

Briefing Paper

Council Housing: A Real Future

April 2010

1. Introduction

- 1.1 Communities & Local Government published a prospectus 'Council Housing: A Real Future' on 25th March 2010. This paper contains the government's detailed proposals for the introduction of self-financing to the Housing Revenue Account.

2. Council Housing: A Real Future

2.1 Introduction

- 2.1.1 This prospectus follows the 2008 review of the future of the financing of council housing and the government's consultation paper of July 2009. The review of council housing aimed to find a long-term, sustainable system for funding council housing that would be fair to both tenant and taxpayer and fit with wider housing policy. Adrian Waite was one of the people who were invited by Communities & Local Government to sit on the working party that considered future mechanisms for funding the Housing Revenue Account.
- 2.1.2 The consultation sets out proposals for dismantling the current Housing Revenue Account subsidy system and replacing it with a devolved system of funding and responsibility. Externally commissioned research reports are published alongside the prospectus. The government invites views on the proposals for self-financing with a closing date for comments of 6th July 2010.
- 2.1.3 In his foreword to the prospectus, Rt. Hon. John Healey MP, Minister for Housing, states that:

"The far reaching changes set out in this prospectus will bring council housing funding up to date – replacing a system which was introduced before the Second World War and has operated in its current form since 1989.

"My plan will give councils the freedom to fund and run their council houses, without annual government decisions over subsidy. It will release at least 10% more money in every council for maintaining and managing their homes. And it will create the funding capacity to build over 10,000 new council homes a year. Above all, it will mean tenants getting better homes and better housing services from their council.

"Under the new self-financing system, councils will keep all of the rent they collect from their homes and all the receipts from any sales of housing or land.

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Not a single penny will subsidise other councils, as the current Housing Revenue Account system dictates. In return, councils will accept a share of the overall £25billion debt, though no council will take an allocation of debt which is not sustainable for the long-term.

“This is a once and for all settlement between central and local government.”

2.2 The Vision for Self-Financing

- 2.2.1 The basic proposal for self-financing is as envisaged in the July 2009 consultation paper which is that the housing subsidy system will come to an end on a national basis. At the same time, local authorities would have the level of their housing revenue account debt re-established at a level that would be calculated to be affordable given certain assumptions about future rent and expenditure levels. This calculation would exclude expenditure required to achieve the decent homes standard or to meet any backlog of investment as this would be funded through a separate stream of capital grants.
- 2.2.2 The prospectus recognises that £3.2billion of works is still needed to meet the Decent Homes Standard. However, it states that meeting this investment need will be a central element of its deliberations on investment priorities at the next spending review. The prospectus makes no mention of the cost of the backlog of works that was estimated to be about £6billion in the 2009 consultation paper and neither does it provide information on how the government envisages managing the capital grants process.
- 2.2.3 It could be expected that the government would publish a definition of the decent homes and backlog works that it would be prepared to fund through capital grants and would invite local authorities to make applications for capital grants through a similar process to that which was used to apply for ALMO funding. The total size of local government's bid for capital grants would therefore not be known until after all stock holding local authorities had carried out stock condition surveys and made their bids. At the same time, Communities & Local Government would have to bid for resources to fund capital grants as part of the Comprehensive Spending Review 2010 process. The extent to which Communities & Local Government could afford to provide capital grants to meet investment needs would therefore not become clear at least until after the completion of the Comprehensive Spending Review 2010.
- 2.2.4 The prospectus states, however, that for local authorities with ALMOs, funding would be on the basis of the agreed ALMO funding and a continuation of the level of funding presently provided for Supported Capital Expenditure for the planned life of the ALMO programme.

- 2.2.5 The government is proposing to include in the self-financing settlement some headroom to enable councils, after they have met the spending needs of their existing stock, to deliver a substantial new build programme. Under this proposal, government would use a 7% discount rate in calculating the tenanted market value, rather than the 6.5% discount rate typically used in housing transfer. They calculate that this would reduce tenanted market value by £1.2billion that should enable councils to deliver 10,000 new homes each year from the end of the next Parliament. The government wants local authorities to set out their ability and willingness to use this headroom to deliver new housing so that they can decide whether this is an efficient way to deliver this extra funding. The process through which local authorities are expected to demonstrate this is not clear although it may be assumed that this would be done prior to the debt settlement for self-financing being finalised.
- 2.2.6 The government suggests that there may be a need for capacity building in local authorities in the following areas. However, they suggest that local authorities whose stock is managed by ALMOs should be especially well placed to take forward these reforms:
- Business Planning
 - Asset Management
 - Managing a Loan Portfolio
 - Procurement
 - New Build
- 2.2.7 The government has identified two main options for the treatment of Private Finance Initiative schemes under self-financing. Where the contract has been signed at the date of the self-financing settlement it is proposed to include Private Finance Initiative costs in the calculation of the self-financing settlement. Where the contract has not been signed it is proposed to continue to pay Private Finance Initiative subsidy.

2.3 The Self-Financing Settlement

- 2.3.1 Communities & Local Government have published their calculations of how much debt they would expect each local authority to assume responsibility for alongside the prospectus. However, they make clear that the key assumptions about rents, discount rates and timing of implementation will be subject to confirmation at the next Spending Review.
- 2.3.2 The assumption on rents is that convergence will take place in 2015/16 and that this would require real annual increases in rents of 2.2% in 2011 and 2.1% in each of the following four years. Under self-financing, adherence to rent policy would be secured through the continuation of rent rebate subsidy limitation and regulation by the Tenant Services Authority. New Council homes that have been built outside the housing revenue account would be excluded from the self-financing valuation.

- 2.3.3 It is proposed to increase the Major Repairs Allowance by 27% on average and Management and Maintenance allowances by 11%. However, for individual local authorities the increases range from 0% (Bolsover District Council) to 13.3% (City of London Corporation) for management and maintenance and 4.7% (City of London Corporation) to 50.3% (South Cambridgeshire District Council and South Holland District Council) for major repairs. Taken together the increase in allowances ranges from 6.1% (Blackpool Borough Council) to 15.4% (South Cambridgeshire District Council). It is understood that these increases relate to management and maintenance allowance targets rather than actual allowances.
- 2.3.4 However, the government proposes to implement a 'collar' that would ensure that all local authorities get a minimum 10% aggregate uplift in their combined allowances. The net present value of this 'collar' would be around £50million at a 7% discount rate. This cost will be considered as part of the next Spending Review alongside evidence of councils' willingness to use this extra capacity to build new homes.
- 2.3.5 Many local authorities have raised other spending pressures on housing including adaptations for disabled local authority tenants, asbestos removal and the Housing health & safety rating system. The government states that these spending pressures will be considered as part of the next Spending Review.
- 2.3.6 The proposal to allow local authorities to retain all their capital receipts represents a transfer of funds from central to local government and so would reduce the resources available for centrally funded housing programmes. A proportion of local authority expenditure that is currently supported by capital grant would instead be financed by a local authority's own housing receipts.
- 2.3.7 Debt would be allocated based on the Subsidy Capital Financing Requirement rather than the actual level of debt.
- 2.3.8 The government sees merit in a clearer separation of housing revenue account debt and other local authority debt that would limit the impact that business decisions in one area have on the other. They are therefore attracted to a full separation of loans and would like to work with the Chartered Institute of Public Finance & Accountancy and the Audit Commission to ensure that a suitable framework could be put in place.
- 2.3.9 The consultation paper confirms that proposed housing stock transfers that are already in the programme as identified in the statement of the Housing Minister of 16th December 2009, should proceed to completion on terms agreed with the Homes & Communities Agency, subject to tenants approving the change in ownership.

- 2.3.10 For other transfer proposals prior to the implementation of self-financing, the government will require the transfer valuation to be based on the self-financing settlement value. The government would continue to write-off 'overhanging debt' but would not provide funding for negative value transfers. This implies that stock transfers will not be able to proceed on the basis of a higher standard of investment than is envisaged in the self-financing model. Furthermore, the self financing model takes no account of the need to invest to address any backlog of works or to achieve the decent homes programme; and does not take account of additional costs that are faced by stock transfer housing associations such a value added tax.
- 2.3.11 After the introduction of self-financing, no government financial support would be made available to clear debt or to provide grant support through gap funding, other than any grant support that the Homes & Communities Agency might provide for Estate Regeneration or New Supply.
- 2.3.12 These proposals would appear to remove any incentive for tenants to agree to a stock transfer and to effectively bring the stock transfer programme to an end.

2.4 Financial, Accounting and Regulatory Framework

- 2.4.1 The prospectus raises a range of technical financial, accounting and regulatory matters including:
- Housing Balance Sheet
 - Unpooling Housing Debt
 - Depreciation and Debt Repayment
 - Borrowing by Self-Financing Landlords
 - Arms Length Management Organisations
 - Transfer Policy before introduction of Self-Financing
 - Housing Transfer under Self-Financing
 - Housing Revenue Account and the Ring Fence
 - Managing Performance and Risk
 - Leaseholders
- 2.4.2 The government proposes that all council landlords should maintain a council housing balance sheet.
- 2.4.3 The government sees merit in a clearer separation between housing revenue account debt and other local authority debt which would limit the impact business decisions in one area have on the other. This would also provide the opportunity to eliminate complexities in the existing rules for calculating the housing revenue account's share of debt charges and leave a more robust system that would be less vulnerable to significant changes in the economy. The government is therefore attracted to a full separation of loans.

2.4.4 One of the challenges for the government in developing these proposals has been to find a mechanism that encourages local authorities to fund ongoing major repairs from revenue and to limit their borrowing. In the prospectus these matters are addressed through the proposals on depreciation, debt repayment and borrowing. The prospectus states that:

“Control over public sector borrowing is a high priority for government. In implementing self-financing, we will need to retain tight control over the contribution housing makes to overall levels of public sector borrowing.”

2.4.5 The government proposes an approach to depreciation that would be based on accounting and financial principles and rooted in prudent local management. It would be for local authorities to balance investment in major repairs and repayment of council housing debt. Local authorities would have a long-term incentive to reduce debt, but no obligation to do so.

2.4.6 It is suggested that in setting the right provision for depreciation and debt repayment, local authorities should take account of evidence about investment needs. It would be for each local authority to satisfy itself that its approach to depreciation and debt repayment meets the requirements of the accounting code. Depreciation and debt repayment should be a core part of business planning and asset management. This approach should ensure that a backlog of capital works does not build up in future and that, if there is an identifiable need for higher levels of capital spending at a later point in the thirty year business plan, provision is made for this.

2.4.7 There are a number of constraints over the amount of new prudential borrowing that self-financing local authorities might undertake:

- The new debt allocated in the self-financing settlement will restrict the amount of income available for prudential borrowing
- Local authorities will need to satisfy their Chief Finance Officer that extra borrowing for housing is affordable within the prudential borrowing rules
- The Housing Revenue Account ring fence will continue under self-financing. This ensures that borrowing for housing revenue account assets is charged to the housing revenue account and that housing revenue account income can only be used to finance borrowing for housing purposes.
- The amount of income that local authorities can raise to support borrowing will be limited by social rent policy. Subject to consultation, the government intends to direct the Tenant Services Authority to set a regulatory standard that reflects the policy.
- In addition, government is proposing a cap on borrowing at the self-financing debt level.

2.4.8 The government expects councils to test the opening debt figure proposed under self financing in a local business plan that reflects local information about actual income and spending needs and borrowing costs. A number of factors will have an effect on the borrowing profile in these individual business plans, including:

- Interest rates on existing and new debt
- Investment needs and the timing of this spend

- Difference between current actual housing debt held by a council and the level of debt supported by the subsidy system
- Capital receipts and any housing revenue account reserves that can be used to supplement the revenue in the business plans

2.4.9 The government expects that, as the research undertaken by the Building Research Establishment showed that most major repairs costs fall in the later years of business plans, local authorities should be able to significantly reduce the borrowing needed in the early years relative to the notional business plan generated by the self-financing model. The government believes that most councils should be able to pay off debt from the first year of self-financing creating an amount of borrowing 'headroom' up to the opening level of debt that could be used to fund new supply. The prospectus states:

"We want local authorities to use this extra capacity to build new homes. In responding to this proposal, we would like all local authorities to indicate what size of new supply programme they could deliver at a valuation based on a 7% discount rate. In light of these responses, we will consider whether this is an efficient way to deliver this extra funding for housing."

2.4.10 The prospectus makes the following reference to arms length management organisations:

"The Government sees a strong future for ALMOs. The governance and accountability in the ALMO model should make them well placed to take advantage of the flexibilities that self-financing would provide."

"The Government will ensure that all ALMOs who have yet to complete their Decent Homes investment programme will be able to do so with the right level of funding support."

2.4.11 As expected, the prospectus proposes a clearer definition of the housing revenue account ring fence and includes a draft revised circular. The draft circular is based on the following key principles:

- 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 housing revenue account and the general fund.
- Housing services that a landlord is required to provide through statutory obligations or by the Tenant Services Authority should be paid through the housing revenue account
- Some defined services should be paid for from the general fund (e.g. housing advisory services, a proportion of the administration of a common housing register and other strategic housing functions).

2.4.12 Over time it is proposed that non-core services should be regarded as services provided by the landlord but funded from sources other than rent. Non-core services include:

- Administration of a common housing register – costs should be split between the housing revenue account and the general fund

- Maintenance of tenant gardens – unless a separate charge is made for the service
- Street Lighting
- Dog Wardens
- Personal Care Services
- Homelessness Administration
- Housing Advisory Services

2.5 Implementing Reform

2.2.1 If there is agreement, government proposes to work towards voluntary implementation from 2011/12, subject to confirmation at the next Spending Review. Alternatively, they will seek to implement self-financing through new primary legislation. Subject to parliamentary time, this could be as early as 2012/13.

2.6 Consultation Questions

2.6.1 The specific consultation questions are as follows:

- What are your views on the proposed methodology for assessing income and spending needs under self-financing and for valuing each council's business?
- What are your views on the proposals for the financial, regulatory and accounting framework for self-financing?
- How much new supply could this settlement enable you to deliver, if combined with social housing grant?
- Do you favour a self-financing system for council housing or the continuation of a nationally redistributive subsidy system?
- Would you wish to proceed to early voluntary implementation of self-financing on the basis of the methodology and principles proposed in this document?
- Would you be ready to implement self-financing in 2011/12? If not, how much time do you think is required to prepare for implementation?
- If you favour self-financing but do not wish to proceed on the basis of the proposals in this document, what are the reasons?

3. Modelling Business Plans for Council Landlords

3.1 Alongside the prospectus, the government has published a paper that outlines how it proposes to calculate the tenanted market value for each local authority that will form the basis for the redistribution of debt.

- 3.2 The current “national housing debt” on which subsidy is paid comprises two elements. The Subsidy Capital Financing Requirement for each council and, for those councils in the early rounds of Arms Length Management Organisation funding, the debts incurred under the Arms Length Management Organisation programme which are held separately from the Subsidy Capital Financing Requirement. In the 2010/11 housing subsidy determination the combined mid-year Subsidy Capital Financing Requirement of all councils totals £19.201 billion. The total (rounds 1 and 2) Arms Length Management Organisation debt is calculated as £1.855 billion, giving a total debt of £21.056 billion. The estimated total debt in the subsidy calculation at the end of 2010/11 is therefore £21.485 billion.
- 3.3 The following table shows the calculation of the Net Present Value of the projected net income stream over thirty years at a 6.5% annual discount rate. The impact on the Net Present Value calculation of excluding or including the Private Finance Initiative allowance projections is also shown in the table:

Scenario	Valuation
Base (rents less revised M&M and MRA allowances)	£27.68 billion
Base plus PFI schemes signed prior to April 2011	£26.35 billion

- 3.4 The current level of debt assumed is:
- | | |
|----------------------------|----------------|
| 2010/11 SCFR and ALMO debt | £21.49 billion |
|----------------------------|----------------|
- 3.5 The government’s proposals therefore result in an increased level of housing revenue account debt across England of £4.86 billion. However, the proposal to increase the discount rate to 7% would reduce the level of housing revenue account debt with self-financing to £25.15billion and the increase in debt would be £3.66billion.

4. Reaction to the Consultation Paper

- 4.1 Local Authorities and the Social Housing sector have broadly welcomed the consultation paper. For example, the Chartered Institute of Housing said:

“The Chartered Institute of Housing welcomes the proposal to dismantle the outdated and unfit-for-purpose Housing Revenue Account subsidy system. We have worked closely with many authorities, with other agencies and government over many years to advance proposals to this point and believe that the moment has come to make this vital reform. The move is consistent with the aspirations of tenants, the need for greater efficiency in the use of resources and the move to cross-domain regulation from the Tenant Services Authority with its emphasis on more local control, more local offers and active tenant empowerment in planning and decision-making. It is also an essential reform towards achieving the government objective of building more council homes.”

“The Chartered Institute of Housing further recognises that in the tight fiscal climate, the government may feel it has no choice but to restrict capital investment through capital grants and also through borrowing. This is understandable but also represents a challenge. We want to work actively with government and stakeholders across the sector to enable investment to be undertaken to complete the decent homes programme, address other backlogs of improvements works, to regenerate those areas in need of investment and to develop a long-term role for new council housing to meet new housing needs.”

- 4.2 Disappointment has been expressed in some circles about the proposal to introduce borrowing limits. For example, the Chartered Institute of Public Finance and Accountancy said:

“There is some disappointment that the consultation document proposes placing capital limits on councils. CIPFA does not support capital limits and believes that the introduction of the Prudential Code has consistently proved – since its introduction in 2004 – that local authorities can and do act responsibly when borrowing. Re-introducing an element of capital control seems to indicate that the substantial strengths of the Prudential Code have been overlooked.”

- 4.3 All major political parties support self-financing in principle.

5. Responding to the Consultation Paper

- 5.1 The Chartered Institute of Public Finance & Accountancy has identified a number of issues for local authorities to consider:
- Robustness of existing business plans
 - Opening debt and the viability of the thirty year business plan
 - Stock Condition Survey – how up to date is it?
 - Treasury management issues regarding the taking on or paying off of debt and Housing Revenue Account debt separation
 - Any unique circumstances for your authority
 - The calculation of the offer, how relevant is this to reality of spending needs
 - How will you use 100% of any capital receipts?
 - Backlog repairs/disabled adaptations funding – what is the potential shortfall?
 - Accounting for depreciation and Minimum Repayment Provision – what will the impact be?
 - What are the sensitivities in the business plan under self financing and how are they to be managed?
 - The headroom for new build, how many units are possible and what level of Social Housing Grant is required?
 - Skills analysis and gaps to manage under self financing

- 5.2 The Chartered Institute of Housing advises that the overwhelming need is for local authorities to model the impact of the proposed settlement into their housing revenue account business plans, removing the line of housing revenue account subsidy and incorporating a longer-term plan to meet capital needs. They advise that key sensitivities and scenarios will need to be developed to model the future, including:
- The progress to rent restructuring (and implication of caps and limits adjustments)
 - The investment needed in management and maintenance service costs in the context of the Tenant Services Authority's standards framework
 - Inflation and interest rate sensitivities
 - Scenarios around the volume and use of Right to Buy receipts
 - The application of different standards for stock improvement and investment
 - Whether debt is paid down and re-borrowed or whether the plan is 'interest only'
 - Property acquisitions and disposals
 - The long-term scope for asset management and asset replacement.

6. Conclusions

- 6.1 The government has published its prospectus for the self-financing of council housing.
- 6.2 While the prospectus makes local authorities a clear offer on the 'revenue' side in the form of the ending of housing revenue account subsidy and the redistribution of housing revenue account debt it does not make a clear offer on the 'capital' side. Assurances are given that capital grants would be provided to achieve decent homes at a similar level to existing arms length management organisation funding but no details are given and the whole process is dependent on the next Comprehensive Spending Review.
- 6.3 The government is expecting self-financing local authorities to deliver 10,000 new units of council housing each year and calculates that this will be possible as a result of them reducing tenanted market value by increasing the discount rate to 7%. They are looking for councils to respond to this as part of the consultation on the prospectus.
- 6.4 The calculation of tenanted market value is based on the assumption that rent convergence will take place in 2015/16. It also assumes increased levels of management, maintenance and major repairs allowances. The level of increase varies between 6.1% and 15.4% between different authorities. However, government has decided to operate a 'collar' and to provide all authorities with a minimum increase in allowances of 10%.
- 6.5 The government has identified a need to control local authority borrowing in the housing revenue account and proposes that an additional control be put in place to prevent authorities raising the level of their housing revenue account debt above the initial level established with self-financing.

- 6.6 Nationally, indebtedness in the housing revenue account would increase from £21.5billion to £25.2billion. The government would also like to see a separation of housing revenue account and general fund debt.
- 6.7 It is proposed that any future stock transfers, other than those that are already on the agreed programme, would take place on the basis of the same tenanted market value that would be used in self-financing. This would effectively remove any incentive to do a stock transfer and could bring the stock transfer programme to an end.
- 6.8 The prospectus also proposes greater clarity around the operation of the housing revenue account ring fence that is likely to result in costs being moved from the housing revenue account to the general fund.
- 6.9 The government proposes to introduce the new system voluntarily in 2011/12 or to do so by legislation in 2012/13 if agreement is not forthcoming.
- 6.10 The prospectus includes a list of specific consultation questions to which the government would like responses by 6th July 2010.
- 6.11 Local Authorities and the Social Housing sector have broadly welcomed the proposals although some misgivings have been expressed. There are a range of issues for local authorities to consider during the consultation period and in the lead up to the implementation of self-financing.
- 6.12 The Chartered Institute of Public Finance and Accountancy and the Chartered Institute of Housing have identified a number of issues that they have advised local authorities to address.

7. AWICS Actions

- 7.1 AWICS is already working with local authority clients in preparing responses to the consultation paper and preparing for the introduction of self-financing itself including preparing self-financing business plans. For further information on how AWICS can support local authorities in this way please contact Adrian Waite at Adrian.waite@awics.co.uk or 017683-52165 or 52347.
- 7.2 Each year AWICS holds a series of seminars on 'Developments in Local Authority Housing Finance in England' that are becoming increasingly popular. The 2010 series starts in London on 7th July 2010 and is followed by sessions in Coventry and Leeds. This year these seminars will focus on the government's proposals for self-financing (which enjoy cross-party support) and the implications of the general election – when this is known! These seminars are also available as in-house courses. For more information on 'Developments in Local Authority Housing Finance in England 2010' please visit our website at http://www.awics.co.uk/RegionalSeminars/ViewCourse/developments_in_local_authority_housing_finance_in_england_10/ or contact Adrian Waite at Adrian.waite@awics.co.uk or 017683-52165 or 52347.

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