Agenda Item No. 7

Meeting of the Cabinet – 30th June 2010

Joint Report of the Director of Adult, Community and Housing Services and the Treasurer

Review of Housing Finance

Purpose of Report

1. To update Cabinet on developments in HRA finance.

2. To propose revisions to the Housing Revenue Account (HRA) budgets to reflect latest financial forecasts.

3. To propose revisions to the Public Sector Housing capital programme, to be recommended to Council.

Background

4. The HRA is a ring-fenced revenue account and deals with landlord functions associated with public sector housing. The costs of improvement and programmed maintenance of the Council's housing stock are treated as capital expenditure and are accounted for separately.

   Developments in HRA finance

5. The report on the HRA and Public Sector Housing Capital to Cabinet in February 2010 highlighted the considerable degree of uncertainty around the financial outlook after 2010/11. It emphasised that the capital programme from 2011/12 onwards was provisional and was dependent on the outcome of a government review of HRA Subsidy. This report outlines further developments in that review.

6. For some years, the current HRA subsidy system has been criticised as unfair, inflexible, opaque and unsuited to long-term housing strategy planning. In 2008, the Government announced that a review of the system would be undertaken, focusing on
   - the operation of the subsidy system
   - the operation of the HRA ring-fence
   - standards and expectations following achievement of the Decent Homes Standard.

   An initial consultation paper was issued on 21 July 2009, which recommended a "radical dismantling" of the HRA subsidy system and its replacement with a devolved system of responsibility and funding. Councils would finance their own operations from their own rents, in exchange for a one-off allocation of housing debt. The intention was to free councils from the annual funding decisions in the current system and enable longer-term planning and better management of their homes, leading to greater efficiencies and an improved quality of service to tenants.

In addition, it was proposed that councils would be able to retain all capital receipts arising from the sale of council houses and other HRA assets. Currently, up to 75% of the proceeds from such sales must be paid to Government to repay historic national housing debt.

It was impossible from the information given in the consultation paper to assess the impact on the Council of the proposed reforms. A response to the consultation was submitted in October 2009 indicating a cautious welcome to the proposals.

7. In March 2010, a second consultation paper was issued, outlining the specific proposals for reform of HRA funding and giving a financial model for every housing authority. The proposals are complex but take the form of an “offer” to councils which is in essence as follows:

- Abolition of the HRA Subsidy system – whereas Dudley currently makes negative subsidy payments into a national pool (around £20m and likely to rise) we would in future be able to retain all rental income.
- In return we would take on a one-off allocation of housing debt based on an affordability calculation. This would be around £300m under the current proposals. At this level, the interest payments would be more than offset by the removal of negative subsidy payments, allowing greater investment in management, maintenance and major repairs than would be possible if the current system were to continue.
- A cap on new borrowing above a set maximum level.
- Abolition of capital receipts pooling – we would able to retain all capital receipts from house sales, provided that at least 75% of the receipt is spent on affordable housing or regeneration.
- Transfer of investment, borrowing and inflation risks to housing authorities
- Continued compliance with central government rent policy.

Financial modelling suggests that any continuation of the existing HRA Subsidy system would be very detrimental to our ability to maintain standards and investment in the housing stock at the levels achieved in recent years. While a number of questions remain, it appears that the Government’s “offer” is likely to be beneficial to the Council, particularly in the medium to long term. It is therefore proposed that the Council gives a positive response to the Consultation as attached at Appendix 1.

Currently, all retained capital receipts arising from the sale of HRA assets are earmarked for the improvement of council homes, other than a proportion allocated to support private sector housing, and it is recommended that this ring-fence of all HRA capital receipts should continue under the new system. It is likely that there will be a reduction in capital grants that will at least partially offset the increased level of retained receipts.

It should be noted that the consultation was released by the previous Government subject to a spending review in the Autumn. The position of the new Coalition has not been stated in detail but its programme for government states a commitment to “review the unfair Housing Revenue Account”. Earlier this month, Grant Shapps, the new Housing Minister, has stated that the government ”…is committed to genuine action to overhaul the system...” and has encouraged everyone to use the remaining weeks of the consultation to send him their views. Review of the Housing Revenue Account is specifically mentioned as an area that the Public Expenditure Committee will consider as part of the Spending Review.

At this stage, therefore, considerable uncertainty remains around the future funding of the HRA for 2011-12 and subsequent years. It should be noted that this uncertainty extends also to the funding of public sector housing capital schemes, as the proposed reform affects capital as well as revenue budgets.

HRA Revised Budget

8. The current budget for 2010-11, approved by Cabinet on 10 February 2010, shows a surplus on the HRA of £0.092m at 31st March 2011. There are now a number of variations to the original budget, arising mainly from resources brought forward from 2009-10 including earmarked reserves.

The original 2010-11 budget and the proposed revised 2010-11 budget are shown in Appendix 2.

Public Sector Housing Capital Programme

9. In February 2010, a 5 year housing public sector housing capital programme was agreed, with years 2012-2015 still provisional pending the final outcome of the Housing Subsidy Review. An additional £3.5m is now proposed to be added to Void Property Improvements [Decency]. This is required to address an increase in the number of high cost empty homes, generally where the previous tenant refused improvement works in the past. The additional budget will allow around 140 homes to have the necessary capital improvements carried out to them to ensure that they comply with the Council’s Empty Homes Standard and the Government Decent Homes Standard when they are re-let. Cabinet is asked to approve that the additional budget, funded from prudential borrowing, be recommended to be added to the Council’s capital programme.

10. Community Energy Savings Programme (CESP)

The February 2010 Cabinet Report ‘Deployment of Resources: Housing Revenue Account and Public Sector Housing Capital’ also contained proposals about the Community Energy Savings Programme [CESP], which is a funding programme placing an obligation on energy suppliers to meet a CO_2 reduction target by providing 'whole house’ energy efficiency measures to domestic homes in areas with high levels of low incomes [called Lower Super Output Areas, or LSOAs]. It was approved that any additional resources obtained through the CESP [or similar] schemes be added to the public sector housing capital programme. In addition to this approval it is now apparent that some energy providers are providing scheme funding where they carry the works out on behalf of the Authority. Since these works are often both undertaken and funded by energy providers at subsidised or no cost to the Council, CESP resources will not necessarily be added to the capital programme [in many instances funding may be conditional on the energy provider carrying out or managing the works]. Cabinet is asked to approve that such works be approved to be undertaken by the energy providers subject to their contractors being approved on the grounds of technical competence and health and safety.

11. Orchard Street
Cabinet has previously (11 June 2008) approved the disposal of 12 houses and 8 site plots and the associated land in Orchard Street, Brierley Hill to Black Country Housing Group [BCHG]. The properties were council owned Unity systems built housing and have significant structural defects. Aided by Homes and Communities Agency [HCA] Social Housing Grant [SHG] BCHG planned to repurchase three homes in Orchard Street that had been sold under the Right to Buy process and to demolish all defective homes replacing them with new build affordable housing. In conjunction with one of their preferred contractors BCHG have prepared scheme designs, secured planning permission and determined indicative build costs under a design and build arrangement. Unfortunately, whilst their contractor is in a position to start, no contracts have been exchanged and the HCA SHG is no longer available to BCHG. BCHG are therefore unable to progress this scheme any further.
The Council is very keen for this development of 27 new build houses to progress, with the development considered to be contributing significantly towards improving the local area and community, and providing more social housing for the borough. No land transfer has yet taken place and the Council has established that it could finance the scheme in its entirety at an estimated total cost of £3.35m through prudential borrowing, supported by rental income from the new homes with the cost neutral payback period envisaged to be 29 years. The homes will be constructed to the Code for Sustainable Homes level 3, which will provide good, energy efficient homes that will benefit the residents. Cabinet are asked to approve that:

- The Council repurchase the three former Right to Buy homes from BCHG.
- The Council undertake negotiations with BCHG's proposed contractor and, subject to value for money being demonstrated, enter into agreement with them to undertake the development on a similar design and build basis, or to seek alternative procurement arrangements in accordance with the Council's standing orders if this is not possible.
- The Council agree to refund BCHG the reasonable direct costs they have incurred in progressing the scheme to this stage, these being the costs the Council would have incurred if it had progressed the scheme from inception.
- The project be added to the public sector housing capital programme within the new build housing programme.

There is also an aspiration for a mixed tenure community within the development and approval is also sought to explore with BCHG mechanisms to provide affordable homes in Orchard St whereby it is possible, at no cost to the Council, for a small number of the new homes to be built, either on behalf of BCHG by the Council, or later sold to BCHG, with BCHG then owning or managing the homes in a shared ownership scheme for private householders.

Finance

12. Section 76 of the Local Government and Housing Act places a duty on the Council to ensure that no action will be taken that may cause a deficit to arise on the HRA at 31 March 2011. A duty is also placed on the Council to review the

financial prospects of the HRA from time to time. Reviews and regular monitoring carried out confirm that the HRA will be in surplus at 31 March 2011 and therefore complies with the requirements of the Act.

Law

13. The housing finance regime is governed by Sections 74-88 in Part VI of the Local Government and Housing Act 1989.

Equality Impact

14. This is primarily a financial report concerned with forecasting of income and application of resources. Some areas of proposed expenditure are intended to promote independence and improve the quality of life for disadvantaged groups.

Recommendations

15. It is recommended that Cabinet:

- approve the response to the consultation on HRA funding reform (Appendix 1);
- approve in principle that all capital receipts arising from the sale of HRA assets continue to be used for the improvement of council homes (other than those specifically committed to support private sector housing);
- note the continued uncertainty around future years' funding arrangements for the HRA;
- approve the revised HRA budget for 2010-11 (Appendix 2);
- recommend that Council approve the amendments to the Public Sector Housing capital programme for 2010-11 to 2014-15 (Void Property Improvements, CESP);
- recommend that Council approve the addition of the Orchard Street scheme to the public sector housing capital programme within the new build housing programme;
- approve the repurchase of the three former Right to Buy homes at Orchard Street from BCHA;
- approve re-taking ownership of all of the nine former Council owned homes, the site plots and the associated land at Orchard St;

- agree to undertake negotiations with BCHG's proposed contractor and, subject to value for money being demonstrated, to enter into agreement with them to undertake the development on a similar design and build basis, or to seek alternative procurement arrangements in accordance with the Council's standing orders if this is not possible;
- agree to refund BCHA the reasonable direct costs they have incurred in progressing the scheme to this stage, these being the costs the Council would have incurred if it had progressed the scheme from inception.

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Linda Sanders	**Iain Newman**
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List of Background Papers

Consultation paper on HRA Subsidy Review and New Build Council Housing (July 2009)

Council housing: a real future – Prospectus March 2010

Appendix 1

Council Housing: a real future

Response to consultation proposal March 2010

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?

1. We note that housing authorities will still be subject to government rent policy, so there is a risk that the settlement will be reopened or the terms and conditions altered. We would seek assurance that this would happen only under exceptional circumstances.

2. We would like to know how compliance with government rent policy will be regulated. What data will be used and what sanctions will there be for housing authorities that may not comply?

3. Caps and limits – in our 2010-11 budget we have lost £450k through the operation of the limit on actual rent increases (because inflation was negative in September 2009). Will we get our caps and limits adjustment in 2011-12 regardless of whether we move to the new system or not?

4. A 10% minimum increase in assumed management and maintenance allowances is included in the proposal and the financial model. But at para 2.20 the proposal states that "the net cost to Government…will be considered as part of the next Spending Review". This implies that it is far from certain, and adjustments to the implied allowances would make a significant difference to the affordability of the new system.

5. We welcome the proposed increase in major repairs funding, but note that the BRE research undertaken for the July 2009 consultation exercise estimated that in fact an increase in major repairs spend of at least 43% would be required to achieve and maintain the Decent Homes standard. It is worth noting that although we do expect to have fully met the Decent Homes standard by the end of the year, further properties will fail to meet the standard in future years, for example as kitchens and bathrooms reach the end of their estimated useful life. Authorities such as ours which undertook substantial modernisation programmes in the 1970s will see in the next few years a significant demand for major repairs work to renew the works done at that time.

6. We are disappointed that the proposal does not address the issue of the ever-increasing demand for adaptations for the elderly / disabled (para 2.39).

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

7. The proposal includes a cap on borrowing at the self-financing starting point level. We would seek assurances that our cap would be adjusted to take account of our proposed new build scheme where the balance of spend after grant is funded by prudential borrowing. We are also undertaking prudential borrowing this year to

complete Decent Homes work, and would also seek assurance that the cap will be adjusted accordingly.

8. We would prefer Council debt to continue to be pooled, as we consider that a single treasury management function can operate more effectively than if general fund debt and HRA debt are separated.

9. We would question whether a 7% interest rate adequately compensates for the transfer of risk.

10. We hope that a reasonable approach will be taken to depreciation in the regulations and by external audit.

11. We welcome the proposal that all capital receipts would be retained so long as at least 75% was used for affordable housing and regeneration projects.

12. What capital grants are likely to be cut to offset the retention of all capital receipts locally?

13. On the ring-fence, we welcome the update of Circular 8/95 but feel that Annex D is over-detailed and prescriptive. Particular issues for us include maintenance of tenants' gardens and street lighting. Garden clearance can be a significant element of the cost of work to void properties, and we have worked with local charities to offer a gardening service to elderly and disabled tenants, which has improved their quality of life and also the appearance and condition of their properties. Street lighting would be an additional cost to the General Fund if transferred.

14. How will the role of the regulator be determined and defined? How will its statutory obligations be enforced? What links to external audit requirements will be put in place? What links to Area Assessments will there be? How is it envisaged that tenant involvement will work?

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

15. We welcome in principle the opportunity to deliver new build council housing and will examine options to undertake this. As a result of the proposed cap on new borrowing, the first few years of the new arrangements would be unlikely to furnish us with sufficient resource to undertake new build schemes immediately.

16. We do however, in common with most if not all housing authorities, still have a lot to do by way of improving our existing stock. The Decent Homes Standard is very basic and there are lots of improvements that we would like to do – more new kitchens and bathrooms, double glazing, energy efficiency improvements, etc. Our tenants have petitioned for "Decent Homes Plus" and we have received many comments while publicising our proposed new build programme along the lines of "Why are you building new homes? Why can't you improve the ones you've got first?"

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

17. In principle we welcome a self-financing system, in order to give housing authorities more autonomy and the ability to make reasonable medium- to long-term plans. Maintenance and development of housing stock is not something that can be adequately planned on an annual, stop-start basis, and we have been hampered under the current system by the short-term nature of financial settlements.

Q5. Would you wish to proceed to early voluntary implementation of self-financing on the basis of the methodology and principles proposed in the 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?

18. Yes, we would wish to proceed on the basis of the methodology, principles and indicative figures presented in the prospectus. Clearly, before any final sign-up, we would need a final financial model and proposal.

19. We would need final figures by December 2010 at the latest to implement for 2011-12.

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

20. We favour self-financing on this basis in principle.

Appendix 2

HRA Revised Budget 2010-11

	Original Budget £m	Proposed Revised Budget £m	Variance £m
<u>Income</u>			
Dwelling rents	-76.025	-76.025	0.000
Non-dwelling rents	-0.666	-0.666	0.000
Charges for services and facilities	-0.158	-0.158	0.000
Contributions towards expenditure	-1.224	-1.139	0.085
Interest on balances	-0.006	-0.006	0.000
Total income	**-78.079**	**-77.994**	**0.085**
<u>Expenditure</u>			
Management	14.588	15.867	1.279
Responsive and cyclical repairs	24.685	25.397	0.712
Negative Subsidy	27.546	27.546	0.000
Transfer to Major Repairs Reserve	5.474	5.474	0.000
Interest payable	5.509	5.509	0.000
Revenue contribution to capital expenditure	0.000	0.000	0.000
Other expenditure	1.321	1.321	0.000
Total expenditure	**79.123**	**81.114**	**1.991**
(Surplus)/deficit	**1.044**	**3.120**	**2.076**
Surplus brought forward	**-1.136**	**-3.292**	**-2.156**
Surplus carried forward	**-0.092**	**-0.172**	**-0.080**

The variances between the original and the proposed revised budgets for contributions to expenditure, management and responsive and cyclical repairs relate to earmarked reserves brought forward into 2010-11. These reserves include sums for general housing repairs, continuing ICT projects, and Housing Management office accommodation moves.

The variance between the original and the proposed revised budgets for the surplus carried forward relates to a better than expected revenue balance on the HRA at the end of 2009-10.