CABINET	Agenda Item 27 Brighton & Hove City Council

Subject:		**Response to the Consultation Document from DCLG: Council Housing: A Real Future**	
Date of Meeting:		**17 June 2010**	
Report of:		**Director of Finance & Resources** **Director of Housing, Culture & Enterprise**	
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Key Decision:	**Yes**	**Forward Plan No: CAB16168**	
Wards Affected:	**All**		

FOR GENERAL RELEASE

1. SUMMARY AND POLICY CONTEXT:

1.1 This report provides a summary of the proposals to reform the Housing Revenue Account (HRA) subsidy system as set out in the consultation document 'Council Housing: A Real Future' issued on 25 March 2010 by the Department for Communities and Local Government (DCLG).

1.2 This report highlights the likely financial implications, risks and benefits to the council from the proposal and provides the council's draft response to the consultation as attached in Appendix 1.

2. RECOMMENDATIONS:

2.1 That Cabinet supports the proposals for self financing of the HRA as set out in the DCLG Consultation paper 'Council Housing: A Real Future' issued on 25 March 2010.

2.2 That Cabinet approves the council's formal response to the consultation as attached at Appendix 1 supporting the proposal to move to self financing for the HRA.

3. COUNCIL HOUSING: A REAL FUTURE PROSPECTUS

Background Information

3.1 The current HRA subsidy system has been in operation since 1989 and serves 177 local authorities. It is subject to an annual settlement of housing subsidy where rents are effectively pooled nationally and the subsidy system subsequently reallocates these resources. Reallocation is based on a notional HRA and the repayment of historical debt. The system however has a number of flaws:

- The notional system is complex and difficult to understand, is based on assumptions and does not really take into account local situations.

- The annual nature of the process makes it difficult to develop a strategic approach to longer term planning.
- The requirement for the majority of local authorities to pay a proportion of their rents known as 'negative subsidy' back into the national pot is unpopular, particularly now that the national pot creates a surplus overall.
- For local authorities similar to Brighton & Hove where HRA subsidy debt is greater than HRA debt the system does not promote efficient treasury management. For example action to reduce the average cost of the council's debt portfolio results in a decrease in General Fund expenditure but an increase in HRA expenditure.

3.2 The review of the Council Housing Finance system was launched by Ministers in March 2008. Following the review the DCLG issued a consultation paper in July 2009 outlining proposals for the reform of council housing finance with responses due by the end of October 2009. The responses have now been reviewed by DCLG and their detailed proposals were then announced on 25 March 2010. These proposals are set out in a consultation prospectus document entitled 'Council Housing: a real Future'. The consultation is highly technical and the prospectus is supported by a number of technical documents and financial models.

3.3 This is the last step in the HRA review process and responses to the proposals in the consultation paper must be submitted by 6 July 2010.

Self Financing Proposals

3.4 The consultation paper proposes a number of radical changes to the financing system of council housing which if implemented would have a significant impact on the local authority's HRA Business Plan. A summary of the main proposals are as follows:

1. Self Financing & Investment in New Council Housing

3.5 The government propose that self financing will put all local authorities in a position where they can manage their homes from their own income in the future and can sustain their stock in a good condition. All authorities will be better off financially as a result of the settlement and simply put, the majority of the future forecast surpluses in the system will be retained by local authorities (see also paragraph 3.8 below).

3.6 Self financing will be created by abolishing the HRA subsidy system, in exchange for a one off redistribution of housing debt. Under the new system annual subsidy determinations and associated payments will cease. Local authorities will be free to self finance, meaning all rental income will be retained, providing greater control locally, which will enable longer term planning to improve the management and maintenance of council homes.

3.7 The proposed debt settlement for each local authority is determined through a Net Present Value calculation based on estimating 30 year income and expenditure subsidy allowances using new evidence of spending needs.

3.8 The calculations in the model include significant increases to assumptions on spend on management, maintenance and capital investment ensuring every council will have at least 10% more to spend than at present. It should be noted however, that the assumptions do not take into account funding for any backlog of works local authorities may have, which the government advise will be funded through capital grants. In addition the prospectus is silent on future funding for aids and adaptations and other health & safety works.

3.9 The self financing model proposes a 6.5% discount factor rate (a rate typically used in housing transfer valuations) to determine the present net value of the housing stock. This will provide a level of sustainable opening debt for each authority which will be measured against that authority's Subsidy Capital Financing Requirement (SCFR), which is the amount of notional debt the subsidy system currently supports. If the opening debt generated from the model was lower than the SCFR, Government would pay that local authority a capital sum equivalent to the difference. If the amount was higher than the local authority would need to pay the Government.

3.10 The government also proposes that where councils are prepared to take on a greater role in developing and delivering new council housing they would provide some headroom in the self financing settlement to enable councils, after they have met the spending needs of existing stock, to deliver a substantial new build programme. This additional 'headroom' given by using a 7% discount factor rate is expected to reduce the net receipt to Government by around £1.2 billion and should enable councils to deliver 10,000 new homes each year from the end of 2014 when combined with Social Housing Grant.

3.11 The paper also suggests that local authorities should start to pay off debt from the first year of self financing creating additional borrowing 'headroom' up to the settlement debt level which could be used to fund further new build in five years.

2. Retention of National Rent Policy

3.12 Under self financing local authorities will still be required to follow national rent policy and rent convergence. The current rent restructuring formula provides a mechanism for protecting public expenditure and rent increases by providing a cap on the level of Housing Benefit an authority will receive for its tenants.

3. Retention of All Capital Receipts

3.13 The current rules determining what capital receipts local authorities may retain and what receipts must be pooled (i.e. paid over to the Government) are complex. Under the current system 75% of the capital receipt from the sale of council homes is paid across to the Government and local authorities only retain the remaining 25%.

3.14 The consultation paper proposes that authorities retain all their capital receipts from the sale of housing and land that fall within the HRA, providing that at least 75% of those receipts are used for affordable housing and regeneration projects. The remaining 25% may be used for any capital purposes.

3.15 This change represents a transfer of funds from central to local government and so would reduce the resources available for centrally funded housing programmes. Therefore a proportion of local authority expenditure which is currently supported by capital grant would instead be financed by a local authority's housing receipts.

4. Financial, Accounting and Regulatory Framework

3.16 The HRA operates as a separate ring fenced account and is a record of revenue income and expenditure relating to local authority's own housing stock. Items that must be accounted for within the ring fence are defined by Schedule 4 of the Local Government and Housing Act 1989 and also a DoE Circular 8/95 published in 1995. This consultation proposes updated guidance on the operation of the ring fence which does not introduce any new issues of principle and restates Ministers established policy for the ring fence. However, this guidance is intended to bring clarity to some areas and highlights the need to ensure that there should be a fair and transparent apportionment of costs between the General Fund (GF) and HRA where appropriate.

3.17 It is also proposed to develop a memorandum balance sheet for the HRA. It will not be a statutory account but a requirement to report as part of the annual report of the council. This will identify clearly the assets and liabilities that support the HRA and help understanding of the way assets are used.

3.18 At present, local authorities hold all their debt in one single 'pool' across all services so the debt attributable to housing is part of each local authority's overall debt portfolio. Interest on the HRA debt is charged at the consolidated rate of interest (CRI). The current system of pooling debt allows for more efficient treasury management but leaves the HRA exposed to interest rate changes from treasury management decisions taken by the GF and visa versa. The consultation proposes to separate the housing debt from the single pool, thus offsetting the impact of GF treasury management decisions on the HRA and increasing transparency around the costs of debt charges to tenants.

3.19 The Prudential Code for Capital Finance (developed by the Chartered Institute of Public Finance & Accountancy) prescribes the methodology to determine the levels of borrowing affordable for local authorities. This consultation proposes to add a further control by capping future housing borrowing at the self financing debt settlement level calculated for each authority. The consultation also states that local authorities would have a long term incentive to reduce debt but there is no obligation to do so. Any decision to reduce debt levels will need to be balanced against decisions to invest in major repairs.

5. Timetable

3.20 At this stage the consultation proposals are not an offer open to acceptance by local authorities. The figures used have yet to be validated for each council; any settlement figure provided will be subject to confirmation in the next Spending Review and the new Governments position.

3.21 The agreement for self financing will only be achieved if the majority of local authorities agree, in which case the changes are likely to come into effect from 2011/12, subject to the new government's agreement. Failing this, there would need to be new legislation and this is unlikely to be before 2012/13.

Financial Implications for Brighton & Hove

3.22 This section outlines the implications arising from the proposals for Brighton & Hove and provides background information to Appendix 1, the council's formal response to the consultation supporting the self financing proposals:

1. Self Financing & Investment in New Council Housing

3.23 The settlement debt calculation is based on increases in Brighton & Hove's allowances of 7.1% for Management and Maintenance and 21.5% for the Major Repairs Allowance creating a combined uplift of 11.3% in the self financing model. Although this increase confirms the authority's belief of underfunding in past years it does not address additional funding required to cover communal areas, improvements or backlogs which maybe addressed through grants.

3.24 The council will need to recognise that all the risks inherent in running a housing business will now transfer to the local authority. In particular an increase in the cost of borrowing will no longer be matched by an increase in HRA subsidy. The government have made it clear that this settlement is a full and final offer and that the generous discount factor of 6.5% should provide room for movement in key variables such as inflation rates.

3.25 Using a discount factor of 6.5%, the settlement debt is calculated at £137.633 million, compared to the council's SCFR of £137.056 million. This means the council will need to make a one off payment of £0.577 million to the government. However, the council will no longer need to pay 'negative subsidy', currently budgeted at £3.321 million for 2010/11 although it would be prudent to allow for capital repayments of debt in the future.

3.26 In order to assess the long term viability of the 30 year Business Plan various sensitivities and scenarios have been tested through the model. The starting position incorporates the removal of the subsidy system, the redistribution of debt and amendments to assumptions reflecting the additional risks now carried by the Authority instead of central government.

3.27 All scenarios show that the revised financial position of the HRA is significantly improved when compared to the current position and therefore as set out in Appendix 1, officers recommend the council should support self financing as it currently stands. There must be some caution in relation to the fact that this is based on a consultation, which may change depending on the outcome of the consultation and is subject to the Spending Review and the new governments view on the prospectus. For example, based on a discount factor of 6% (rather than 6.5%) the payment due from the council increases from £0.577 million to over £7.0 million. The various discount factor scenarios are shown in Appendix 2.

3.28 The current HRA 3 year capital programme will enable the council to meet the Decent Homes Standard by 2013. The consultation paper will provide additional resources for the HRA to deliver much more than previously anticipated including:

- Continue to maintain the Decent Homes Standard and deliver the new warm homes standard based on the initial proposals for this standard.

- Support the development and implementation of a longer term asset management strategy and associated redevelopment and regeneration schemes.
- Invest in sustainability projects.
- Deliver some environment improvements to estates.
- Develop a debt management policy with provisions to repay existing historic debt and new borrowing over a long term period.

3.29 At a discount factor of 7%, the settlement debt is calculated at £131.7 million which means the government will need to make a one off payment of £5.389 million to the council. This payment would be used to repay debt and would provide headroom of £6 million for the council to start a new build programme. For the 7% factor to be applied the council will need to give a strong commitment to build new social housing. In addition the government expects the council to match this headroom with Social Housing Grant and to use available funds from the Business Plan to maximise the new build programme.

3.30 The council will need to continue with its current programme to meet the Decent Homes Standard before reducing any debt and therefore it will not be able to contribute from its own Business Plan within the first five years unless grant funding does become available to fund backlogs of work.

3.31 Projections show that combined with 50% social housing grant, the council could build around 130 new homes over a five year period from 2014. It is not possible at this stage for the council to estimate the number of new homes it could fund from within its own Business Plan for the following reasons:

- It is unclear what funding will be available for backlogs, communal areas, disabled aids and adaptations and improvements.

- Our longer term asset management strategy is being developed. This will include future regeneration proposals that will require funding from within existing resources at unit costs which will differ from standard new build unit rates. These costings will need to be evaluated before determining new build proposals.

- The headroom imposed by the cap on borrowing may need to finance, firstly backlogs of works, improvements (identified as local priorities by tenants) and proposed new build from the 7% discount rate. These items combined will significantly limit the level of borrowing headroom available for other new build.

2. Retention of National Rent Policy

3.32 The main assumption in the proposal is that rents will converge by 2015/16 and not by the current date of 2012/13. This means that rents will rise more slowly than currently anticipated. The prospectus continues to assume that formula rents will increase by 0.5% above inflation every year. The control of rental policy will remain with the government and it is currently proposed that the Tenants Services Authority will regulate our compliance with rent policy in the future.

3. Financial, Accounting and Regulatory Framework

3.33 Brighton & Hove already operates the HRA within the ring fencing rules. The additional guidance within the consultation will provide further clarity in terms of allocating costs to the appropriate services.

3.34 The council operates a single pooled debt portfolio which is consistent with the Code of Practice issued by CIPFA. Interest paid on housing debt is charged to the HRA based on an average interest rate (CRI). The calculation of the CRI is based on the council's overall debt portfolio and therefore changes in the level of debt, either GF or HRA, can impact on the rate and hence the interest charged to the HRA. This can lead to an element of cross subsidisation between the GF and HRA and therefore the true cost of housing debt can not be identified. The proposal to have a separate pool for housing debt will eliminate any cross subsidisation – the link between housing debt and the charge to the HRA will be transparent. It will also ensure that the GF does not suffer from being unable to recover interest payments from the HRA due to changes in interest rates and the ratio of HRA debt to GF debt (which is possible under the current subsidy system).

3.35 The proposal to introduce a HRA borrowing ceiling at the settlement debt level should not cause much concern for the council. The council's actual housing debt at March 2010 is £92.6 million which is much lower than the self financing debt level (using the 6.5% discount factor) of £137.6 million thereby providing capacity to borrow a further £45m subject to affordability.

4. Retention of All Capital Receipts

3.36 Brighton & Hove's Housing Strategy sets clear strategic objectives around improving housing supply, housing quality and housing support in the city. Allowing the council to retain their housing capital receipts will encourage regeneration and more effective and innovative asset management in response to locally identified priorities.

3.37 It is difficult to accurately determine the level of retained capital receipts resulting from this proposal as this is dependant on the extent of right to buy (RTB) take up to date, current housing market and the saleability of remaining stock. However, a proportion of the RTB receipts should be allocated to the HRA following disposal to recognise that the debt associated with the property no longer has an income stream to service it.

5. Summary

3.38 The government's intention is that the self financing settlement will ensure every local authority will have more money to spend and the freedom to manage their resources more efficiently through improved long term planning.

3.39 These proposals provide Brighton & Hove with significantly more funding which will enable the council to meet the Decent Homes Standard by 2013 and develop and deliver a robust asset management strategy meeting the needs and local priorities of tenants. This settlement will also provide the council with the ability and flexibility to manage and repay debt and explore options for future redevelopment and regeneration.

3.40 However, it must be noted that these are only consultation proposals at this stage. The final settlement maybe subject to change as detailed in section 3.21 above.

4. CONSULTATION

4.1 This report will be presented to both Housing Management Consultative Committee and Cabinet.

5. FINANCIAL & OTHER IMPLICATIONS:

Financial Implications:

5.1 The financial implications of the consultation are detailed in paragraphs 3.22 to 3.40. If a self financing settlement is agreed, the resulting financial implications will be included in the appropriate HRA Budget Report and Business Plan.

Finance Officer Consulted: Sue Chapman Date: 13/05/10

Legal Implications:

5.2 Reform of the council housing finance system as described in the report could be achieved through reliance on existing powers in the Local Government and Housing Act 1989 or by introducing new primary legislation. The consultation paper does not make it clear what approach is to be adopted. Further it is not yet known what effect the Decentralisation and Localism Bill with its commitment to "Review the Housing Revenue Account" will have upon the proposals. No adverse Human Rights Act implications are considered to arise from the report.

Lawyer Consulted: Liz Woodley Date: 27/05/10

Equalities Implications:

5.3 There are no direct equalities implications arising from this consultation prospectus.

Sustainability Implications:

5.4 The self financing settlement will provide a framework within which all local authorities can sustain their stock in a good condition in the future. This should enable the council to deliver a range of measures that will benefit and sustain the local environment.

Crime & Disorder Implications:

5.5 There are no direct crime and disorder implications arising from this consultation.

Risk and Opportunity Management Implications:

5.6 The council will need to recognise that all the risks inherent in running a housing business will now transfer to the local authority and a more detailed risk management strategy will need to be adopted in preparing the HRA Business

Plan. The key risks which will need to be managed and developed as sensitivities and scenarios within the model may include:

- Inflationary risk that expenditure inflation is greater than income, particularly with rental increases determined by national rent policy.
- Managing interest rate fluctuations and debt portfolio
- Long term capital and maintenance responsibilities cannot be met by available resources
- Balancing regeneration and redevelopment needs with tenants priorities

Corporate / Citywide Implications:

5.7 The self financing settlement will provide a framework within which all local authorities can manage and maintain their stock in a good condition in the future. This should create housing that improves the city's appearance and provide secure homes and communities that tenants enjoy living in.

6. EVALUATION OF ANY ALTERNATIVE OPTION(S):

6.1 The option of not responding was discounted on the basis that it will deprive the Council of an opportunity of influencing the debate.

7. REASONS FOR REPORT RECOMMENDATIONS

7.1 The recommendation is to welcome the consultation proposals and to approve the formal response from the Council supporting self financing. This will enable the council to have a say in the process and thereby influence the outcome.

SUPPORTING DOCUMENTATION

Appendices:

1. Formal Response to 'Council Housing: A real future' from Brighton & Hove City Council.

2. Brighton & Hove HRA Self Financing Prospectus Proposals.

Documents In Members' Rooms

None

Background Documents

1. Council housing a real future: Prospectus, issued by CLG 25 March 2010

2. Modelling business plans for council landlords, report on model inputs assumptions and outputs, issued by CLG 25 March 2010

3. Working papers held with Financial Services.