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Executive – 19 October 2009

Consultation Paper on the Reform of Council Housing Finance

Report by: Councillor Jon Hardy, Lead Member for Housing and Service Improvement and
Councillor Gerald McGregor Lead Member for Finance

Summary

This report provides a summary of the Government's Proposals to change arrangements for council housing finance and provides a response to each of the seventeen questions contained in the Government's consultation document. Comments on the proposals need to be submitted to Communities and Local Government (CLG) by 27th October 2009.

1. RECOMMENDATION

- 1.1 That Members approve the Hounslow Council and Hounslow Homes joint response to the Government's consultation proposals on the reform of council housing finance as set out in Appendix 1 of this report which is to be sent to the CLG before the end of the Consultation period on 27th October 2009.

2. BACKGROUND

- 2.1 Councils manage around 2 million council homes. The funding of council housing is an obscure, national system, based on notional income and expenditure figures. It does not provide for local decision making, or accountability, and makes it difficult for local authorities to plan for the management and maintenance of their housing stock on a long term basis. This has been recognised by Government, who set up a national review of council housing finance in July 2007. The review was to look at
- Costs and standards for social housing
 - Rents and service charges
 - Rules governing a local authority's Housing Revenue Account and capital and
 - Mechanisms for delivering funding

3. THE CURRENT HOUSING FINANCE SYSTEM

- 3.1 Local authorities are required to maintain a Housing Revenue Account, which is a ring fenced account, in which the income and expenditure of the council's housing stock would be dealt with as a "landlord account". The Housing Subsidy system is administered by the Government on a national basis. The government makes notional calculations of income and expenditure, and any deficits or surpluses on the account are taken from, or added to the national pot.
- 3.2 Of the 202 local authorities in the subsidy system, 148 are in surplus and therefore making a contribution to the pot (negative subsidy) and 54 are in deficit and therefore

receiving from the national pot. Hounslow went into negative subsidy for the first time, in 2009/2010. The notional nature of the account means that there is no relationship between cost and effectiveness of the landlord.

- 3.3 One of the big problems to be resolved is the national housing debt. Different authorities have accumulated different amounts of debt, depending upon when they borrowed, and how much they have repaid over time. Historically local authorities together have accumulated £18bn of debt, or about £7,000 per property. Currently this debt is being serviced by the national housing subsidy system, but in the future, how it is serviced will make all the difference to whether local authorities get their freedom to manage their assets without the subsidy system controlling them on an annual basis.
- 3.4 The Housing Revenue Account controls revenue, but Housing Authorities get capital receipts as well, from the sale of assets. There are controls over the use of these receipts.
- 3.5 The Decent Homes Standard was conceived as a target to improve the quality of the national housing stock. The Government's commitment to ensuring that social housing reaches the decent homes standard, led to them to introduce four routes to achieving Decent Homes. These were: Setting up an ALMO (the option adopted by Hounslow); carrying out the work within existing resources; stock transfer, or the Private Finance Initiative. This programme is still ongoing, but nationally one million homes have been brought up to decency through this programme.
- 3.6 Current rent policy is largely controlled through the Rent Restructuring regime, by which the Government aims to bring rents in line with one another for similar types of property, whether owned by councils, or Housing Associations. There are no proposals on rents in this consultation at this stage.
- 3.7 Generally, the Government recognises that the current system is unpopular, because it lacks transparency, it is perceived as unfair, it is volatile and does allow for long term planning, and there is no local responsibility for accountability.

4. **CONCERNS**

- 4.1 The Consultation Paper acknowledges that the council housing functions are not fully funded through the current subsidy system. Management costs are around 5% under funded, and maintenance costs are underfunded by a larger amount, of about 24%. The review acknowledged that around 40% of management costs are now funding "non-core services", such as services to deal with antisocial behaviour. The Consultation Paper takes the view that core services should be funded from the HRA, as well as any services which are developed to meet the standard required by the new Regulator, the Tenants Services Authority (TSA). Changes to the rules governing the HRA ring fence could result in an increase in cost for the General Fund.
- 4.2 The Consultation paper acknowledges that the Decent Homes standard was a minimum standard, and they are committed to delivering it. However, it did not include some important essential elements, and funding should be provided for these, e.g. lifts and common areas. Improving energy performance remains important to the Government, and they suggest that improvements could be better delivered by local authorities in control of their budgets, when their own cost efficiencies will enable them to divert funds to these priorities.

- 4.3 The Consultation Paper also acknowledges that there is no express provision or encouragement for local authorities to establish sinking funds to smooth the costs of major repairs for leaseholders. It proposes to make this easier.
- 4.4 The Consultation paper proposes two alternative reforms: improvements to the current system, or a devolved system of self financing. The paper quickly dismisses the proposal to try and improve the current system, because of the criticisms which are well known. Three to five year subsidy settlements still carry the risk of being unpredictable. The Government also dismisses the possibility that they would pay off all the housing debt held by local authorities. It therefore goes on to propose a Self Financing system.
- 4.5 Self financing would be a one off settlement of the housing debt leaving councils in a position where they could support their management and maintenance costs, and their share of paying off the national housing debt. Local authorities would have a certainty of funding and would be able to plan in the longer term. Housing debt would be allocated to councils on the basis of their ability to service it. The opening debt level would be one based on the tenant market value of the stock. Each council would produce a 30 year business plan. The value of the stock would be calculated from the present value of the cash flows in the business plan, and each council's housing debt would be adjusted to reflect the value of its stock, entailing either a payment to Government or from Government. The Government is hoping to achieve fiscal neutrality.
- 4.6 There are complexities in settling debt for each local authority, including such things as the requirement to pay a premium for the early settlement of debt, for example. This means that the changes to the Housing Revenue Account system would have an impact on the General Fund.
- 4.7 Borrowing under self financing would be easier, as borrowing currently is limited by achieving better surpluses than the notional surplus in the HRA. If local authorities obtain more freedom, through self financing the Government is keen to limit the level of unrestrained borrowing. The Government is therefore considering how to limit the level of borrowing under the proposed new system.
- 4.8 The Consultation Paper also considers whether under the new financing system, Councils should be allowed to retain 100% of their capital receipts. If Councils take on responsibility for supporting housing debt generally, then they should also be allowed to retain their capital receipts. It is proposed that 75% of the capital receipt should be reinvested in housing. The aim in particular is for Councils to be able to meet the demand for Disabled Facilities in Council housing through the 75% HRA capital receipt, and for the 25% Housing General Fund receipt to support the expenditure required for Disabled Facilities Grants in private housing.

5. **TIMING**

- 5.1 The Government believe that it can put in place arrangements for self financing by the spring of 2010, if all stock owning authorities accept the terms. However, if there is no agreement, then the Government would need primary legislation to make it work, and in practical terms this could not happen until 2012 – 13. There is the possibility remaining open, that there could be early departures for some authorities, as long as councils accept the principles and work positively on agreements that would be sustainable for all councils.

5.2 The current arrangements for council housing finance are difficult to understand and explain, and therefore solutions will also be complicated. Stakeholders are invited to put forward their views on the consultation questions before the deadline of 27th October.

6. EQUALITIES IMPACT ASSESSMENT

6.1 The potential impact on equalities forms part of the consultation response in Appendix 1.

7. COMMENTS OF THE DIRECTOR OF FINANCE

7.1 This report outlines the Government's proposals to radically change the funding of local authority Housing provision. The proposal is to replace the present system of subsidising notional annual revenue costs with a system which reallocates the capital costs of historic borrowing for Housing purposes between authorities. It is also proposed to transfer to the General Fund certain functions that are at present included in the HRA. The details of the proposal have not yet been developed and the impact on the Council will be crucially affected by this detail.

7.2 Any proposals to rationalise and clarify HRA funding are to be strongly welcomed. Also to be strongly welcomed are any proposals that give the Council greater flexibility in the funding of its Housing activities. In principle, the proposed changes offer an opportunity to achieve both these desirable objectives.

7.3 However, members need to recognise that it is a possibility that, when worked out in detail, these changes could either reduce or increase the costs falling on the HRA. This may impact on the rent levels required to fund the costs involved. This cannot be determined until the detail of the changes proposed has been worked out.

7.4 Members also need to recognise that there is a probability of a redistribution of costs between the HRA and the General fund, which will either increase or reduce the costs met by the General Fund. Changes in the General Fund costs will obviously have an impact on the overall General Fund budget, and thus on Council Tax setting.

7.5 Members may therefore feel that, while welcoming any attempt to introduce greater clarity and local flexibility into the Housing Finance system, they would be concerned at any detailed proposals that had an adverse impact on local rents and local taxation.

8. COMMENTS OF THE BOROUGH SOLICITOR

8.1 The Borough Solicitor supports the recommendations.

Background Papers:
CLG's Consultation Paper on the Reform of Council housing finance
This report has been or is due to be considered by:
Tenant & Leaseholder Joint Consultative Committee 2 nd September 2009
This report is relevant to the following wards/areas:
Borough wide

APPENDIX 1

Response to the – Reform of council housing finance Consultation

London Borough of Hounslow
Civic Centre
Lampton Road
Hounslow
TW3 4DN

October 2009

The London Borough of Hounslow is a 4 star Audit Commission rated Local Authority situated to the West of London. The Council owns 16,500 properties which are managed by its wholly owned ALMO – Hounslow Homes. Hounslow Homes also holds the highest rating by the Audit Commission and both organisations are currently working in partnership on a number of housing regeneration strategies. This response is a joint response from the London Borough of Hounslow and Hounslow Homes; it has been presented to tenants and received full support from the Hounslow Federation of Tenants and Residents Associations.

INTRODUCTION

Hounslow is grateful for the opportunity to take part in the consultation. As we were one of the six self-financing pilot authorities that has worked on developing a self-financing model, we are pleased to see that the government is seeking to replace the HRA subsidy system with a devolved system of responsibility and funding. Hounslow would wish to take advantage of the proposals to provide greater financial flexibility and increased responsibility on risk management, borrowing and capital receipts. We would therefore urge the Government to confirm the terms of the reform with the view that Authorities such as Hounslow, who are in support of a self-financing model based on the redistribution of debt in principle, can consider the terms of adopting the self-financing model at the earliest opportunity.

Although Hounslow is in support of the self-financing model in principle, the final terms of the reallocated debt settlement must be sustainable. The changes may create winners and losers and for the authorities for which self-financing will not work further support should be given. Whatever method of reallocating debt is used, any additional costs of servicing this debt should not impact on Councils' General Funds. Either some sort of transparent Government support may still be required to prevent this or authorities should be allowed to charge any housing costs falling outside the transfer system back to the HRA.

RESPONSES TO THE QUESTIONS POSED

Hounslow puts forward the following response to each of the specific questions set out in the consultation document:

Core and non-core services

Question 1: We propose that the HRA ring fence should continue and, if anything, be strengthened. Do you agree with the principles for the operation of the ring fence set out in paragraph 3.28?

Hounslow agrees that a separate landlord account is required and that landlord services should be paid through this account (the HRA). We support the view that the HRA ring fence should continue in its current form.

However, Hounslow is concerned that being obligated to meet Tenants Services Authority (TSA) standards will take away local control. We feel that a clear procedure is required on how Local Authorities can make input to the standards set by the TSA and that a policy for arbitrating conflicts between local needs and TSA standards will need to be established. We are concerned that Local Authorities may face penalties for not following TSA standards and how such penalties will be implemented.

We agree standards should build in tenant choice and influence, but we believe it is not clear how the government expects to achieve this and how tenant groups will be selected to be consulted on their choices for input into the standards.

Question 2: Are there any particular ambiguities or detailed concerns about the consequences?

Hounslow is broadly in favour with the operation of the ring fence since the 1988 Housing Act came into force and supports the use of circular 8/95. We would have concerns regarding any change to the current practice not just in Hounslow but in general. Any change in current practice could be destabilising and potentially cause increases in expenditure, above historic levels, on either the HRA or the General Fund. This in turn would cause budget pressures in either area which would be directly related to the review of HRA financing. We believe that any such change to current practice could detract from the benefits of this review in terms of creating a sustainable self financing HRA.

An exercise could be done to survey local authorities on any changes on the ring fence rules to obtain an assessment of the likely transfer of costs from the HRA to the general fund, or vice versa. A transfer could then take place in each authority to avoid any destabilisation but allow for a new ring fence arrangement to be adhered to in the future.

Hounslow is concerned that the TSA will be a restrictive management tier between the local and central government. We feel this will generate more administrative responsibilities for us and thus require resource input to complete TSA returns and requests for statistical information.

Whilst Hounslow tenants would welcome TSA quality standards, tenants' confidence that the standards could be achieved would be subject to confirmation that sufficient resources are available to work towards the standards.

Standards and funding

Question 3: We propose funding the ongoing maintenance of lifts and common parts in addition to the Decent Homes Standard. Are there any particular issues about committing this additional funding for lifts and common parts, in particular around

funding any backlog through capital grant and the ongoing maintenance through the HRA system (as reformed)?

Hounslow was one of the first authorities to achieve the Decent Homes standard in April 2006 for its housing stock. We have always taken the view that the decent homes funding was inadequate to bring about the level of upgrading of our estates that was required. As far as possible we supplemented the resources from other funding sources but have now reached the stage where that is no longer possible. We therefore very much support this proposal. However, this does need to be extra funding and not a reallocation of existing resources. Backlogs do need to be adequately funded and if the current system continues additional MRA would be the most appropriate mechanism.

Question 4: Is this the right direction of travel on standards and do you think the funding mechanisms will work or can you recommend other mechanisms that would be neutral to Government expenditure?

Hounslow believes that this is the right direction of travel and we support the principle of a national minimum standard that provides for the actual standard to be determined locally. Energy efficiency is a key issue for Hounslow. We are delivering some key energy efficiency project which aim to improve existing buildings (retrofitting). The standard that has been achieved in Hounslow is comparable with any high performing local housing authority but we recognise that more needs to be done. Funding for further work is extremely limited and does not have a direct payback, since the benefit accrues to tenants. For this reason we would very much like to explore ways in which that benefit can be shared in a way that can reduce fuel poverty but enable more efficiency improvement work to be completed.

Leaseholders

Question 5: We propose allowing local authorities to set up sinking funds for works to leaseholders' stock and amending HRA rules to permit this. Will there be any barriers to local authorities taking this up voluntarily, or would we need to place an obligation on local authority landlords?

Many leaseholders in Hounslow have had considerable difficulty in meeting the cost of major repair works carried out to their blocks over the last few years. Clearly this has become more acute in the last year or so because of the national economic situation. We therefore welcome any move from the Government which would make financing major repairs easier for leaseholders. Sinking funds should not be considered as a panacea and can only assist in resolving the problems if major works are some years in the future. Introducing sinking funds will also be very difficult in practical terms, when a considerable number of leaseholders have just paid considerable sums for major works or are still paying for them through loans, mortgages or arrears arrangements. There are further concerns over whether sinking funds would be compulsory or voluntary for leaseholders and how the wording of the leases deals with that point. In addition extra administrative costs will arise and these will fall to be met by leaseholders themselves.

Debt

Question 6: We propose calculating opening debt in accordance with the principles set out in paragraphs 4.22- 4.25. What circumstances could lead to this level of debt not being supportable from the landlord business at the national level?

At the national level the current subsidy system produces a surplus which is projected to increase over time. Therefore, the only situation where the debt levels would not be supportable on a national level is if that surplus is taken out of the system. If the system is able to keep that surplus the debt will be sustainable in the long run.

Under the self financing scheme rent levels will have to sustain debt on an individual basis. If rent policies change or the cost of borrowing was adversely affected, possibly as a result of having to redeem old debt and exchange for new debt, that may have an affect on the sustainability of debt levels.

Question 7: Are there particular circumstances that could affect this conclusion about the broad level of debt at the district level?

We believe that this will be supportable and our work as one of the six self financing pilots provided a valuable insight. It is clear that as time goes on, with increasing rent levels, surpluses arise which can meet the demands on the landlord business and we fully expect that to be clearly demonstrated over a 30 year planning period.

From the self-financing pilot work, the most likely circumstances that would provide difficulty would arise where there is a need for very considerable investment in the early years of the planning period, before surpluses could be built up.

There is no provision in current regulations for a Minimum Revenue Provision to repay HRA debt. Individual Authorities must ensure that their debt levels are sustainable in line with the prudential code.

Question 8: We identified premia for repayment and market debt as issues that would need to be potentially adjusted for in opening debt. How would these technical issues need to be reflected in the opening debt? Are there any others? Are there other ways that these issues could be addressed?

It would be possible to physically reallocate Public Works Loan Board (PWLB) debt, and any premia or discounts could be estimated, as they are formula based. However, any premium on premature repayment of a market loan would be subject to negotiation with the lender and would not be easy to assess.

The payment of premia in order to reallocate debt around the system could potentially result in a cost which would have to be met from HRA resources or added to the debt levels. This could have an impact on the sustainability of debt levels.

Question 9: We propose that a mechanism similar to the Item 8 determination that allows interest for service borrowing to be paid from the HRA to the general fund should continue to be the mechanism for supporting interest payments. Are there any technical issues with this?

As at present borrowing for the HRA could have a positive or negative impact for the general fund, depending on whether the new borrowing is above or below the Consolidated Rate of interest (CRI).

It could be worth exploring creating a notional split at point of transfer between HRA debt and GF debt with fixed CRI. Any new debt transferred/ undertaken would then be attributable to either the HRA or the GF - and hence there wouldn't be the problem of the movements in the CRI having inequitable impacts on either the HRA or the GF.

Question 10: Do you agree the principles over debt levels associated with implementing the original business plan and their link to borrowing?

We understand that Government wishes to control overall public debt and that housing debt is currently included within that definition. However, our overriding concern is that borrowing should be determined locally for investment in Council housing. The provisions of the prudential code would ensure that borrowing levels would remain sustainable.

Question 11: In addition to the spending associated with the original business plan, what uncommitted income might be generated and how might councils want to use this?

If a viable self financing model is established it should lead to local authorities having increased resources in future years. Given that the HRA ring fence will operate the only real options to spend these funds would be on:

- to support borrowing for new build projects
- to carry out improvement works on existing properties
- to carry out improvement works on estates
- to carry out other services for tenants

Hounslow believes that these types of expenditure are desirable and there should be no concerns relating to how uncommitted income will be spent.

Hounslow would seek to reinvest in projects prioritised by working together with our tenants, with a possible emphasis on sustainability. Hounslow already has a track record in working closely with residents in this way in determining priorities for reinvesting efficiency savings.

Capital receipts

Question 12: We have set out our general approach to capital receipts. The intention is to enable asset management and replacement of stock lost through Right to Buy. Are there any risks in leaving this resource with landlords (rather than pooling some of it as at present)?

Hounslow does not see any disadvantages with ending the current pooling arrangements. It will allow local decision making to make best use of resources.

We welcome the proposals for authorities to keep 100% of their receipts, with 25% being available for any purpose and 75% to be reinvested in housing. We would support proposals that the 75% available to housing could be used for wider housing needs, for example, to support grants in non-HRA housing.

At Hounslow Right to Buy sales are virtually non existent partly due to the changes to RTB discounts and the effects of the current economic climate. As a result, capital receipts income

is now minimal and does not provide the investment needs for new build or major refurbishment schemes even if the government does introduce the proposal to allow Authorities to retain 100% of receipts. We feel that while these proposals go some way towards securing the provision of new affordable housing, success would be limited without the support of adequate social housing grant.

Question 13: Should there be any particular policy about the balance of investment brought about by capital receipts between new supply and existing stock?

We do not think there should be direction as to the split between new supply and existing stock. The London Borough of Hounslow believes that this type of decision is best made at the local level in consultation with residents and taking into account information on stock conditions and future revenue streams.

A well prepared business plan would assist Authorities to make the most beneficial decisions and therefore more control over the business plan balances is required. Hounslow feels that local control over rent setting, would enable business plans to demonstrate the ability to meet local investment needs.

Question 14: Are there concerns about central Government giving up receipts which it currently pools to allow their allocation to the areas of greatest need?

Hounslow believes that measuring need accurately in order to distribute resources between areas is limited in effectiveness. Moreover, the peak in RTB receipts is likely to have been reached in recent years and therefore now would be appropriate to allow resources to remain in their current area as pooling receipts which can be redistributed will be modest. Local Authorities themselves should have the opportunity to reinvest receipts from reductions in stock to increasing stock again in order to increase supply for which there is significant demand.

Equality impact assessment

Question 15: Would any of our proposed changes have a disproportionate effect on particular groups of people in terms of their gender or gender identity, race, disability, age, sexual orientation, religion or (non-political) belief and human rights?

We do not believe that any of the proposed changes would have a disproportionate effect on particular groups of people in terms of their gender or gender identity, race, disability, age, sexual orientation, religion or (non-political) belief and human rights.

Question 16: What would be the direction (positive or negative) and scale of these effects and what evidence is there to support this assessment?

The capital receipts proposals are likely to help to have a positive effect for tenants in need of disabled adaptations. Like most other housing authorities, Hounslow has had great difficulty in meeting the demand within reasonable timescales and these proposals should provide more resources and help us to reduce waiting times.

Question 17: What would be necessary to assemble the evidence required?

We would make use of our adaptations programme, waiting list details and the funding sources before and after the resources became effective.