WARWICK DISTRICT COUNCIL	**AGENDA ITEM NO.**

Report Cover Sheet

Name of Meeting:	Executive
Date of Meeting:	25 March 2008
Report Title:	HRA Self Financing Business Plan
Summary of report:	To provide an update on the progress of the Self Financing project and the future options for financing the housing stock and to propose the establishment of a cross party member's working group to monitor the progress of the Government's HRA review and the potential impact it could have for WDC.
For Further Information Please Contact (report author):	Bill Hunt Head of Housing and Property Services 01926 456403 bill.hunt@warwickdc.gov.uk
Business Unit:	Housing and Property Services
Would the recommended decision be contrary to the Policy Framework:	No
Would the recommended decision be contrary to the Budgetary framework:	No
Wards of the District directly affected by this decision:	None
Key Decision?	Yes
Included within the Forward Plan?	Yes Ref No. 35
Is the report private & confidential and not for publication by virtue of a paragraph of schedule 12A of the Local Government Act 1972, following the Local Government (Access to Information) (Variation) Order 2006?	No
Date and name of meeting when issue was last considered and relevant minute number:	Executive 12 February 2007 Minute number 849
Background Papers:	HRA Self Financing Business Plan, Executive 12/2/07 Review of the HRA Business Plan, Executive, 11/12/06 Communities and Local Government, Self Financing Modelling Group, papers and reports. Self financing and Business Plan working papers

Consultation Undertaken

Below is a table of the Council's regular consultees. However not all have to be consulted on every matter and if there was no obligation to consult with a specific consultee they will be marked as n/a.

Consultees	**Yes/ No**	**Who**
Other Committees	n/a	
Ward Councillors	n/a	
Portfolio Holders	Yes	Councillor Doody
Other Councillors	n/a	
Warwick District Council recognised Trades Unions	n/a	
Other Warwick District Council Service Areas	Yes	Finance
Project partners	n/a	
Parish/Town Council	n/a	
Highways Authority	n/a	
Residents	n/a	
Citizens Panel	n/a	
Other consultees	n/a	

Officer Approval

With regard to officer approval all reports must be approved by the report authors relevant director, Finance Services and Legal Services.

Officer Approval	**Date**	**Name**
Relevant Director(s)	4/3/08	Mary Hawkins
Chief Executive	29/2/08	
CMT	29/2/08	
Section 151 Officer	4/3/08	
Legal	3/308	Simon Best
Finance	28/2/08	Mike Snow
Final Decision?		Yes
Suggested next steps (if not final decision please set out below)		

1. **RECOMMENDATION(S)**

1.1 To note this report and the progress of the work undertaken by officers as part of the Modelling Group established by the Department of Communities and Local Government (CLG).

1.2 To note the Government's establishment of a review of the national Housing Revenue Account (HRA)

1.3 To approve the establishment of a member working group comprising of one member from each political group to work with the Housing Portfolio Holder and Head of Housing and Property Services.

1.4 To agree that the working group's remit should be twofold. Firstly to monitor the progress of the Government's HRA review and assess the potential impact of its emerging outcomes on WDC. Secondly to assess whether the potential for a self financing HRA to ensure the long term sustainability of our housing stock and to contribute to meeting housing need within the district is sufficient to warrant full consideration of this option were it to be offered in the future.

2. **REASON(S) FOR THE RECOMMENDATION(S)**

2.1 In July 2006 the Government announced the establishment of a project to explore the viability and implications of council housing being funded outside of the national HRA subsidy system, i.e. for a council's HRA to become 'self financing'. Six local authorities, three with a retained stock and three with an arms length management organisation (ALMO) were invited to work with CLG on the project and this group, which included WDC, became known as the Modelling Group (MG).

2.2 Since September 2006 the MG has worked collectively, with shared consultancy support, enabling the development of a common methodology and business plan format. Using a set of criteria defined by CLG this common approach was used to produce separate 30 year self financing business plans which assumed each council would leave the national HRA subsidy system.

2.3 The MG's work has provided demonstrable proof to CLG that:

- The amount of funding that the current national HRA subsidy system would make available to each member of the group would be insufficient to meet even the basic investment needs of their stock over the next 30 year period
- Each member's self financing business plan has the <u>potential</u> to not only generate sufficient finance to fund this shortfall on the basic investment needs of the stock but also deliver significant additional finance that would secure the long term sustainability of their existing stock and provide for growth of the stock through building or acquisition.

2.4 These outcomes have presented Government with a dilemma. The project has shown that self financing appears to offer significant potential benefits. However, these benefits can only be realised by allowing some councils to leave the national HRA subsidy system. Ministers appear to have become concerned that this could potentially disadvantage those councils remaining within the national system, creating a two-tier council housing sector of 'haves' and 'have-nots', the elimination of which had been a driving force behind the establishment of the current redistributive national subsidy system.

2.5 The government response remains positive. Enabling legislation has been included in the Housing and Regeneration Bill that would provide for a Secretary of State to permit a council to leave the national subsidy system. The Bill has completed its Committee stage, during which the Government chose to highlight and debate, but not amend, this specific clause. This has been widely interpreted as a demonstration of intent signalling their continued support for the concept of self financing. The Bill is due for its second reading in the near future and is likely to become statute before the summer.

2.6 Whilst the Bill has been progressing through Parliament the Government has announced a major review of the national HRA, to be jointly led by CLG and the Treasury. A number of emerging issues appear to have prompted the review, for example, an examination of future rent setting policy and whether the existing rent restructuring arrangements should be maintained, the future regulation of the combined RSL and council housing sectors and the implications of the worklessness agenda on the housing sector. However, an examination of the future financing of council housing lies at the core of the review which will entail an examination of the future of the national HRA subsidy system and further exploration of the potential for local self financing HRAs.

2.7 Government intends to have substantially completed the review by spring 2009. This timetable will allow for consultation on its outcomes to enable these to be finalised so they can inform the next Comprehensive Spending Review which is scheduled to begin in autumn 2009. This timetable means it is unlikely that any council would be offered the opportunity to begin a process that could see it leave the national HRA subsidy system until late 2009 with a view to becoming self financing from April 2010.

2.8 Whilst the prospects of any council becoming self financing may have been delayed by the review the prospects of the option being offered at some point in the future do not appear to have been damaged and the MG's contacts within CLG talk in terms of 'when' not 'if'. CLG have consequently proposed that they continue to meet the MG throughout the review period, partly to provide them with a 'sounding board' to discuss the issues emerging from the review but mainly to allow for further financial modelling to be undertaken to assess the impact of those issues, for example, a change in national rent setting policy, against the existing self financing business plan models.

2.9 There are considerable benefits to remaining engaged with CLG. Contact through the MG offers the opportunity of advance information on the likely direction of future policy development and the potential to influence the national debate. It also ensures we would remain within the group of councils, who are likely to be amongst the first to be offered the opportunity to consider becoming self financing should it become an option. The Head of Housing and Property Services has therefore provisionally indicated our intention to remain a member of the MG provided that its future work can continue to be accommodated within existing resources.

2.10 To gain the maximum benefit from our continuing involvement it is proposed to establish a cross-party member working group to work with officers and the

Housing Portfolio Holder to examine the potential impact of issues emerging from the review on our existing business plan, which assumes we remain within the national HRA subsidy system. The group will also be able to assess whether becoming self financing would be a viable and sustainable option for WDC.

3. ALTERNATIVE OPTION(S) CONSIDERED

3.1 One alternative option would be to withdraw from the MG, on the basis that we have already expended effort on a project that to date has offered no tangible reward. However, this could effectively 'write-off' our work to date, whereas remaining within the MG would allow us to keep that work updated. By doing so we would retain the information needed in order to make an informed decision as to whether self financing is a viable option for WDC to pursue.

3.2 Another option would be to remain within the MG but not commit any member resource to the on-going work, on the basis that there remains no certainty that self financing will ever be offered as a housing option. Members could instead request that the Head of Housing and Property Services provides regular updates on the progress of the national review and the implications for WDC.

4. BUDGETARY FRAMEWORK

4.1 The HRA is a key component of the Council's budgetary framework. The Council is required to have a 30 year HRA Business Plan, signed off as 'fit for purpose' by the Government Office. Our business plan achieved sign off in 2004 following the Options Appraisal that resulted in the Council decision to retain the housing stock.

4.2 The current HRA Business Plan is only financially viable until 2020/21, after which the investment needs of the stock exceed our ability to finance our housing investment programme. This would mean we would be unable to maintain the Decent Homes Standard after that date and would be forced to consider alternative options other than stock retention.

4.3 There are no direct financial implications arising from the proposals. Continued membership of the MG can be sustained through existing resources as can officer support to the proposed member Working Group.

5. POLICY FRAMEWORK

5.1 A key objective of the Corporate Strategy 2007-11 is to improve housing services efficiency to meet the housing need of the district. Having a viable HRA Business Plan and being able to finance the investment needs of the housing stock is a major factor in ensuring that this objective is met.

5.2 There is currently no external pressure or requirement to undertake a further Options Appraisal. However, should it not be possible to design a viable HRA Business Plan, options other than stock retention will need to be considered at some point in the future.

5.3 The work undertaken by the MG suggests that, subject to a suitable agreement relating to the level of housing debt, self financing HRAs appear to offer significant potential to deliver long term financially sustainable Business Plans.

6. **BACKGROUND**

6.1 When CLG embarked on the self financing project it established a MG of six local authorities. 3 of the group have a retained, directly managed, housing stock and 3 have established an ALMO to manage their stock. An ALMO, or arms length management organisation to give its full title, is a body established by a council to run the investment programme to meet the Decent Homes Standard and undertake the day to day management of the stock. A council with an ALMO still owns stock, runs an HRA and remains responsible for all the strategic decisions on the stock which are then implemented by the ALMO.

6.2 The MG provides CLG with a good geographical spread of different types of councils, with varying political control, stock types, stock numbers and local issues faced. The common factor is that all the councils have an excellent overall CPA rating with an excellent housing rating within it, or in the case of those with ALMOs, a three star rating for their ALMO.

6.3 The councils with a retained stock are Warwick District Council, Darlington Borough Council and Cambridge City Council. Those with ALMOs are Carrick District Council, Sheffield Metropolitan Borough Council and London Borough of Hounslow.

6.4 At the start of the project the respective stock numbers of the participants were:

Carrick	Cambridge	Darlington	Hounslow	Sheffield	Warwick	All
3,729	7.652	5,596	13,709	48,437	5,677	84,800

6.5 Cambridge and Warwick are debt free councils. The remainder have varying levels of existing housing debt.

7. **HOW IS COUNCIL HOUSING CURRENTLY FUNDED**

7.1 The financing of council housing currently sits within a national housing finance system and all key funding decisions are controlled by central government.

7.2 A national HRA subsidy system has been in operation for many years. It works on the basis of there being one national HRA which is effectively a closed system, recycling housing finance to or from local HRAs on the basis of need. This assessment of need is governed by a set of nationally defined criteria and is calculated annually by CLG.

7.3 There are three key components to the national system:

- The system makes an annual notional assessment of allowances for the cost of management and maintenance of the stock in each local authority
- Guideline rents are set for each local authority based on a national formula
- The capital financing costs of housing debt are fully met by subsidy. This means that unless a council chooses to repay debt and become debt free, or increase its debt through prudential borrowing, the level of debt only reduces very slowly.

7.4 The annual subsidy determination uses these components to calculate whether an individual council is in subsidy ‘surplus’ or ‘deficit’. This determination uses a set of nationally defined criteria, based on stock and management information, to calculate the notional revenue spend required for the management and maintenance of the stock and the notional capital investment needs of the stock. This calculation determines the level of subsidy the council is notionally entitled to receive, payable through:

- Management Allowance (revenue)
- Maintenance Allowance (revenue)
- Major Repairs Allowance (capital)

7.5 The notional needs of the stock, represented by the total of the 3 allowance entitlements, are then compared to the notional income that the HRA is calculated to receive through rental and service charge income. If the notional allowance entitlement exceeds the notional income the council is deemed to be in ‘deficit’ and will receive subsidy through the national HRA subsidy system. If, as in our case, the notional income exceeds the notional allowance entitlement the council is deemed to be in ‘surplus’ and is required to make a compensatory payment to a ‘rent pool’ established under the national HRA subsidy system.

7.6 The rent pool is used to redistribute subsidy nationally. The payments made by those councils deemed to be in surplus, and paying into the rent pool, are redistributed to those councils deemed to be in deficit and eligible to receive subsidy.

7.7 The amount a council in surplus pays to the rent pool is governed by the difference between their notional income and their notional allowance entitlement. The payments they make are referred to as ‘negative subsidy’. Likewise the subsidy received by those councils deemed to be in deficit is equal to the shortfall between their notional income and their notional allowance entitlement.

7.8 For 2008/09 WDC has been assessed as being £6.6m in surplus and will be required to make negative subsidy payments of this amount to the national rent pool.

7.9 Our payments have doubled in the six years since the Council decided to retain the housing stock as shown in the table below:

Year	Payment to National Rent Pool
2003/04	£3,304,175
2004/05	£4,436,355
2005/06	£4,410,512
2006/07	£4,955,470
2007/08	£5,375,500
2008/09 (projected)	£6,667,500

7.10 An overwhelming majority, and an increasing number, of councils are now in negative subsidy and making payments to the national rent pool. Historically the national HRA subsidy system has been in deficit requiring Government to find additional resource to cover the subsidy payments made to councils in deficit.

However, a recent ministerial response to a Parliamentary Question has revealed that from 2009/10 the national system is projected to go into credit, with the payments to be made to the national rent pool exceeding the subsidy payments to be made to councils in subsidy deficit.

7.11 How this surplus will be treated, and whether it will remain ‘ring fenced’ for spending on council housing, appears to be as yet undetermined. It is hoped that the current review of the national HRA subsidy system will bring the required clarity needed on this issue.

8. OUR EXISTING HRA BUSINESS PLAN

8.1 Our existing 30 year HRA Business Plan was formulated in 2003/04 following the stock retention decision and signed off as ‘fit for purpose’ by the Government Office for the West Midlands (GOWM) during 2004.

8.2 At the time of sign off the Business Plan demonstrated that sufficient funding was available (taking account of our ‘real’ income and expenditure as opposed to the notional figures used in the annual subsidy determination) to ensure we could meet the requirements of the Decent Homes Standard for the stock by 2010. However, it also indicated that our finances would slip into deficit from 2011/12 onwards and we would no longer be able to maintain levels of capital investment sufficient to maintain the standard. GOWM therefore made their sign off conditional subject to us providing an annual assessment of our continued ability to meet the Decent Homes Standard and conducting a further full Options Appraisal in 2007/08.

8.3 We have subsequently been able to demonstrate to GOWM that our financial position is more robust that it appeared immediately after the stock retention decision. We have revised our financial modelling using updated stock condition survey information which has demonstrated that the ‘tipping point’, at which we are no longer able to finance the investment needs of the stock, is not 2011/12 but 2020/21.

8.4 This revised financial modeling together with our selection to become a member of the MG led GOWM to waive the original conditions set against sign off of our Business Plan and to remove the requirement for us to conduct a further full Options Appraisal.

8.5 Nonetheless our existing Business Plan does have a number of fundamental weaknesses. Firstly it can only demonstrate viability for the next 13 years, until 2020/21, rather than the full 30 year period. Secondly we can only maintain viability until that date by depressing our revenue spending on management services below the levels of equivalent sized housing providers. By doing so we are currently able to add to our HRA balances, which now total over £14m. The accumulation of these balances is critical to our Business Plan which envisages them being fully spent in later years as we approach the ‘tipping point’ in our finances.

8.6 Projecting forward from 2020/21 we face a £79.4m shortfall on the levels of investment required to maintain the Decent Homes Standard and the needs identified by our latest stock condition survey. This figure also assumes we continue to depress our management spending to make £35m savings against our notional management allowances. Therefore, the total funding gap on our existing Business Plan can be expressed as being £114.4m over the 30 year period

9. OPTIONS FOR MEETING THE FUNDING GAP

9.1 Our existing Business Plan assumes that we remain within the national HRA subsidy system. The national HRA is known to be projected to go into credit and the national subsidy system is now subject to a full government review. Were the current system for calculating subsidy to be changed then our financial position would change fundamentally. The unknown factor is whether any change would be for better or worse. A beneficial change could potentially eliminate the current funding gap.

9.2 Another possibility is that revised and updated stock condition survey information improves our financial position. Our stock condition was initially based on a 20% sample of differing stock types. When this initial survey was updated with further sampling the original extrapolations were revisited and the situation found to be better than first anticipated hence the movement of the ‘tipping point’ from 2011/12 back to 2020/21.

9.3 Unfortunately we can’t rely on further new information automatically improving our financial situation and it could have the opposite effect and worsen the funding gap. Even if it improved the situation it is unlikely that the funding gap would be eliminated entirely. However, were there to be beneficial changes to the way subsidy is calculated it might prove cost effective to undertake a full stock condition survey, surveying every property, to ascertain if a combination of both elements could fully close the funding gap.

9.4 If neither of these options, nor a combination of the two, resolved the funding gap and no new alternatives, such as self financing, emerged from the current national review, the council will have no option other than to conduct a further Options Appraisal prior to 2020/21 (or any revised ‘tipping point’). Based on the current options available it is likely that the only viable option to stock retention would be stock transfer, as was the case in 2003/04.

10. WHAT IS SELF FINANCING

10.1 Self financing is a new financial model that could potentially offer a solution to the current funding gap.

10.2 A self financing HRA would operate outside of the national HRA subsidy system. A self financing council would therefore neither receive subsidy if it were deemed to be in notional deficit nor make any payments to the national rent pool were it deemed to be in notional surplus.

10.3 Put simply the methodology underpinning self financing is that at the point a council left the national HRA subsidy system a calculation would be made of their notional subsidy entitlement over the coming 30 years. If they were in surplus and receiving subsidy their future subsidy payments would be calculated and they would receive them as a one-off payment, reducing their current housing debt.

10.4 If they were in deficit the negative subsidy payments that they would otherwise make to the national rent pool would be calculated and the council would be required to make a one-off payment, effectively ‘buying’ their way out of the national system. To finance this payment the council would be required to borrow money and add to their exiting housing debt, or if debt free, take on a housing debt.

10.5 Once outside of the national HRA system the council is free to use any rental income surpluses it generates to fund local housing investment rather than use such monies to fund negative subsidy payments to the national rent pool. It would also be able to develop new housing and/or dispose of existing stock more easily using capital receipts from disposals or cross tenure developments to re-invest in further social housing and generate new income streams for further investment.

10.6 All six members of the MG have developed sustainable self financing Business Plans to demonstrate the viability of the financial model. The models demonstrate that significantly more investment could be made in the stock than could be delivered through the existing national HRA subsidy system.

10.7 The models assume that the debt initially taken on by those councils in negative subsidy could be paid off over the 30 year period. There is currently debate at ministerial level as to whether this should be an underpinning assumption behind self financing given that the current national subsidy system provides funding to service existing debt with no expectation of repayment. Were the requirement to repay the initial debt removed the self financing business models would generate further additional funding beyond that currently modelled.

10.8 WDC is currently debt free. Had we become self financing from April 2008 our opening debt (based on the negative subsidy payments we would be projected to make over the coming 30 years) would have totaled £158.9m.

10.9 Whilst this is a considerable sum the self financing Business Plan we have currently modelled provides for it to be repaid in full with no detriment to the ability to meet the funding gap explored above.

11. WHAT COULD SELF FINANCING POTENTIALLY OFFER

11.1 Our existing Business Plan would deliver £197.8m of capital investment in our stock. This is £79.4m short of the £277.2m requirement identified by our latest stock condition survey information and also assumes £35m of management spending savings.

11.2 Our self financing Business Plan model could potentially deliver £424.6m of capital investment, eliminating the £79.4m shortfall and the required £35m management savings and still delivering an extra £147m on top.

11.3 We have currently modelled a number of investment scenarios which provide for:

- Meeting the stock condition investment needs in full
- An additional major investment programme to tackle fuel poverty; providing affordable warmth to council tenants by converting existing communal heating systems to bio-mass, installing new communal systems and replacing electric heating in rural homes; reducing our carbon footprint by investment in renewable photo-voltaic and wind powered systems for communal lighting;

further cladding and energy conservation works. Total additional investment £22.5m

- A new programme of targeted environmental improvements to deliver enhanced security, fencing, lighting and CCTV; additional car parking; remodeling of communal areas to flats and reprovision of door entry systems; provision of play areas, landscaping and enhancements to the natural environment on housing land to promote biodiversity and provide opportunities for exercise and leisure. Total additional investment £18m
- Investment in HRA shops and local shopping precincts to ensure the continued viability of these valued community assets. Total additional investment £3.5m
- Acceleration of the kitchen and bathroom replacement programme to ensure every home has a new kitchen and bathroom by Year 6 of a self financing Business Plan.
- Additional investment in older people's accommodation and the community alarm/telecare service; demolition of obsolete sheltered housing and reprovision with new technologically advanced sheltered and extra care housing schemes; provision of a new and expanded Control Centre for Warwick Response. Total additional investment £9m
- New build schemes providing for 427 new units of housing with initial modelling based on 60% rented, 30% shared ownership and 10% sale.
- Reprovision schemes providing for demolition of selected HRA properties and garage sites with new homes built on the sites. Demolition of 85 homes and 374 garages could provide an additional 163 homes.

11.4 The current modelling provides for 713 new homes. Allowing for demolitions of high cost/low demand stock and future Right to Buy sale projections this would represent a net stock gain of 295 rented, 158 shared ownership and 50 extra care properties.

11.5 The scenarios currently modelled are not fixed but merely illustrative of the potential that self financing could unlock. If we were to consider self financing as a viable option for our housing stock the modelling would need to be revisited following full debate to ensure it captures our housing priorities.

11.6 However, the modelling undertaken to date demonstrates the potential financial headroom that self financing could provide <u>after</u> opening debt is repaid <u>and</u> the basic investment needs of the stock are fully addressed.

12. WHAT ARE THE POTENTIAL PROBLEMS WITH SELF FINANCING

12.1 In simple terms the catch with self financing is the need to take on an opening debt equivalent to the amount of commuted future payments to the national rent pool.

12.2 Whilst our model demonstrates this debt could be repaid over 30 years without affecting the financial headroom that self financing could provide, taking on debt is nonetheless a major departure for a hitherto debt free council. Managing a debt of this size would require our Finance team to undertake a significant treasury management role. If it were considered that we lacked the necessary expertise to undertake this role this could entail outsourcing of the function.

12.3 Whilst financing for the debt could be obtained at favourable rates from the Public Works Assistance Board a self financing Business Plan would be susceptible to future changes in interest rates and high level of risk based sensitivity analysis would need to be incorporated in its formulation.

12.4 The calculation of opening debt and the subsequent treatment of that debt (i.e. will repayment be required unlike within the national HRA subsidy system) are the two main unresolved issues arising from the project. The MG has collectively advised CLG that unless an alternative methodology can be found for calculating the level of opening debt none of the group would currently recommend self financing to their members, even if the option was made available to them. CLG and the MG are continuing to debate the question of debt and the MG remains hopeful of movement on the Government's part on these fundamental issues.

12.5 Assuming progress can be made on the issue of debt the other main risk around self financing relates to the future of the national HRA subsidy system itself. It appears that once a council becomes self financing and leaves the national HRA subsidy system it would not be permitted to return in the future. This raises the risk of a self financing council being potentially disadvantaged were there to be future beneficial changes to the national system.

12.6 The review of the national HRA subsidy system is therefore timely as no decision on self financing will be required until the outcomes of that review are known. This will allow a more informed decision to be made, in the future, on the level of risk attached to leaving the system.