To: City Executive Board

Date: 30th June 2010 **Item No: 9**

Report of: **Head of Oxford City Homes**

Title of Report: **Reform of Council Housing Finance; Consultation Response**

Summary and Recommendations

Purpose of report:
To agree a response to the Consultation prospectus, Council Housing: A Real Future issued by the department for Communities and Local Government (CLG) on 25th March 2010.

Key decision? No

Executive lead member: Cllr Joe McManners
Cllr Ed Turner

Report approved by:

Finance: **Jacqueline Yates**
Legal: **Jeremy King**

Policy Framework: Transform Oxford City Council and More Housing, Better Housing for All.

Recommendation(s):

1. That the proposals for the self financing of the Housing Revenue Account detailed in the CLG consultation paper is welcomed.

2. That the Councils formal response to the CLG Prospectus consultation on the reform of council housing finance is that set out at Section 6.

1. Background;

1.1. CLG published its long awaited voluntary 'offer' to local authority landlords on 25th March. The offer is in the form of a prospectus setting out the terms within which the government plans to implement the dismantling of the Housing Revenue Account (HRA) subsidy system and introduce a system of self financing from April 2011 on a voluntary basis.

1.2. The review of the Council housing finance system was announced in December 2007 and launched by ministers in March 2008. Following the review the Government issued a consultation paper in July 2009 setting out in outline proposals for reform of the housing revenue account (HRA) finance system.

1.3. On 25 March 2010 John Healey, Minister for Housing, announced the detail behind the move to dismantle the current HRA subsidy system and replace it with a devolved "self-financing" system.

1.4. The detailed proposals are set out in a prospectus document entitled "Council housing: a real future". The plan is highly technical and the prospectus is accompanied and supported by a number of technical documents and financial models.

1.5. This government consultation is the last step in the HRA review process. The responses to the proposals in the consultation paper are requested to be submitted by 6 July 2010

2. The HRA Self Financing Prospectus

In summary the main proposals include;

2.1. Moving towards a self financing HRA system in which negative or positive subsidy is exchanged for a single one-off settlement of housing debt that allows councils to retain locally 100% of all future rental income and capital receipts.

2.2. The changes would have a significant impact on the Council's HRA Business Plan and stock management strategy.

2.3. The current national HRA subsidy system would be dismantled but a separate "ring fenced" HRA would be retained, to account for housing services that a landlord is required to provide. The proposals include a clarification of guidance on the operation of the HRA ring fence and definition of "core", "core plus" and "non-core" services based on the principle of "who benefits" from the particular service – council tenants or general council tax payers.

2.4. Under self-financing local authority landlords will still be required to follow national rent policy and the self-financing model assumes adherence to this policy and rent "convergence" to the national formula rents by 2015/16.

2.5. Under this new self-financing system, the Council will keep all of the rent it collects from council housing in Oxford and would also retain all capital receipts from sale of housing and land that fall within the HRA, providing that at least 75% of those receipts are used for affordable housing & regeneration projects. The remaining 25% can be used for any capital purposes. – For Oxford, our right to buy sales for 2009/10 amounted to 4 sales with proceeds of £0.8m. From these proceeds OCC would need to repay debt on those properties sold. There would be an average debt per property of £27k if this proposal is implemented.

2.6. A self-financing settlement is calculated based on a model to calculate the income and spending needs and the calculation of a sustainable level of debt for each Council using a proposed model. The calculations in the model include significant uplifts to the existing Management & Maintenance Allowances and Major Repairs Allowances giving every council a guaranteed 10% more money than they have under the current system.

2.7. The discount rate used in valuing the present net value of the business is proposed to be 7% rather than the 6.5% discount rate that has been typically used is assessments for housing stock transfers. This means the Government will receive less from self financing the HRA or around £1.2 billion. In return the Government expects the additional financial headroom to be used to deliver 10,000 new council homes when combined with access to Social Housing Grant through the Homes & Communities Agency.

2.8. The self-financing model will indicate a sustainable level of opening debt for each local authority and compares this with the current level of subsidy debt (SCFR). The difference between these two levels is the amount of debt that will be allocated to councils under this offer. For Oxford this amounts to £173.4 million.

2.9. The creation of a council housing balance sheet to clearly set out the assets and liabilities that support the HRA. This would be held as a memorandum balance sheet within the local authority accounts.

2.10. The Introduction of a cap on borrowing at the self-financing debt level – for Oxford this would be £207.9 million.

2.11. The CLG offer will remove the annual round of subsidy determinations and the uncertainty for revenue planning that this caused. The funding system will become clearer and fairer. It will remove from the Government the funding, management and standards of council housing to elected councils.

2.12. Rent setting policy would remain a national policy ensuring some protection for tenants and the regulation will transfer to the new Tenant Services Authority.

3. **The Implications of self financing for Oxford City Council**

3.1. The self financing offer is based on notional subsidy rent and allowances. To assess the affordability and impact that the CLG offer would make to the Council a 30 year Business Plan has been prepared.

The plan is based on our actual budgeted and forecast spend to maintain properties at the Decent Homes Standard over a 30 year period. The Plan has been prepared by the Chartered Institute of Housing (CIH) and they have provided an independent report detailing the viability of self financing for

Oxford City Council and comparing our forecast expenditure base with other local authorities.

The report is attached at Appendix 1.

3.2. We have presented the report findings to Senior Officers, Members and Tenant Representatives in a series of workshops. The CLG offer has been seen as a positive move by all the representative groups. The concerns raised have been incorporated into the consultation responses detailed later in this report.

3.3. The report findings will be presented to more tenants at the next Involvement Monitoring Panel meeting. Further workshops or presentations can be provided for officers and members should it be required.

3.4. Self financing brings additional responsibilities in terms of the skills required to strategically plan for servicing and repaying the debt alongside potential expenditure strains for new housing, improved service and capital spend programmes. This will become a key role within corporate finance. It also means that Members will be more actively involved in setting rent levels on an annual basis while recognising the national rent policy and the business plan assumptions.

4. Key Conclusions for Oxford City Council.

These are the key conclusions from the analysis carried out by the CIH;

- The settlement of £207.891m results in a net debt take-on of £173.401m. The uplifts to the allowances to arrive at this figure are generally higher than the region and national averages.

- The financial position under self-financing is significantly improved compared to remaining within subsidy. Subsidy payment estimated for 2011/12 is £12.8m and this will esculate considerably over future years because of rent convergence and policy. Servicing the debt, assuming an interest rate of 6% is £10.4m. The modelling shows the surplus being used to repay debt.

- The resulting take-on of debt and withdrawal from the subsidy system result in revenue surpluses to finance the resulting interest charges and facilitate debt repayment within 17 years, though various factors could extend this period.

- The HRA will remain viable throughout this period with balances accruing after debt repayment. The key reasons for the viability and resilience to changes in assumptions is that our business plan starts with balances on reserves of £8 million, which have been derived from;

    - Capital receipts that are currently loaned to the General Fund,
    - Decent Homes,
    - General reserves,
    - Interest rates that can outperform those allowed for in the settlement, and
    - Headroom of £14 million provided by the difference between actual and Subsidy Debt levels.

- The Council’s assessment of its stock investment needs can be fully met, through some re-profiling, would be required in the early years. This is achievable as some of the spend relates to Tower Blocks which are currently under review.

- The settlement offers the potential for HRA new build.

5. Areas for concern should self financing proceed.

5.1. There are a number of concerns that would need further detailed analysis and risk assessment should the proposals be implemented. In summary these are;

- Treasury Strategy and Management;
    - Separating General Fund and HRA Debt
    - Management of cashflow surplus
    - Impacts of interest payments +/-
    - Cashflow forecasting
    - Whole picture necessity
    - Revenue and Capital summary
- Rent Policies
    - Potential to change existing national rent setting policy from RPI plus 0.5%
    - Potential to apply additional rent restrictions
- Stock Maintenance Standards
    - Potential to increase standards above decent homes to meet revised sustainability code standards
- NAHP Grant
    - Potential to reduce grant funding below current levels making new build unviable
- Borrowing Capability
    - Market view of local authority credit status affect Public Works Loans Board capacity to loan funds and proposed debt cap.
- Final Debt Settlement
    - Potential for Government to reopen debt settlement unless explicitly stated in legal agreements that this will not happen. Alternative is to state limited circumstances under which this could happen – enabling local authorities to assess and manage risk in business plans.
- Management Capability
    - Necessary explanation to Members of business plan assumptions to understand critical responsibilities associated with local rent setting policies.

5.2. In summary although there are concerns that need to be addressed, they are not insurmountable and this offer from the Government remains a viable proposition for Oxford City Council and has the potential to realise major benefits.

5.3. It is important to note that this response to the consultation does not enter Oxford City Council into a legally binding agreement.

6. Consultation Questions and the Proposed Response

Q1 What are your views on the proposed methodology for assessing income and spending needs under Self Financing and for valuing each council's business?

Response;
The proposed methodology provides a reasonable approach for valuing the housing business. With the uplifts to management and maintenance and major repairs allowances and the proposed 7% discount rate, Self Financing will provide a basis for a viable HRA Business Plan for Oxford City Council.

Q2 What are your views on the proposals for financial, regulatory and accounting framework for self financing?

Response;
We support the proposal for local authorities to maintain a virtual housing balance sheet and a separation of the loans pool between the HRA and the General Fund. This will make the results of investment decisions in the respective areas more transparent.

We also welcome the further clarification of the accounting treatment of core, core plus and non-core services. Whilst the Council is already accounting for expenditure appropriately between the HRA and the General Fund, the revised guidance on the operation of the HRA ring fence will improve comparability of actual costs between local authorities.

The Council will require some clarity in regard to applications for funding backlog of works or other Capital costs relation to early years stock condition surveys.

Q3 How much new supply could the settlement enable you to deliver, if combined with social housing grant?

Response;
The use of a 7% discount rate within the debt allocation methodology does provide scope for resources to be set aside to support the provision of new affordable housing.

By assuming build costs of £100k, grant of 30%, rents of £93 and assumed levels of repairs and maintenance we estimate that 240 properties could be provided for in the first 5 years. This analysis indicates that taking account all income, expenditure and notional interest, the new build schemes would break-even over 30 years.

However in bringing forward a housing programme on this scale the Council would require additional borrowing in the short term in excess if the original debt allocation.

Land availability is also a concern for local authorities. We are currently reviewing the land and development potential through our asset management strategy. Further clarity is required around the potential for local targets to be set and what their duration would be.

Q4 Do you favour a self-financing system for council housing or the continuation of a nationally redistributive subsidy system?

Response;
Oxford City Council does favour self financing and would like to move to an early implementation of the system. However there are issues that need further consideration;

i. The CLG and the Treasury should consider bringing future borrowing under existing Prudential Borrowing regulations

ii. The CLG must confirm the terms of the 'one off' settlement and that it means just that and the debt settlement cannot be reopened at a later date. In the least there needs to be explicit guidance on the circumstances in which this could happen. All Councils need to understand this risk to their business plans.

Q5 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?

Response;
Moving to early voluntary implementation of self financing based upon the information currently provided is supported by Oxford City Council subject to obtaining full and acceptable financial details. Implementation in 2011/12 would be feasible subject to early receipt of final acceptable details from the CLG and conclusion of the financing and legal arrangements.

Q6 If you favour self-financing but do not wish to proceed on the basis of the proposals in this document, what are the reasons?

Response;
Oxford City Council does favour self financing, how ever should it not proceed we would like to suggest that the CLG may like to consider alternate ways of making the subsidy system more manageable such as a 3 year subsidy charge. This would enable Council's to improve HRA Business planning in the longer term.

Name and contact details of author: Roy Summers and Sarah Fogden
List of background papers:
Version number: 1