

## Briefing Paper

# Local Authority Housing Finance in Wales

July 2009

### Introduction

This briefing paper summarises the operation of the local authority housing finance system in Wales with an emphasis on how it differs from the system that applies in England.

Housing is a devolved responsibility of the National Assembly for Wales, which has secondary legislative powers and controls the overall budget for most public services in Wales. Responsibility for primary legislation rests with Westminster.

The current governing primary legislation is the same as in England, but much of the secondary legislation is now different from England.

Welsh Housing Policy is based on the National Housing Strategy and on 'One Wales' – the programme agreed by the new Welsh Assembly coalition Government in 2007.

### Statutory Housing Function

A Local Housing Strategy planning regime has been introduced in Wales. There are three key components:

- The Local Housing Strategy. This is a locally agreed, long-term 'housing vision' with clear objectives and target outcomes consistent with the local authority's Community Strategy, produced on a five-year cycle beginning in April 2004;
- The Local Authority Housing Operational Plan. This is an annually prepared planning and review document containing interim targets and actions for achieving the strategic housing aims;
- The Local Authority Housing Stock Business Plan. This is an annually prepared 30-year plan covering the management, maintenance and investment needs of the council's housing stock, from April 2003.

### National Housing Strategy: Better Homes for People in Wales

The Welsh Assembly Government believes it is reasonable to expect everyone to be able to live in a safe, warm and affordable home. The housing community in Wales has forged a common view with colleagues in planning, health and economic development on the main housing challenges facing Wales if this expectation is to be fulfilled.

There is broad consensus on the housing problems faced in Wales:

- The supply of good quality housing is so limited that until 2008 house prices increased by £2,000 per month;
- Nearly 1 in 10 people live in homes that are not fit for human habitation; and
- Social housing is so scarce that every 6 minutes someone presents themselves as homeless.

The cost to Wales of poor quality housing is difficult to establish but poor housing contributes to:

- Poor health;
- Low educational attainment levels;
- Lower levels of satisfaction with the local environment;
- Increased fear of crime; and
- Low community self confidence.

In July 2001 the Welsh Assembly Government published the first national housing strategy for Wales 'Better Homes for People in Wales'. It was drawn up in partnership with the Welsh housing community and centred on the aspiration to deliver safe, warm and affordable homes for all.

Housing policies for Wales are being developed within the strategy framework. 'Better Homes for People in Wales' sets out the National Assembly's vision that 'all households in Wales... shall have the opportunity to live in good quality homes that are:

- In a good state of repair;
- Safe and secure;
- Adequately heated, fuel efficient and well insulated;
- Contain up-to-date kitchens and bathrooms;
- Well managed (for rented housing);
- Located in attractive and safe environments;
- As far as possible suit the specific requirements of the household (eg specific disabilities).'

### **Homelessness**

The National Assembly for Wales has produced a National Homelessness Strategy. The Code of Guidance for Local Authorities on Allocation of Accommodation and Homelessness sets out how local strategies should be developed, taking account of national priorities and objectives. Local authorities' homelessness strategies are updated annually.

Local authorities can apply for 'Leasing Subsidy Limits' to provide temporary accommodation for homeless people. In 2008/09 a total of £7.0million was provided. The authorities receiving the largest allocations were Cardiff (£1.8million), Torfaen (£1.0million), Isle of Anglesey (£0.6million), Pembrokeshire (£0.5million) and Conwy (£0.5million).

### **Private Sector Housing Regeneration**

Significant investment has been made to rejuvenate private sector housing stock in Wales. Previously, the funding was in the form of a mix of Supplementary Credit Approvals (SCAs) and Exchequer Grant. Funding is now made available from within supported borrowing. Funding for strategic housing schemes is also made available through SCAs.

### **Home Loans by Local Authorities**

Local authorities have a discretionary power to offer loans in respect of housing within their areas.

## **Housing Revenue Account**

The Housing Revenue Account is a ring-fenced landlord account, and all expenditure and income relating to authorities' own housing stock is recorded in the Housing Revenue Account.

Welsh Councils prepare an Income and Expenditure Account for the Housing Revenue Account. Most income is from dwelling rents but there is also usually income from non-dwelling rents, service charges, contributions towards expenditure and investment income. The main items of expenditure are usually supervision and management, revenue repairs and maintenance and capital financing costs. Housing subsidy is usually negative.

## **Local Authority Housing Accommodation**

The same types of tenancy apply to council houses in Wales that apply in England.

## **Rent Restructuring**

There is no formal rent restructuring exercise in Wales, although there are various statutory obligations on local authorities to keep their rents under review.

The National Housing Strategy for Wales states that:

*“By setting Housing Revenue Account System guideline rents, we are able to exert significant influence to help ensure a more rational distribution of overall average rent levels across Welsh local authorities.*

*“Actual rents, however, are the responsibility of individual authorities. Underpinning this responsibility, authorities have a legal requirement to charge consistent rents under section 24(3) of the Housing Act 1985 (inserted by section 162 of the Local Government & Housing Act 1989). In simple terms, authorities must ensure a broadly consistent relationship between the rents of all the Council's dwellings and market rents.*

*“Since April 2001 we have been working in partnership with local authorities and registered social landlords to enable them to put in place long-term schemes to periodically review their rent levels, and where major inconsistencies are widespread, to restructure their rent systems.”*

Although the decision to set the rent is taken by the local authority, the framework for housing subsidy set by the United Kingdom Treasury and Welsh Assembly Government (see below) effectively takes the decision away from the Council. This is because the local authority is penalised through the subsidy system if it sets rents that are significantly higher or lower than the guideline rent set by the Welsh Assembly Government. Guideline Rents and Housing Subsidy are considered in more detail below.

Average council house rents in Wales were £58.09 in 2008/09 and increased by 5.4% to £61.23 a week in 2009/10. In 2008/09 there were significant variations in rents between authorities with Cardiff charging £65.28 a week and Blaenau Gwent charging £51.51 a week. Local authority housing rents in Wales are about 7% lower than Housing Association rents.

## **Management and Maintenance Expenditure**

As in England, all repairs and maintenance expenditure is charged against the Housing Revenue Account. There is no limit or allowance on repairs, other than the overall budgetary constraints of maintaining a balanced Housing Revenue Account. The same is true of expenditure on supervision and management.

## **Housing Revenue Account Subsidy**

Housing Revenue Account Subsidy is paid by the National Assembly to local authorities. The key elements are:

- Notional rental income based on the average number of council houses multiplied by guideline rents. The guideline rent for each local authority area is calculated with reference to an economic return based on Right to Buy sale valuations and the costs of management and maintenance
- Interest receivable on cash balances
- A Management and Maintenance Allowance. This was a flat rate of £2,006 per local authority dwelling in 2009/10
- Charges for capital based on historic debt charges
- Other reckonable expenditure

The Major Repairs Allowance is treated as a capital grant in Wales.

Responsibility for setting guideline rents is the responsibility of the Welsh Assembly Government that has devolved responsibility for housing. However the funding arrangements for Council Housing, (the Housing Revenue Account subsidy system) are the responsibility of the United Kingdom Treasury.

## **Guideline Rents**

The Welsh Assembly Government assesses a 'Guideline Rent' for each authority and this along with the number of properties forms the basis of the calculation of the 'Rent Income' figure within the Subsidy Account. This is done by taking the lower of the following:

- Benchmark rent
- A formula based on the guideline rent for the previous year adjusted for variations in property values

The benchmark rent is increased by using a formula introduced in 1990 based on rents increasing by the retail price index plus 1%. It is based on the benchmark rent that has been established for registered social landlords. The guideline rent is increased by a greater proportion than the benchmark rent as it is intended that the two will converge. Where an authority has a guideline rent that is below the benchmark rent, the formula sets the guideline rent at a level that is above the previous year's guideline rent by the equivalent of 6.01% of the difference between the previous year's guideline rent and the total economic cost.

The total economic cost is calculated by adding the management and maintenance allowances to the economic return that is calculated as 6% of the average valuation of right to buy and voluntary sales.

In practice Cardiff, Ceredigion and the Vale of Glamorgan have their guideline rents determined by the Benchmark rent while the other authorities have their guideline rents determined by making the adjustment to the previous year's guideline rent.

There is a variation in guideline rents. In 2009/10 the highest is in Cardiff at £66.53 a week while the lowest is in Merthyr Tydfil at £49.30 a week.

In 2008/09 the average increase in guideline rents was 5.9% with a range of 4.3% to 7.0%. In 2009/10 the average increase in guideline rents was 5.4% with a range of 3.8% to 6.1%.

The Chartered Institute of Public Finance and Accountancy has suggested that a formal policy statement by the Welsh Assembly Government on rent convergence would be welcomed to explain better such high rent increases in certain areas of Wales to Members and Tenants. They also suggest that an allowance made for voids in the calculation of notional income would better reflect the actual rental stream.

### **Capital Financing Costs**

Most of an authority's Capital Financing costs are included in the calculation. With one or two technical exceptions, all of the capital financing charges arising through borrowing up to the Admissible Basic Credit Approval and Supplementary Credit Approvals until 2003/04 received by the authority for Housing Revenue Account purposes and used to finance housing revenue account schemes were included in the Notional Account.

Under the new regime that came into force in April 2004, local authorities can receive an allowance as part of the housing subsidy system that is designed to support borrowing. They may therefore have 'admissible supported borrowing' that will be financed through the capital financing element of housing subsidy, and unsupported borrowing under the 'prudential borrowing' under the prudential borrowing regime that will have to be supported from other resources within the housing revenue account. In 2007/08 and 2008/09 the Isle of Anglesey Council was the only authority to receive admissible supported borrowing. £1million was provided in 2008/09. In 2009/10 a further £1million was provided to the Isle of Anglesey and a further £280,000 to the Vale of Glamorgan.

### **Management and Maintenance Allowances**

The Management and Maintenance allowance per dwelling is the same for all authorities and has been set at the following levels for recent years:

	£/dwelling per year	Increase
2006/07	£1,545	
2007/08	£1,678	+8.6%
2008/09	£1,827	+8.9%
2009/10	£2,006	+9.8%

This represents a significant real increase in the allowances.

Over the last few years management and maintenance allowances have increased on average by 8% to 10% a year in real terms. No information is included within the determinations to explain these increases. It has been suggested that the Welsh Assembly Government should provide the assumptions behind these increases to allow for better budget planning in the medium term.

No attempt is made to reflect different levels of need to spend in different areas in the management and maintenance allowances. It could be considered that numbers of high rise flats, levels of deprivation and sparsity of population could influence the need of authorities to spend on management and maintenance.

It is considered by some that the management and maintenance allowance is the balancing figure in the housing subsidy calculation that allows the Welsh Assembly Government to set the national level of negative subsidy at the level that corresponds to its budgets.

### **Social Housing Management Grant**

Social Housing Management Grant is an annual programme aimed at assisting local authorities, Housing Associations and Voluntary Organisations to research innovative approaches to housing management or implement innovative ideas.

### **Welsh Housing Quality Standard**

'Better Homes for People in Wales' set out the Welsh Assembly Government's long term vision for housing in Wales. Central to that vision was the expectation that all households in Wales will have the opportunity to live in good quality homes. To achieve this, the physical standard and condition of existing housing must be maintained and improved to the Welsh Housing Quality Standard.

The Standard was established in April 2002 and has been developed to provide a common target standard for the physical condition of all housing in Wales and specifically to help local authorities to assess their housing stock against the Standard. Separate guidance has been issued to deal with Registered Social Landlords' stock and privately owned housing.

The Welsh Assembly Government recognises that the Standard represents a major challenge for the social housing sector in Wales, but believes that aiming for anything less than the standard would mean that they were content with second best for the people in Wales. The Assembly Government therefore expects all social landlords in Wales to adopt the Standard and to devise realistic programmes for bringing all their properties up to it by the end of 2012. In August 2007 a spokesman was quoted in 'Inside Housing' as saying:

*"Guidance has been issued to... local authorities for assessing their housing stock and we have requested they submit a business plan for achieving the standard. Based on this, we will work with them to help to meet these needs."*

Local Authorities were required to assess the implications of bringing stock up to the Standard by 2012 and provided their initial overall assessment on the condition of their stock, the investment needed to achieve the Standard and the capital and revenue financial implications to the Assembly by 1st September 2002.

## Capital Finance

Housing capital investment is currently funded from four main sources:

- Major repairs allowance grant distributed from the Welsh Assembly Government
- Prudential Borrowing
- Usable capital receipts
- Direct revenue from the Housing Revenue Account via capital funded from current revenue (CFCR)

## Major Repairs Allowance

Major Repairs Allowance (MRA) is a capital grant to local authorities and forms part of their overall housing capital resources. It may be used for any capital expenditure on Housing Revenue Account assets.

The Major Repairs Allowance was introduced in 2004/05 and is designed to provide funding to housing authorities that is adequate to maintain their housing stock in an acceptable condition on an ongoing basis. This excludes any funding for the backlog of repairs and renovation that is required to council housing stock. The Major Repairs Allowance is allocated by:

- Establishing standard likely timings and costs of replacement of building elements for a number of building archetypes.
- Totalling anticipated required expenditure over thirty years and converting this into an annual average amount.
- Calculating each authority's Major Repairs Allowance by multiplying the average archetype cost by the number of dwellings of that archetype in the authority's stock.

When it was first introduced, the Major Repairs Allowance was funded by reducing the existing local authority capital allocations provided through Credit Approvals. However, while investment in Council housing in Wales reduced to 1999, it levelled off from 1999 to 2004 and since then has increased.

The level of Major Repairs Allowance varies between authorities. In 2009/10 the highest allowance was in Ceredigion at £697 a unit while the lowest was in Gwynedd at £643 a unit. The average was £673 a unit and a total of £76.4million was paid to Welsh local authorities.

## Prudential Borrowing

Prudential Borrowing was introduced in Wales under the Local Government Act 2003 in the same way as in England. The Prudential Code of the Chartered Institute of Public Finance and Accountancy applies in Wales as in England.

The Local Government Act 2003 sets the legal framework within which local government may undertake capital expenditure. The Act also empowers the National Assembly for Wales to further regulate capital finance matters as appropriate.

Section 3 of the Act requires all borrowing to be subject to an affordability assessment by a Local Authority. Section 12 also provides for a general power that allows an authority to invest resources in support of their services or for sensible treasury management activities.

Local authorities are free to raise additional finance for capital expenditure - without specific Assembly Government consent - over and above that already provided by the National

Assembly, where they can afford to service the debt within their own resources. There are however, reserve powers for the National Assembly for Wales to set limits on borrowing and credit arrangements of all or individual local authorities for National economic reasons. It is however envisaged that these would be used only in very exceptional circumstances. The emphasis therefore is on the ability of the local authority to repay any additional projected borrowing without looking to the Welsh Assembly Government for extra support.

The Welsh Assembly Government Guide to the Prudential Framework was issued with the express objective of explaining the greater flexibility and local discretion available whilst preserving necessary safeguards on levels of public sector borrowing. Legislation imposes a strict separation (or 'ring fencing') between Housing Revenue Account (council housing) activities and other non council housing activities. This is to ensure that there is no cross subsidisation of council housing activities via the general Council Tax payer and vice versa.

In considering raising additional borrowing, the revenue resources required to service this debt will be an important consideration. An authority may propose to increase its revenue income stream by raising rent levels for its tenants. Any such proposal to levy rent increases over and above the Welsh Assembly Government determined rent subsidy guidelines would result in subsidy claw backs on a sliding scale from the authority. Broadly, in practice this could mean that an increase in rent of £1 above the guideline might only raise an additional 50p to be used for housing account activities (including additional borrowing for housing purposes). Exact figures would vary per individual authority depending on a range of other specific factors related to the Housing Revenue Account position. As a consequence such rent increase proposals may soon become unaffordable for many, if not all, tenants.

Similarly an authority may seek to reduce its council housing expenditure to provide an income surplus to fund additional borrowing repayment costs. An outcome from this may be a reduction in operational service delivery and defeat the objective of extra borrowing. Alternatively, if genuine efficiencies can be found within Housing department activities, the savings generated could be used for borrowing without directly impacting on service delivery levels.

Where an authority is able to demonstrate through a robust and achievable thirty year Business Plan that it can achieve and maintain Welsh Housing Quality Standards through its own available resources (which may include assumptions about prudential borrowing) then the Assembly Government is prepared to endorse its proposals and has done so in several instances.

### **Capital Receipts**

Since the establishment of the Welsh Assembly Government local authorities have had discretion over whether to use their capital receipts to fund new expenditure or to repay debt. However, in calculating subsidy entitlement it is assumed that 75% of right to buy receipts are used to repay debt and subsidy on capital financing costs is reduced accordingly.

The pooling requirement does not apply in Wales and Housing Revenue Account capital receipts are ring-fenced to the Housing Revenue Account.

The right to buy applies in Wales, as in England. The discount on houses ranges from 32% to 60% (or from 44% to 70% for flats), subject to an overall maximum discount that was set

at £16,000 as of 2004/05. 'One Wales' has led to the suspension of the 'Right to Buy' in areas of housing pressure.

### **Achieving the Welsh Housing Quality Standard**

Studies of the condition of social housing in Wales show that a large proportion of social housing failed the Welsh Housing Quality Standard in 2001 and that this problem was particularly acute with regard to council housing. This conclusion was supported by housing stock condition surveys carried out by local authorities. Furthermore, most councils reported that the amount of money that would be required to fund the Welsh Housing Quality Standard was greater than the resources that they expected to have available.

The National Housing Strategy stated that there was an estimated backlog of at least £750million worth of essential repairs and modernisation in the Welsh council stock in 2001. The cost of investing in improvements and modernisation of the neighbourhoods in which these homes were located took this figure to well in excess of £1billion. Furthermore, a significant number of households were considered to be in fuel poverty. Half of these were in the social housing sector, a major cause of which was the poor energy efficiency of the stock. The Welsh Assembly Government wished to overcome these problems to ensure that, by 2012, all council estates are places where people wish to live and are able to do so in good, well-built and affordable homes.

Although the Welsh Assembly Government have been able to make some modest increases in housing capital provision, they recognise that this is far from sufficient given the scale of the problem faced. They therefore obliged Local authorities to examine seriously all credible options to secure investment for improvements. It was recognised that all communities would have a unique set of problems and challenges so the Welsh Assembly Government endeavoured to promote a variety of investment options to local authorities.

The Welsh Assembly Government effectively controls the revenue and capital resources that are available to local authorities. It therefore appeared that the government had set a target for the Welsh Housing Quality Standard that required more expenditure than it was prepared to finance. This resulted in an 'investment gap' at national level that was reflected in many local authorities. The Welsh Assembly Government are reported to be unsympathetic to Councils that have financial difficulties as a result, suggesting that past under-investment has probably been a major factor, and suggesting that Councils re-visit their business plans.

Some Welsh local authorities are reporting difficulty in achieving the Welsh Housing Quality Standard by the deadline of 2012. This includes authorities where tenants have rejected proposals from the local authority for a stock transfer including Swansea and Wrexham.

A survey carried out in August 2007 by 'Inside Housing' identified the cost of bringing all Welsh council homes up to the Welsh Housing Quality Standard by 2012 at £1.9billion compared with available resources of £1.0billion. Only Cardiff, Carmarthen, Pembrokeshire and Powys were identified as having sufficient resources to meet the standard. The position in individual authorities is summarised below:

<b>Authority</b>	<b>Gross Cost £million</b>	<b>Resources £million</b>	<b>Shortfall £million</b>
Blaenau Gwent	100	34	66
Caerphilly	77	62	15
Cardiff	100	100	0
Carmarthen	234	234	0
Ceredigion	33	17	16
Conwy	58	30	28
Flintshire	126	40	86
Gwynedd	65	34	31
Merthyr Tydfil	69	41	28
Neath Port Talbot	130	46	84
Newport	233	86	147
Pembrokeshire	0	0	0
Powys	16	16	0
Swansea	371	176	195
Wrexham	250	66	184
<b>Total</b>	<b>1,862</b>	<b>982</b>	<b>880</b>

The level of this shortfall is quite significant. In the case of Swansea City Council the shortfall of £195million represents an average of £13,900 a home. Using prudential borrowing to raise £195million at a 5% rate of interest would have an annual cost of £9.8million. This would require an increase in rents of over £13 a week to fund (not taking account of the clawback of subsidy). In the case of Wrexham Borough Council the shortfall of £184million represents an average of £15,800 a home. Using prudential borrowing to raise £184million at a 5% rate of interest would have an annual cost of £9.2million. This would require an increase in rents of over £15 a week to fund (not taking account of the clawback of subsidy).

### **New Build**

Since the 1970s very few new council homes have been built in Wales. Successive governments have taken the view that housing associations rather than local authorities should build new social housing. Councils have also had to demonstrate that they are achieving value for money from their capital programmes and this has been easy to do where councils support a housing association scheme with grant and less easy where the whole cost of a development would fall on the council.

However, 'One Wales' envisages a future role for local authorities in building new council housing. It is stated that:

*"We will ensure that the supply of affordable housing increases, through investing in social housing, including council housing."*

However, any new build programmes are expected to be modest. Jocelyn Davies AM, Welsh Housing Minister, was quoted in 'Inside Housing' in October 2007 as saying:

*"I am not against councils building housing – we have a few programmes in place – but it has not been a huge programme for many years... But there is much in the 'One Wales' document about the planning system and using section 106 agreements as well as improving the supply of publicly owned land. We are hoping to encourage local authorities to release land for affordable housing."*

### **Stock Options and the Community Mutual Model**

The Welsh Assembly Government obliged all local authorities to carry out a review of strategic stock options, linked to the Housing Revenue Account Business Plan and Best Value Reviews. The key issue to consider was which housing stock option offered the greatest potential to address any backlog of housing repairs and modernisations and achieve the Welsh Housing Quality Standard. The options that were available to local authorities in Wales were:

- Retention of a traditional council housing service.
- Large Scale Voluntary Transfer
- Small Scale Voluntary Transfer

The Welsh Assembly Government does not support Arms Length Management Organisations or the Private Finance Initiative.

As a result all local authorities have looked at housing stock options. Some authorities are now re-visiting stock options.

Community based models of stock transfer are of particular interest to the Welsh Assembly Government as they believe they create direct involvement of the community in the ownership and management, which increases the potential for empowerment and provides a powerful vehicle for building community capacity.

New community based landlords are regulated by the National Assembly and, as such, their roles and operating standards are supervised and directed. Surpluses generated from social housing are recycled for the benefit of the whole community through a range of regeneration projects, typically into such areas as private sector refurbishment, mortgage rescue or equity release providing a total 'housing package' tailored to community needs.

The basis of the 'Community Mutual' model is that the ownership of the local authority stock transfers, following ballot, to the tenants of the new organisation. Board composition of the new body largely follows the traditional 'third/third/third' structure, but potentially provides greater opportunity for tenants to select the composition of each 'third'. The only shareholders in the transferred organisation are its tenants.

Unlike other models, however, not only is the business conducted for the benefit of the community, but the organisation is also owned by the community. This is achieved by having as members of the community mutual organisation those members of the community in receipt of the services being provided, namely the tenants. By this mechanism, there is a real sense of ownership by the local community, and a real sense of participation and involvement by the tenants. It also avoids any sense of some remote or unaccountable organisation owning and running the properties.

The Welsh Assembly Government considers that giving tenants real ownership provides the opportunity to create smaller community management units, under the 'umbrella' of the transferring organisation. These smaller units could reflect the particular size and needs of local communities, and are themselves then managed at a local level by the tenants in those communities. By this means, tenants have a real involvement through membership. No one else owns the organisation, either in the sense of deriving a profit from it, or in controlling decision-making to serve some purpose other than the benefit of the community. This keeps the 'unity' in the community. Empowering tenants effectively through the creation of community businesses would encourage regeneration of those communities at both an economic and housing level. Such structures may potentially have greater access to additional funding sources for wider community initiatives than would otherwise be available to more traditional transfer organisations.

### **Tenant Participation and Tenant Management Organisations**

The National Assembly for Wales requires all councils to develop formal agreements with their tenants that adopt certain core standards. This is often achieved through tenant compacts which detail how tenants will be involved in the decision making process that affects their homes.

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**20th July 2009.**