, then the costs should fall to the HRA. If the service benefits others, then the costs should be divided proportionately, in the General Fund.

## **Standards**

The consultation paper acknowledges that the Decent Homes standard was a minimum standard, and the government is committed to delivering it. However, it did not include some important essential elements, and funding should be provided for these, e.g. lifts and common areas.

Improving energy performance remains important and the review suggests that improvements could be better delivered by local authorities in control of their budgets, when their own cost efficiencies will enable them to divert funds to these priorities.

The consultation paper acknowledges that there is no express provision or encouragement for local authorities to establish sinking funds to smooth the costs of major repairs for leaseholders and proposes to make this easier.

## **Options for fundamental reform of the system**

Two options were considered:

### Improvements to the current system

These are dismissed in the consultation due to it causing the criticisms of the current national system to be continued into the future. Three to five year subsidy settlements still carry the risk of being unpredictable.

### A devolved system of self financing (preferred option of CLG)

Self-financing means that the Council would keep the money raised locally from rents and use it to run the stock.

Its aims are that:

- 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 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

However, the proposals involve a one-off reallocation of housing debt allocated to councils on the basis of their ability to service it. The opening debt level would be one based on the tenant market value of the stock, a method of valuing housing stock by valuing the associated future income and expenditure needs.

The overall effect is designed to be fiscally neutral although at the local council level, it could mean either more or less resource. The value of the landlord business would be based on the present value of the cash flows in the business excluding

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.

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 level of 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 interest on the new borrowing is above or below the CRI.

There are complexities in settling debt for each local authority, including such things as the requirement to pay a premium for the early settlement of debt, for example. This means that the changes to the Housing Revenue Account system would have an impact on the General Fund.

There could be extra debt management expenses incurred in borrowing and managing additional amounts of debt, particularly in councils which are currently debt free such as Charnwood. It is CLG's intention to identify any additional costs that would fall on the HRA or the General Fund as a result of the debt reallocation and to provide a settlement that funds these.

Borrowing under self financing would be easier, as borrowing currently is limited by achieving better surpluses than the notional surplus in the HRA. If local authorities obtain more freedom, through self financing, CLG is keen to limit the level of unrestrained borrowing. CLG is therefore considering how to limit the level of borrowing under the proposed new system using Prudential Borrowing.

The consultation paper also considers whether under the new financing system, councils should be allowed to retain 100% of their capital receipts. If councils take on responsibility for supporting housing debt generally, then they should also be allowed to retain their capital receipts. It is proposed that 75% of the capital receipt should be reinvested in housing. The aim in particular is for councils to be able to meet the demand for Disabled Facilities in council housing through the 75% HRA capital receipt, and for the 25% Housing General Fund receipt to support the expenditure required for Disabled Facilities Grants in private housing.

#### Self-financing ALMO policy

Under these proposals, ALMOs will continue to be supported. With self-financing, local authorities should have the financial flexibility and resources to plan ahead. Once ALMOs have completed their Decent Homes programme, it is possible they could engage in a wider range of activities and secure funding from external sources to increase investment levels, including the management of stock of other social landlords.

## Charnwood Borough Council's response to the consultation

Charnwood Borough Council welcomes this opportunity to comment on the proposals to reform council house finance.

We welcome the recognition that a 5% increase in management and maintenance allowances is required at a national level. We hope that this means that these allowances will increase at local authority levels by this proportion to help fund our work, particularly as housing subsidy operates at a surplus on the national level. Pending the implementation dates for this review of the HRA, we request that these increases are taken into account in the forthcoming 2010/11 subsidy determination.

The review suggests that a number of items are included in the major repairs allowance (maintenance of lifts etc) that were previously excluded and that the Major Repairs Allowance should be uplifted by 24% at a national level. There is, however, still no provision for disabled adaptations within this uplift nor for common areas. Pending the implementation dates for this review of the HRA, we request that these increases are taken into account in the forthcoming 2010/11 subsidy determination. However, this uplift was originally reported as being 40%, what has reduced this assumption?

The review indicates that backlogs for repairs will continue after the 2010 decent homes timescale and that these could be covered by capital grant. These are governed by rules that are potentially less flexible than if they were funded via Supported Capital Expenditure.

In response to the specific questions raised by the review:-

### Core and non-core services

1. *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 in paragraph 3.28?*

*[3.28 States: 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]*

The continuation of the ring-fence for the HRA is agreed. This will prevent cross-subsidisation of the general fund/HRA and the proposals relating to answering the question “Who benefits?” should strengthen the ring fence. However, the actual implications on the two funds very much depends on the precise definitions once these are published.

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

This is dependant on the final guidance once this is published. With regards to services to be split between the General Fund and the HRA, will the methodology for the split be at the discretion of individual local authorities to judge how much should be apportioned in each area? This is of particular relevance when considering the costs of services such as anti-social behaviour prevention expenditure where all sections of the community would benefit.

### Standards and funding

3. *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)?*

Charnwood Borough Council has an ALMO that is awaiting inspection before it can draw down on the Decent Homes funding once it is awarded two stars. Providing the Decent Homes funding will still be available in full alongside any additional funding relating to amendments to the definition of the Decent Homes Standard, the additional funding for the ongoing maintenance of lifts and common parts is welcomed.

4. *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?*

The increase in the Decent Homes is welcomed, particularly as it appears to be matched with funding although at present, this would only be sustainable if the proposed new funding is both straightforward to administer and ongoing. It

would be appreciated if the capital grant funding included the flexibility to bring forward unspent grant between financial periods.

### Leaseholders

5. *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?*

Charnwood recharge leaseholders for the actual costs of repairs and maintenance for their properties. Estimates of expenditure are billed with adjustments based on that year's Certified Summary of actual expenditure. This is in accordance with the leases that were sold to the tenants under RTB.

A sinking fund could prove unpopular with leaseholders if there is no longer a direct correlation between the monies they pay the council and the work carried out to their specific flat, block or neighbourhood. There would also be problems if the fund did not generate sufficient money and further top up requests were required to cover its costs.

The downside to the current system at Charnwood is that to operate the service, it is a costly and time consuming use of staff for approximately 300 properties compared with 5,800 HRA dwellings.

The council is aware of other local authorities with HRAs which recharge using sinking funds. If reforms are needed to implement sinking funds, do those currently break the HRA rules?

The proposal to add the estimated costs of repairs into a sinking fund could make the sales of these properties more difficult for leaseholders, although it would create greater transparency on what liabilities new leaseholders will face and that they have provided for that cost within the purchase.

### Debt

6. *We propose calculating opening debt in accordance with the principles set out in paragraphs 4.22- 4.25. What circumstances could lead to this level of debt not being supportable from the landlord business at the national level?*

Paragraphs 4.22 – 4.25 read: -

*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.*

*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.*

*It has been suggested that the valuation of the stock could include current housing debt, rather than excluding it. Rather than producing a value to which current debt is adjusted, this would then be a sum which is added to, or, in a negative valuation, subtracted from, the current debt. It is suggested that this could better capture the higher cost of redeeming debt at higher interest rates.*

The inclusion of the debt element to the reforms replicates the current system where councils in Negative Subsidy help fund the debt charges for authorities with large historic debt. Charnwood is debt-free and in 2009/10 will pay £7,791,400 Negative Housing Subsidy. Under the proposals, the council could be required to take on debts from other councils and fund these from rents over an indefinite future period. Unless we agree to this as part of the consensus, it could be imposed on us anyway under primary legislation.

Charnwood's debt would be based on the present value of the cash flows in the business excluding any existing housing debt. The business plans for different authorities could include variances in terms of assumptions and the quality of the stock condition surveys which feed into the data. What reassurances are available that the assumptions on the need to spend in each

authorities business plan is on a comparable footing with each other?

The review assumes that the increase in capital expenditure is 24%. It is not clear what would happen if the sum of the business plans exceeds this amount and additional resources are not available.

The adoption of a 30 year business plan for the settlement of a one-off debt calculation will incur a number of assumptions which will need to be rigorously modelled and comparable with other authorities assumptions with whom, under these proposals we will share their debt. This has been very difficult to date to estimate, with changes to interest rates at a macro-economic level, coupled with the regular alterations to housing subsidy determinations and rent settings by CLG. Until details of the calculation of the net present value and the discount rate to be used are available, it is difficult to commit to a definite view on this proposal.

7. *Are there particular circumstances that could affect this conclusion about the broad level of debt at the district level?*

Charnwood is debt-free and in 2009/10 will pay £7,791,400 Negative Housing Subsidy. Under the proposals, the council could be required to take on debts from other councils and fund these from rents over an indefinite future period. The subsidy capital financing requirement for Charnwood is £6,027,049. There is a potential that this could be higher than the negative subsidy. Until the council is in a position to be able to calculate the present value of cash flows in accordance with the amended rules, it is difficult to establish whether these changes to the methodology will be beneficial or not.

The NPV approach will rely on a number of assumptions. If these prove inaccurate over time, it will be very difficult to manage the Housing Revenue Account, especially as under existing legislation it is unlawful to have a negative balance and government help would be necessary. The reform proposals include the mechanism to recalculate the debt calculation. This could potentially lead to a two-tier HRA unless the debt is recalculated to all, and would add an extra level of complexity to the system. These powers should be restricted to dealing with severe problems associated when any fundamental errors in the initial calculations.

8. *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?*

For Charnwood, the opening debt calculation will need to reflect the £1,919,922 that the council is due to receive between 2009/10 and 2013/14 in housing subsidy in compensation for the costs it incurred when redeeming its

debt when it became debt free.

9. *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?*

We welcome the commitment to ensure there is no net impact on the General Fund and that there is more work needed in this area. If the additional expenditure on Decent Homes was met from assumed increases in rents in the future, the NPV for the council would be increased.

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

The freedoms and flexibilities offered by self-financing include using efficiency gains for 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.

11. *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?*

Value for money efficiencies could be used to be reinvested in service improvements.

#### Capital receipts

12. *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)?*

Since the £24,000 discount cap was introduced, coupled with the current economic climate making mortgages difficult to obtain, the level of RTBs have fallen significantly for the council and this source of funding would have been diminished a source of income had it not already been pooled.

As the reforms require a direct responsibility for supporting the debt on the

operating assets, the council should be able to keep any capital receipts arising on disposal of those assets.

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

The proposal is to devolve the capital receipts to local government. It would be preferred if the responsibility for how this resource was utilised (between new supply and existing dwellings) is retained at a local policy level rather than national.

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

We would prefer these spending decisions to be at a local level (as per the answer to question 13).

#### Equality impact assessment

15. *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?*

In general it is very difficult to assess whether these reforms have a disproportionate impact on any particular group of people. However, the reform proposals include that disabled adaptations for the HRA be funded by the receipts from RTBs. This means that the level of resource available at a local level for adaptations is dependant on the (completely unrelated) level of demand for RTBs in that area.

Local authority investment improvements to flats means that the leaseholders of RTB properties face rising bills for major works for improvements. Anecdotally at Charnwood Borough Council, a sizable proportion of leaseholders are elderly with increasing levels of disability having purchased their flats after being residents after many years of being a tenant, often with the support of spouses. They face rising costs on often limited pensions and it could prove harder to sell their properties due to purchasers fears for future bills. The lack of proposals offering support to this group of leaseholders could lead them to face more disadvantaged than other groups.

16. *What would be the direction (positive or negative) and scale of these effects and what evidence is there to support this assessment?*

There are approximately 300 leaseholders at Charnwood Borough Council. We have not undertaken equality profiling of the leaseholders which anecdotally make up around half of the flats. More profiling would be needed at the council level to establish the make up of the leaseholders and their access to income in order to fund major work improvements in accordance with both their lease and a move towards a sinking fund policy.

17. *What would be necessary to assemble the evidence required?*

Work on profiling leaseholders would need to be done at a council level and would typically involve questionnaires and tenant liaison officers together with the cooperation of the Leaseholder Forum.

In addition to these proposed responses to the questions raised in the Consultation, the Council would also wish to state that the responsibility for setting rents should also be passed to the Local Authorities as otherwise the HRA will be responsible for all aspects of its income and expenditure except for the major income source being the actual rental income. With this still being subject to central government it would make long term planning difficult and not reflect the realities in each of the localities involved.

Financial Implications

There will be financial implications to the proposed changes to the Housing Revenue Account, although these are not quantifiable at present and are flagged up in the council's response to the consultation. There are no implications in replying to the consultation document itself.

Risk Management

There are no discernable risks arising from replying to the consultation in this report.

Key Decision: No

Background Papers: Reform of council house finance Consultation  
(available at:  
[www.communities.gov.uk/publications/housing/councilhousingconsultation](http://www.communities.gov.uk/publications/housing/councilhousingconsultation))

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