WARWICK DISTRICT COUNCIL	**Executive** **21st October 2009**	**Agenda Item No. 8**

Title	Review of Council Housing Finance – Consultation Response
For further information about this report please contact	Bill Hunt Deputy Chief Executive (01926) 456014 bill.hunt@warwickdc.gov.uk
Service Area	Housing and Property Services
Wards of the District directly affected	All
Is the report private and confidential and not for publication by virtue of a paragraph of schedule 12A of the Local Government Act 1972, following the Local Government (Access to Information) (Variation) Order 2006	
Date and meeting when issue was last considered and relevant minute number	Executive 29th September 2009 Minute number 90
Background Papers	Executive report 29/9/09 CLG consultation paper 21/7/09 ARCH papers and reports CLG self-financing project appraisals, modelling and reports CiH Consult presentation to WDC

Contrary to the policy framework:	No
Contrary to the budgetary framework:	No
Key Decision?	Yes
Included within the Forward Plan? (If yes include reference number)	Yes – 244

Officer/Councillor Approval

With regard to officer approval all reports *must* be approved by the report author's relevant director, Finance, Legal Services and the relevant Portfolio Holder(s).

Officer Approval	**Date**	**Name**
Deputy Chief Executive		Author
Chief Executive	12/10/09	Chris Elliott
CMT	14/10/09	Andrew Jones
Section 151 Officer		Mike Snow
Legal	12/10/09	Peter Oliver
Finance	13/10/09	Jenny Clayton, Sandra Jones, Roger Wyton
Portfolio Holder(s)	12/10/09	Cllr Grainger

Consultation Undertaken

Please insert details of any consultation undertaken with regard to this report.

Final Decision?	No

Suggested next steps (if not final decision please set out below)

Further financial modelling of self-financing proposals
Re-assessment of impact of stock transfer

1. SUMMARY

1.1 This report summarises the proposals contained within the Government's Reform of Council Housing Finance consultation paper, considers the implications of these in relation to the Council's housing stock and recommends proposed actions to be taken in response to the paper.

2. RECOMMENDATIONS

2.1 That Executive approves a response to the consultation that indicates that the Council would 'in principle' be prepared to become a self-financing authority.

2.2 That authority to finalise a detailed response to the consultation questions is delegated to the Deputy Chief Executive and s151 Officer in consultation with the Housing Portfolio Holder and the Group Leaders.

2.3 That Executive notes the need for interim management arrangements for the Housing and Property Services service area that will provide for the prioritisation, if necessary at the expense of other areas of work, of further modelling to confirm the viability of a self financing Housing Revenue Account (HRA).

2.4 That Executive delegates authority to the Deputy Chief Executive and s151 officer, in consultation with the Housing Portfolio Holder, to commission any necessary work to update existing stock condition and investment information, utilising existing HRA balances if costs can not be contained within the current year HRA budget and procuring the work without recourse to the normal tender processes set out in the Code of Financial Practice if, but only if, the timescale for completion of the necessary work would be compromised by their application.

2.5 That the financial implications on the Council of transferring the housing stock, last considered as part of the 2004 Housing Options appraisal, are updated and a further report comparing the risks and benefits of this option as opposed to continuing stock retention is brought to a subsequent Executive prior to any final decision on future HRA financing.

3. REASONS FOR THE RECOMMENDATION

3.1 The consultation paper, attached as Appendix One, follows a review of the current national HRA subsidy system which examined a range of options for reform within two broad models for financing council housing in the future:

- improvements to the existing national system for funding council housing in which revenues continue to flow between local and central Government as a result of assumptions made by Government about landlord costs and income
- a devolved (self-financing) system with rents retained by councils to spend on their own housing services, in exchange for a one-off reallocation of debt

3.2 When launching the consultation on 21 July 2009 John Healey, minister for housing and planning, announced his intention to dismantle the current national subsidy system and replace it with a devolved system of responsibility featuring a self-financing HRA regime. It is clear that the Government have concluded as a result of the review that reform of the current subsidy system is only to be considered as an interim measure or if the self-financing option was to prove non-viable.

3.3 Members' will recall that this Council was one of six selected by the Communities and Local Government (CLG) department in 2006 to work on a project examining the potential benefits and implications of self-financing HRAs. The project concluded that, subject to assumptions on the treatment of debt, self-financing was not only a potentially viable alternative to the then current range of housing options but could provide significantly greater resources for council housing than would be delivered through the national subsidy system. This project was one of the main catalysts for the subsequent national review of the subsidy system.

3.4 The financial modelling that we undertook for the project demonstrated that self-financing could potentially secure the long term investment needs of our stock. It could it deliver sufficient finance to fund management, maintenance and improvement spending significantly in excess of current levels and, additionally, could also provide for re-modelling and new build to increase stock numbers.

3.5 The current proposals do not alter this conclusion and the proposed treatment of future capital receipts actually strengthens the potential viability of a self-financing HRA. It is therefore recommended that we record our 'in principle' support for self-financing and the abolition of the national subsidy system. Such an indication of support would be consistent with our previous involvement in the CLG project and our current status as an executive member of the Association of Retained Council Housing (ARCH) which is also supporting the principle of the proposal.

3.6 A detailed response to the consultation questions (listed in full at Annex A on page 47 of Appendix One) is being prepared by officers. Whether or not a draft is ready for circulation prior to the meeting it is recommended that delegated authority is given for a detailed response to be subsequently finalised. This will ensure our response takes account of, and is aligned to, the emerging ARCH response. The ARCH executive is producing an organisational response that will take account of member's views established through on-going dialogue and the two previously reported ARCH organised seminar events.

3.7 Whilst it is possible to establish an 'in principle' position on self-financing, whether or not the option will ultimately be financially viable continues to be dependant on the level of debt that an authority such as ourselves, in negative subsidy within the current national system, would need to take on. In crude terms the higher the debt taken on at the outset of a self-financing regime the lower the ability to finance the potential benefits the option could bring with that ability ultimately reduced to zero at a certain level of debt.

3.8 Government have indicated that if the outcome of the consultation is that all stock retaining local authorities share our proposed position of an 'in principle' acceptance of a move away from the current national subsidy system they would move quickly, setting out their detailed proposals during the spring to enable a new self-financing regime to start at the beginning of the financial year 2010/11.Consequently, not only is further detailed modelling required, there is a need for this to be undertaken in time for Executive to potentially make a final decision before the end of this financial year. Whilst some of this modelling would need to be updated when detailed proposals for a self-financing mechanism emerge the framework can be established now and used to update the work previously undertaken for the CLG project.

3.9 Part of this work will require an update of assumptions on the future investment needs of the stock. In addition to the investment needed to meet and maintain the Decent Homes Standard a revision of that needed for those areas that fall outside

of Decent Homes is required. These areas include, for example, expenditure on lifts, communal areas, disabled adaptations, energy efficiency and climate change measures, environmental improvements, car parking and garages, the costs for which are not adequately provided for within the current national subsidy system.

3.10 To commence and closely manage this work revised interim management arrangements will be needed within Housing and Property Services, in advance of the recruitment of a permanent head of service. It is recommended that work, due to its importance and the timescales driving it, needs to be prioritised above other tasks. Executive is asked to note the implication of such a decision which could potentially mean service delivery improvements are not achieved in the short term.

3.11 Work is underway to establish if there is a need to commission an external evaluation of investment needs through an update of existing stock condition information. Delegated authority is therefore requested to commission any such work, varying current year budgets if costs can not be contained within them and, if necessary, procuring the work other than through normal tendering practices. Any departure from the Code of Financial Practice would be as a last resort necessary only if the timescales under which the work needed to be completed would otherwise be unachievable.

3.12 Finally, it seems likely that the current proposals mark a shift in Government thinking that will mean an end for the previously available council housing financing options of private financing initiative (PFI) and arms length management organisations (ALMO). However, a large scale voluntary transfer (LSVT) of the stock to a RSL vehicle remains a potentially viable alternative to stock retention, whether or not this will in the future be within a revised national subsidy system or with a self-financing HRA. Members will recall that it was the assessment of the potential impact of LSVT on the Council's overall financial position that contributed to this option not being pursued when the 2004 Housing Options appraisal was considered. It is therefore proposed that this study is revisited and a further report brought to Executive to inform future consideration of proposals for revised HRA financing for a retained stock.

4. ALTERNATIVE OPTIONS CONSIDERED

4.1 The Executive could choose not to respond to the consultation paper. However, as a stock retention authority which actively participated in the CLG self-financing pilot and, as an executive member of ARCH, in the subsequent HRA review this would seem to be an inconsistency that could potentially damage our reputation. Engagement with the process, without which we would have no ability to influence the development of proposals relating to council housing financing, supports the principle of acting in the best interests of our tenants

4.2 Executive could choose not to express 'in principle' support of a self-financing option. However, this appears to be an option actively being pursued by Government and one that our past work within the CLG project has demonstrated has significant potential to increase the resources available to invest in our housing stock and to provide finance for new affordable housing.

4.3 A further alternative would be to choose not to prioritise further work on the proposals and instead adopt a 'wait and see' approach. This would have the advantage that interim management resource could be devoted to other areas of work, for example, prioritising short term service delivery improvements. It is,

however, not recommended as it would risk the Council having to make an early decision on a subject of long term importance to the housing prospects of many of the current and future citizens of the district and one that could substantially affect its own future financial situation, without a sound information base on which to assess the merits of the proposed and alternative options.

5. BUDGETARY FRAMEWORK

5.1 A detailed explanation of how a self-financing system would work is set out in section 9. The consultation paper stresses that all changes to the national system must be 'fiscally neutral' requiring a re-allocation of the existing historic debt for council housing supported by the current national subsidy system.

5.2 In crude terms the operation of a self-financing HRA would require us to take on debt. The level would broadly reflect the value of the negative subsidy payments we would otherwise make to Government over the next 30 years. However, the consultation paper accepts that the existing levels of allowances within the current subsidy system are lower than are needed to sustain council housing nationally and proposes these should be raised. The debt settlement would therefore be based on higher than current levels of notional allowance resulting in a lower level of debt take on than if it were simply based on an extrapolation of future projected payments to the national rent pool.

5.3 The level of debt we would be required to take on can not be accurately forecast until further details are issued as to how the proposal would be implemented. The scenario modelling set out at section 9.6 indicates it would be in excess of £100million. Members will recall that since 2004 the Council has, to all intents and purposes, been debt free to date although proposals being developed in relation to the planned Kenilworth Public Service Centre may require temporary debt to be taken on to finance the purchase of properties in Southbank Road. In appraising a future self-financing option members would therefore need to consider their appetite for taking on debt.

5.4 To finance any future debt settlement the Council would borrow from the Public Works Loan Board (PWLB). This borrowing would be on the General Fund with the costs subsequently recharged to the HRA.

5.5 Initial consideration of the implications of General Fund borrowing on this scale indicate that it would be feasible and viable, although it raises some issues that will need to be covered in our response to the consultation.

5.6 One such issue relates to the Housing Capital Financing Requirement (CFR) which is currently negative by £370,000. If we were, for example, to borrow £100m from the PWLB at 4% interest the cost to the General Fund would be £4m in interest payments per annum. However, the General Fund would only be able to charge the HRA the interest on £99.630m of the debt because of the negative £370,000 CFR. Based on current interest rates of 4% for a, say, 25 year PWLB loan and with a 2.4% investment interest rate this could mean the General Fund losing out by around £6,500 per annum. It is therefore proposed that in our response to the consultation we should state that any future debt settlement and the terms for the servicing of that debt should be 'fiscally neutral' to our General Fund.

5.7 The consultation paper also covers the issue of the HRA 'ring-fence'. Any changes to the current ring-fence arrangements could have implications for either the HRA or

the General Fund. Further modelling will be required once the outcome of the consultation is known.

5.8 The consultation also proposes that the Council would be able to keep 100% of all future Right to Buy capital receipts rather than the current 25%. Under the current national subsidy system the 25% retained receipt can be used flexibly, either for direct provision within the HRA or to fund housing functions within the General Fund. This element of discretion would be continued within the proposed system but the remaining 75% of the receipt would be ring-fenced for use on new housing supply or regeneration. This proposal would enable continued provision within the General Funding for private sector housing grants and for funding RSL delivery of new affordable homes.

5.9 If there was a need to commission a new stock condition survey this would be funded by way of HRA consultancy budget. This budget is £189,900 for 2009-10 of which at the time of writing this report £179,000 remains.

6. POLICY FRAMEWORK

6.1 The Financial Strategy provides for prudential borrowing as would be required for any future debt settlement to fund a self-financing HRA.

6.2 We are currently required to have a 30 year HRA Business Plan and this would continue to be a requirement of a self-financing regime.

6.3 There is currently no policy requirement for the authority to undertake a further housing options appraisal. However, as set out in 3.12 it would seem prudent to evaluate alternative options before making a final decision on future HRA financing for a retained stock.

6.4 Housing is a priority theme within the Sustainable Community Strategy and an objective within the current Corporate Strategy is to 'improve housing services' efficiency to meet the housing needs of the district'. Detailed consideration of the current proposals would therefore support corporate priorities and also assist in our preparations for future CAA and Use of Resources inspections undertaken by the Audit Commission.

7. BACKGROUND

7.1 The national review of council housing finance was announced in December 2007 and launched by Ministers in March 2008. Reform of the current national subsidy system had been much debated in the lead up to the review a period that had seen major reports published on potential financing for ALMO new-build and for self-financing HRAs

7.2 Government has consulted widely during the review and we have contributed to the work through over membership of ARCH and our status as a council elected to its executive body.

7.3 The current proposals result from the national review and surprised many in the housing sector by their clear signal of Government's intention to dismantle the current national subsidy system and replace it with a devolved system of self-financing HRAs.

8.0 SUMMARY OF THE CONSULTATION PAPER

8.1 The main thrust of the consultation paper is around the need for a fundamental change to the existing national subsidy system and the move to a proposed self-financing system. Sections 1 and 2 of the paper set out the background to the national review and the operation of the current system. This latter section includes an examination of the inherent weaknesses of the subsidy system (page 21 of Appendix One).

8.2 Section 3 sets out the evidence about the need to increase spending on council housing in future. A separate research report was published alongside the consultation paper which provides the detailed analysis underpinning the proposals, which has been used for scenario modelling as set out in section 9. This paper can be accessed at:
http://www.communities.gov.uk/publications/housing/commissionedresearchsummary

8.3 The future operation of the HRA ring fence is discussed within this section, which proposes the publication of revised guidance which will clearly set out principles for its operation. This guidance is expected to be directive about what should and should not be charged to the HRA but not prescriptive about the methodology for apportioning costs between General Fund and HRA.

8.4 Section 4 then sets out the main proposals relating to a self-financing regime while section 5 addresses potential timescales for implementation. In this final section it is made clear that the option could be offered in spring 2010 but only subject to a voluntary agreement of the proposals by all local authorities and an acceptance on their part of general terms rather than individual negotiations on debt settlements.

8.5 The paper goes on to say that if this could not be achieved by agreement then primary legislation would be needed to implement a national settlement. Subject to parliamentary time, a self financing system could be legislated for and be in operation from 2012-13.

9.0 HOW WOULD SELF-FINANCING WORK?

9.1 The self-financing proposal works on the basis that a local authority would keep all their rental income and any capital receipts, e.g. from Right to Buy sales, but in exchange there would be a one-off change to their housing debt. Some authorities would have debt “written-off” while others would take on debt. As the debt settlement would be based on an individual calculation for each stock retained authority, on current assumptions, the total settlement would increase the national amount of historic supported debt for council housing beyond the current £20billion. The Government is clear that it is not intending to write off any of the existing housing debt and that the proposals need to be ‘fiscally neutral’ to the Treasury.

9.2 In our case, as an authority in negative subsidy within the current national system we would need to take on debt to become self-financing. The amount of debt we would need to take on would be based on a revised notional calculation of income and expenditure, effectively the value of the business, and take into account our ability to service the debt.

9.3 How much debt we would need to take on is not yet known and is dependant on the detail of how the proposal would be implemented. For Government to achieve ‘fiscal

neutrality' the settlement will be based on a commutation of our future (negative) subsidy cash flows over the next 30 years. Future rents will be projected forward from current guideline rents and future allowances deducted from these. The cash flow is then discounted to arrive at a debt value that the business is able to sustain.

9.4 The headline assumptions from the consultation paper are as follows:

- Rent convergence proceeding (but with no target date) – we have assumed 2017 as a medium term goal consistent with inflation returning to around 2.75%
- Management and maintenance allowances uplifted by 5%
- Major repairs allowance uplifted by 24%
- A 'real terms' cash flow at today's prices in which general inflation is ignored and the discount factor of 7% (similar to past valuations used for LSVTs).

9.5 The base assumptions are shown below in bold but these have then been varied for a series of scenarios to show alternative debt settlements:

M&M Uplift	MRA Uplift	Rent Convergence	Type of cash flow	Debt Settlement (£M)	National debt (£bn)
5%	**24%**	**2017**	**Real**	**129**	**27**
0%	0%	2017	Real	145	33
5%	24%	2014	Real	132	28
10%	43%	2017	Real	115	20
5%	24%	2017	Outturn	189	40+

9.6 The base debt settlement for Warwick given the headline assumptions from the consultation paper would be c£129m. If the same assumptions are applied to all other stock retaining authorities the total national housing debt would rise to c£27bn, an increase of c£7bn. If, as many argue, the allocation should be based on a re-allocation of the existing national debt only our settlement would be £115M (penultimate line of the table above) but this would require higher uplifts of allowances (10% for M&M and 43% for MRA).

9.7 It should be noted that the distribution of the uplifts in allowances may not be a single national average as implied in the table above. It is more than possible that Government will distribute these unevenly to reflect differential spending needs. If so, we may not be able to assume we are a beneficiary of such a differential distribution.

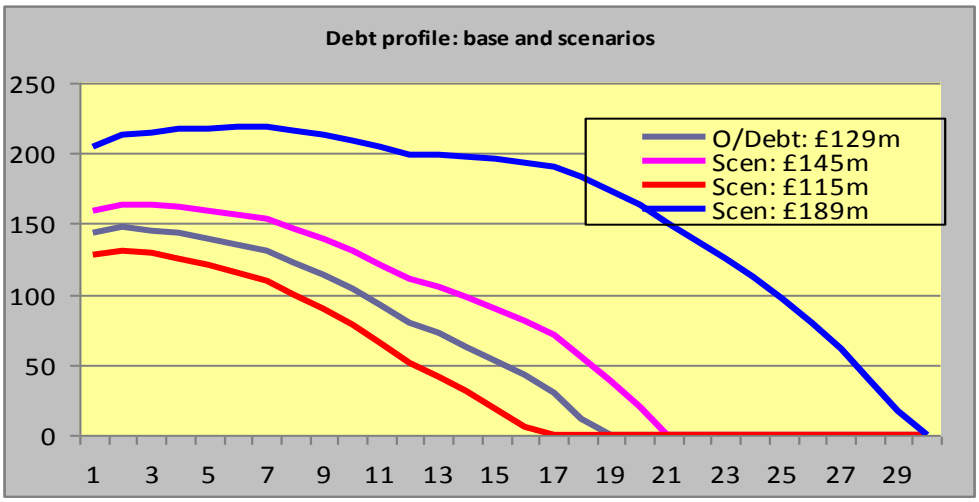
9.8 It is also possible that Treasury might argue, as they did in the CLG self-financing project, for an 'outturn prices' approach to the cash flow forecast (i.e. including inflation with a discount factor at 6.3%). This scenario would give a debt settlement of c£189m. This is consistent with the modelling we undertook for the CLG project which first identified a headline 'buy out' figure of c£160m but any settlement at these levels would leave the business plan unsustainable.

10.0 POTENTIAL FUTURE HRA BUSINESS PLANNING

10.1 The chart below shows four business plan debt profiles as follows:

- The second left profile (grey) shows a debt settlement at £129m with the capital spending profile
- The bottom profile (red) shows a settlement of £115m with the same spending profile

- The third left profile (pink) shows a higher settlement of £144m consistent with there being no assumed uplift in allowances
- The top profile (blue) shows a settlement at £189m consistent with the original approach in the self financing project albeit one that is unsustainable for the HRA as discussed at 9.8.



10.2 In all four cases, capital spending needs, at a higher level than currently provided, can be met and as rental surpluses increase rapidly beyond the next decade, the debt is able to be brought to zero well within 30 years in the scenarios where the opening debt settlement ranges from £115m to £145m.

10.3 In practice the council would probably opt to re-finance the debt throughout the 30 year period rather than physically repay it as in a LSVT model. The reality of a housing business is that provided the stock is maintained to keep it lettable to ensure income levels are maintained debt can be sustained indefinitely.

10.4 This demonstrates that at an opening debt of c£129m (i.e. at the current proposed level based on the assumptions in the consultation paper), there is scope to deliver all the capital investment needs identified by our latest stock condition survey plus an additional early-years headroom of £25m. Only if the debt settlement were to increase beyond the £145m level would the business plan begin to look a lot less sustainable and a lower settlement, consistent with the allocation of the current national debt, would provide increased sustainability with additional headroom.

10.5 Further modelling is required to test the soundness of the current stock condition survey as any increase in projected stock investment needs would eat into the projected financial headroom. However, the initial work shows that a future self-financing business plan would be sustainable at the levels of debt that can be assumed from the current proposals and current spending requirements.

10.6 Such an apparently sustainable result is likely to attract interest from CLG in terms of its approach to any future debt settlement and business planning.