Cambridge City Council **Item**

To:	Executive Councillor for Housing	
Report by:	Director of Community Services Director of Finance	
Relevant scrutiny committee:	Housing Management Board Community Services	15/6/2010 1/7/2010
Wards affected:	All Wards	

COMMUNITIES AND LOCAL GOVERNMENT (CLG) CONSULTATION - 'COUNCIL HOUSING: A REAL FUTURE'
Key Decision

1. Executive Summary

1.1 Following the CLG Consultation, ‘Reform of Council Housing Finance’ issued in July 2009, a subsequent detailed consultation paper was issued on 24th March 2010, entitled ‘Council Housing: A Real Future’.

1.2 The current consultation confirms the intention to move from the current HRA Subsidy regime to a system of self-financing for local authority housing. This would see each local authority landlord retain all rental streams and housing capital receipts, whilst taking on complete responsibility and accountability for the management and maintenance of, and improvement to, the housing stock. To enable this, each local authority housing provider would be required to take on a share of the national debt built up under the HRA system, to be redistributed through a one-off settlement.

1.3 Officers have been working with Housing Quality Network (HQN) to model the initial financial implications of the offer being proposed by CLG in the current consultation paper. This work will help inform the response from the Council to the consultation, which closes on 6th July 2010.

1.4 The proposed response to the consultation is presented for information and comment, to Housing Management Board to allow incorporation of stakeholder views. Community Services Scrutiny Committee will consider the proposed response from a strategic housing perspective.

1.5 As the Council meeting in the June / July cycle is not scheduled to take place until 22nd July 2010, permission has been granted by the CLG to submit a response to the consultation by 6th July 2010, subject to formal approval by Council on 22nd July 2010. The response will then be confirmed / amended as required following decision at Council.

2. Recommendations

2.1 The Executive Councillor is recommended to:

a) Consider the views of Housing Management Board and Community Services Scrutiny Committee members and tenant / leaseholder representatives.

b) Approve the proposed response to the consultation, at Appendix B, to be sent to the CLG by 6th July 2010, pending final ratification by Council on 22nd July 2010.

3. Background

3.1 It has long since been recognised that the existing Housing Revenue Account (HRA) Subsidy System, which collects and redistributes resources nationally in respect of Council Housing, is no longer fit for purpose.

3.2 In particular, the centralised redistributive system, with annual subsidy announcements prohibits long term financial planning at a local level, making effective asset management and identification of financial and operational efficiencies very difficult.

3.3 The proposals made in the initial consultation centred around the abolition of the existing HRA Subsidy System, replacing it with a new self-financing system, devolving both financing and accountability to local authorities, thus providing more flexibility to respond to local needs.

3.4 Under this proposal, local authorities would receive a one-off allocation of housing debt in return for the ability to retain all future rental streams, which could in turn be used to manage, maintain and improve the local housing stock, and service and repay the debt. Any headroom available, either from the outset or during the life of the business plan, would enable local authorities to invest in existing stock at a higher level or deliver new affordable housing, to be managed by the council, in their locality.

Implementing Reform

3.5 The latest consultation paper recognises the size and complexity of the task ahead for local authorities in implementing self-financing, identifying a need for new skills and capacity, while recognising the potential new risks and opportunities the proposal delivers.

3.6 CLG consider the consultation paper provides the information local authorities require to decide whether they wish to proceed with self-financing, and are seeking direct responses in respect of this.

3.7 If mutual agreement is achieved, implementation of voluntary self-financing could take place from 2011/12. If not, it is proposed to implement the new self-financing regime through changes in primary legislation, which could allow implementation from 2012/13.

Summary of the Consultation

The Self-Financing Settlement

3.8 The current consultation paper confirms the then Government's intention to move to a self-financing model for funding council housing, using a 30 year business plan and net present value (NPV) calculation to arrive at the one-off self-financing debt settlement for each local authority. The settlement will be based upon a number of assumptions:

- A discount rate of 7%, as opposed to 6.5% or 6% which had previously been mooted, will be used for the NPV calculation, subject to local authorities being able to demonstrate a willingness and ability to deliver new affordable housing locally. The NPV calculation measures anticipated future cash flows arising from an initial investment. A positive NPV suggests a business will be viable. The higher the discount rate used as part of the NPV calculation, the lower the opening debt settlement will be for local authorities.

- Authorities taking on debt will make a single payment to Government, thus all facing comparable interest rates and conditions for the resulting prudential borrowing. Authorities with existing debt will retain some or all of their loan portfolio, and therefore differing rates of interest will continue to be payable by those authorities. Any additional costs will be met from the HRA and not the General Fund.

- The inclusion of income from dwelling rents only, assuming that these will continue to comply (following delegation of regulation of rent setting to the Tenant Services Authority) with the current rent restructuring regime, with rents intended to reach target levels (convergence) by 2015/16. The limit in individual rent increases of inflation (RPI) plus 0.5% plus £2.00 per week will continue to apply. Local modelling has included all anticipated income streams, including garages and commercial land and property.

- Exclusion of all income and costs related to the provision of additional/special services, where costs are expected to be fully met in the form of service charges.

- An increase in base spending needs in respect of management, maintenance and major repairs. The initial consultation paper identified that an overall national average increase of 5% was required in management and maintenance expenditure allowances and 24% (now increased to 27%) in respect of major repairs allowances to better reflect true costs. The current consultation provides detail of proposed allowance increases for each individual local authority, with Cambridge receiving 1.2% in respect of management and maintenance and 26.3% for major repairs. This provides an overall uplift of 8.7% for Cambridge City Council. An additional proposal in the consultation, which suggests a floor is set nationally, could see the uplift increased to a minimum of 10% for each authority, subject to funding approval as part of the next spending review.

- Exclusion of all housing capital receipts from the current national pooling regime, with a proposal that local authorities can retain all future receipts, instead of the current 25%, subject to audited confirmation that at least 75% are used for affordable housing and regeneration projects.

- The Subsidy Capital Financing Requirement (SCFR), a notional measure of HRA debt, will be used as the starting point for the debt allocation, as opposed to the actual debt attributed to the HRA locally. This will benefit authorities that have previously elected to use their own resources to pay off housing debt, as is the case in Cambridge.

3.9 The consultation paper recognises that time will be needed for local authorities to develop new skills if they have not previously been required and increase capacity where necessary, in respect of activities such as:

- Loan Portfolio Management
- New Build
- Procurement
- Asset Management
- Business Planning

The Financial, Accounting and Regulatory Framework

3.10 It is recognised that self-financing would fundamentally change the relationship between Central Government and local authorities, increasing local accountability, while creating more strategic links between government and local authority housing providers.

3.11 The consultation suggests that changes to the framework should seek to:

- Improve understanding about how income is raised and on what it is spent.
- Increase the transparency of the ring fence between the Housing Revenue Account and the General Fund.
- Support good management and planning.

3.12 To achieve this, the consultation proposes:

- That all Council landlords should maintain a separate Council Housing balance sheet, presented as a memorandum item in the accounts.
- That HRA debt should be clearly separated from other local authority debt, minimising the impact that decisions in one area could have upon the other.
- Depreciation of the housing stock should be based upon accounting and financial principles, with local discretion in balancing investment in major repairs, with repayment of debt.
- Restrictions will apply on the level of new prudential borrowing, with a cap on borrowing at the self-financing debt level.
- Continuation of the HRA ring fence, with updated guidance to allow local authorities to decide whether services should be paid for from the HRA or the General Fund.

- Long term council housing policies will be set and delivered locally, with no assumption of transfer of accountability back to central government if business plans fail.
- The Tenant Services Authority will regulate local authority housing standards and performance.

The Consultation Questions

3.13 The consultation requests responses to a number of specific detailed questions:

1. What are your views on the proposed methodology for assessing income and spending needs under self-financing and for valuing each council's business?
2. What are your views on the proposals for the financial, regulatory and accounting framework for self-financing?
3. How much new supply could this settlement enable you to deliver, if combined with social housing grant?
4. Do you favour a self-financing system for council housing or the continuation of a nationally redistributive subsidy system?
5. Would you wish to proceed to early voluntary implementation of self-financing on the basis of the methodology and principles proposed in this document? Would you be ready to implement self-financing in 2011/12? If not, how much time do you think is required to prepare for implementation?
6. If you favour self-financing but do not wish to proceed on the basis of the proposals in this document, what are the reasons?

4. Implications

4.1 As part of the consultation, CLG commissioned PricewaterhouseCoopers (PWC) to produce a base business model nationally, identifying a self-financing debt settlement for each local authority with HRA housing stock.

4.2 The model uses basic data only in respect of each local authority; stock numbers, target and guideline rents, management, maintenance and major repairs allowances and a subsidy capital financing requirement.

4.3 The model produces a proposed debt settlement figure for each local authority and allows a variety of options for the discount rate to be used in the net present value calculation. The outputs for the City Council are summarised in the table below:

Discount Rate	Debt Allocation	Existing Debt (SCFR)	Increase / (Decrease) in Debt
6%	£230,829,000	£10,473,000	£220,355,000
6.5%	£218,851,000	£10,473,000	£208,378,000
7%	£207,844,000	£10,473,000	£197,371,000

The above settlement figures would represent a per property debt of between £28,067 and £31,171.

4.4 It must be noted that the above figures are taken directly from the PWC model provided as part of the consultation.

4.5 At this stage, it is not possible to quantify the potential impact on the General Fund. The Council is currently debt free, affording the opportunity to account for HRA debt completely independently. More detailed guidance on the HRA ring fence is still awaited, although the current consultation paper does not raise any immediate concerns with regard to our current accounting practices between the General Fund and the HRA. The position will need to be reviewed fully once prescriptive guidance is available.

4.6 Assuming a discount rate of 7%, as indicated in the consultation paper, HQN have populated a self-financing model with actual data for Cambridge City Council, affording us the opportunity to investigate a number of operational scenarios. At 7%, Cambridge City would be required to take on additional debt of £197,371,000 and would be capped on borrowing at the total opening debt level of £207,844,000. The initial headroom of £10,473,000 could be used immediately, allowing the authority, if it so chose, to borrow up to this sum to deliver new affordable housing or invest in existing stock, or a combination of the two.

4.7 The following scenarios are provided at Appendix A, alongside the current HRA Subsidy 30 Year Business Plan, for consideration:

- Self-financing using current HRA Business Plan assumptions, with the addition of funding for areas with currently identified need:

    - Additional £500,000 per annum revenue repairs investment
    - Additional 26.3% in decent homes investment to maintain current standard and invest in communal areas and lifts
    - Additional £3,000,000 capital investment to meet anticipated costs of residual fire safety risk assessment works
    - Removal of need to deliver ongoing savings at an unrealistic level (currently 3.9% per annum)

- Self-financing with above assumptions and use of available headroom to deliver new build affordable housing

4.8 The graphs in Appendix A, demonstrate (with the assumptions currently being used in our modelling for inflation rates, interest rates, right to buy sales, etc), that status quo is not a financially viable option for the Council. Under the current HRA subsidy system our revenue position is untenable from year 19, with our capital programme undeliverable from year 8. Under the self-financing scenario, the additional investment required in revenue repairs, decent homes and fire safety works could all be met, whilst still being in a position to repay debt and undertake an element of new build affordable housing.

4.9 The consultation questions each local authority's desire to move out of the HRA Subsidy system by means of voluntary negotiation, with powers afforded to the Secretary of State allowing exclusion of properties from the HRA on an individual basis. It is suggested that, with agreement, exit could be achieved from April 2011.

4.10 Alternatively, if primary legislation were required to secure exit by all local authorities, this would not be expected to be effective until April 2012 at the earliest.

5. Background Papers

These background papers were used in the preparation of this report:

- CLG Consultation Paper – 'Council Housing: A Real Future'

- HQN / Chartered Institute of Housing (CIH) Financial Modelling

6. Appendices

6.1 Appendix A provides output from the financial modelling and scenario modelling prepared with HQN and CIH, working with officers of Cambridge City Council.

6.2 Appendix B is the proposed response to the CLG in respect of the consultation ‘Council Housing: A Real Future’.

7. Inspection of Papers

To inspect the background papers or if you have a query on the report please contact:

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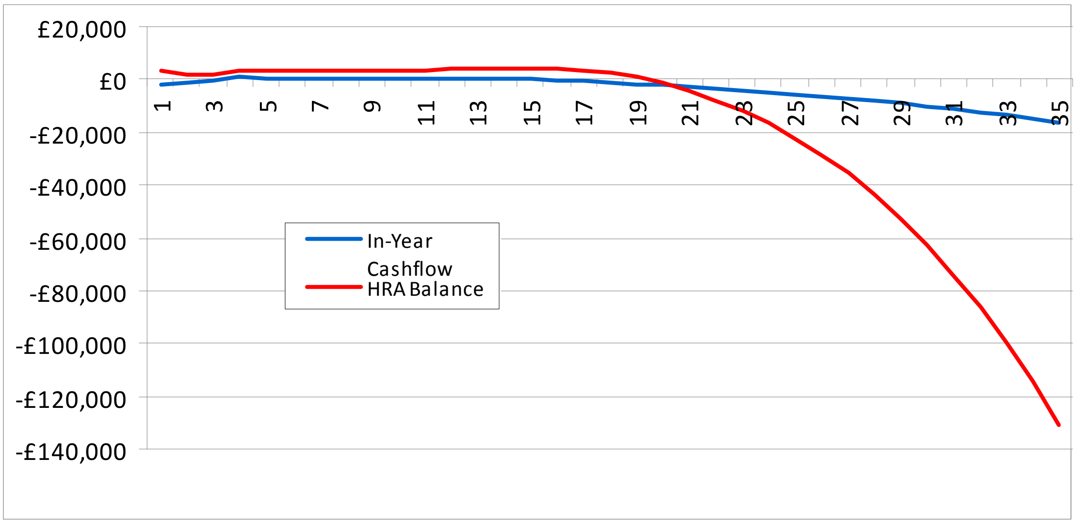
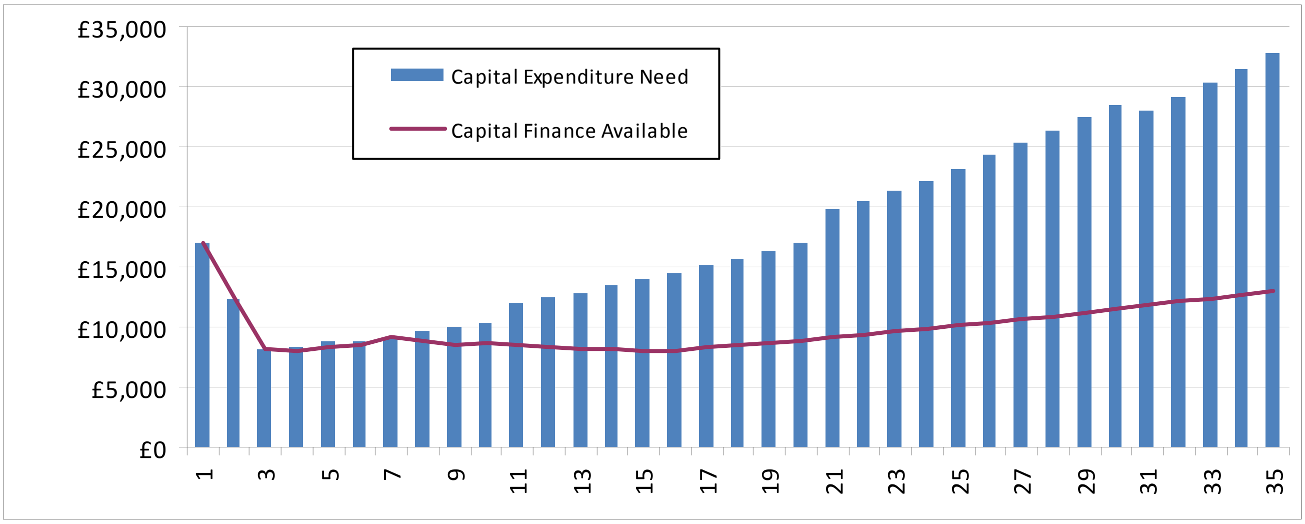
Appendix A

Current HRA 30 Year Business Plan – Within HRA Subsidy System

HRA Revenue Position (£'000)



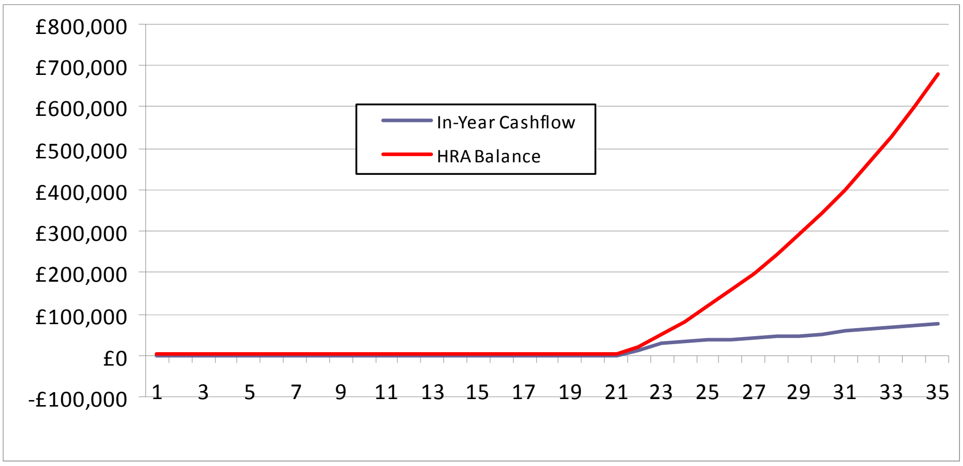
HRA Capital Programme (£'000)



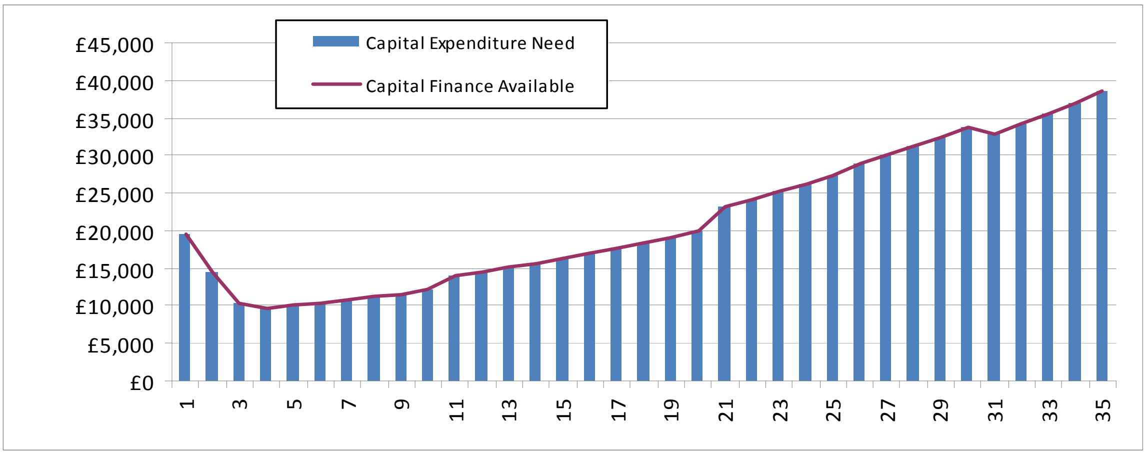
HRA Self-Financing 30 Year Business Plan

Includes additional £500,000 repairs expenditure, 26.3% increase in decent homes expenditure and £3,000,000 fire safety works

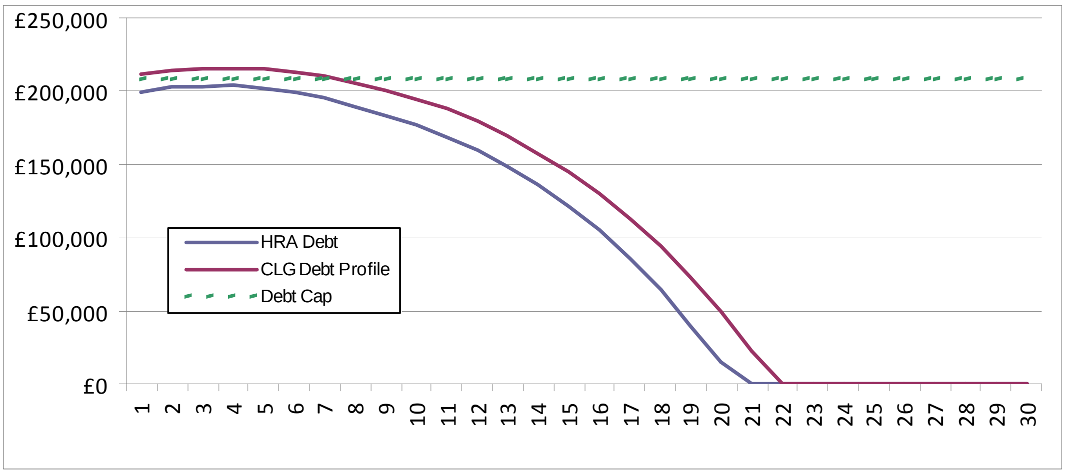
Revenue Position (£'000)



Capital Programme (£'000)



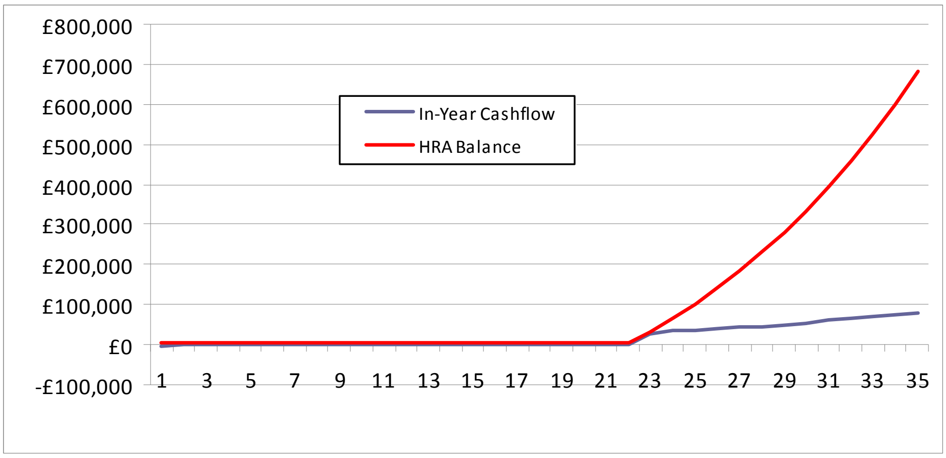
Debt Profile (£'000)



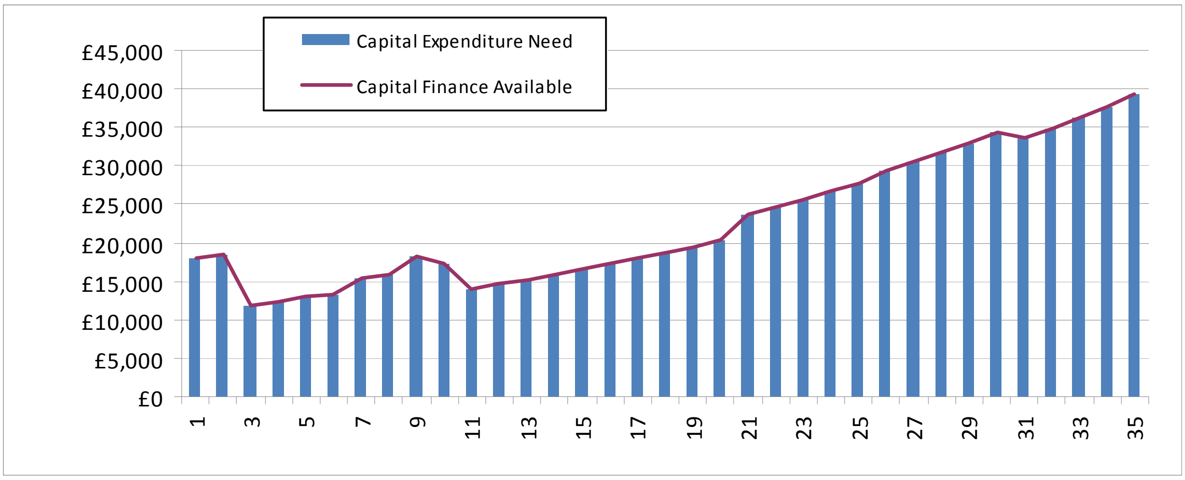
HRA Self-Financing 30 Year Business Plan – With New Build

Includes additional £500,000 repairs expenditure, 26.3% increase in decent homes expenditure (deferred until year 5), £3,000,000 fire safety works and new build of 100 units over 5 years (250 units over 10 years)

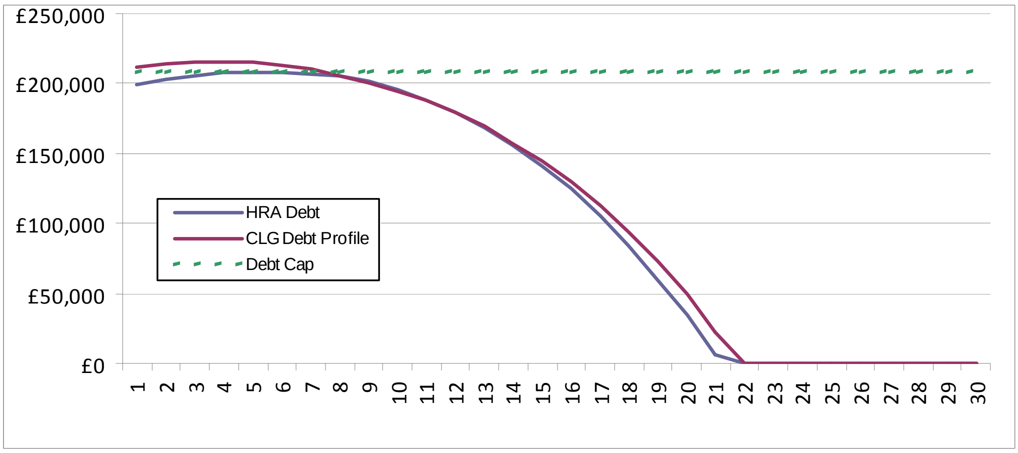
Revenue Position (£'000)



Capital Programme (£'000)



Debt Profile (£'000)



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CAMBRIDGE
CITY COUNCIL

Community Services

Review of Council Housing Finance
Communities & Local Government
Zone 1/J9
Eland House
Bressenden Place
London
SW1E 5DU

1 July 2010

Dear Sir,

Council Housing: A Real Future – Formal Response

Further to the consultation in relation to the reform of Council Housing Finance, the following is the response by Cambridge City Council:

General Overview

Cambridge City Council supports the principle of self-financing and welcomes the intention of CLG to replace the existing Housing Revenue Account Subsidy system, which has for many years, collected and redistributed housing resources nationally, with a system which is fairer at a local level. In broad terms, the proposals being made will allow local authorities to make appropriate decisions to meet locally identified priorities and to plan effectively for the longer term.

Included below are Cambridge City Council's responses to the specific questions raised as part of the consultation document.

Question 1 - What are your views on the proposed methodology for assessing income and spending needs under self-financing and for valuing each council's business?

The assumption that the only income in the self-financing model is from dwelling rents is strongly supported, as is the inclusion of an estimate of the rental income foregone due to the limits on individual rent increases and rent caps as applied through the rent restructuring regime. Although there is a clear need for consistent policy with regard to the setting of rents in the future, some degree of local discretion, or the ability to make local agreements, should be possible, to ensure that rents can be set to meet locally identified priorities and match customers expectation in service levels.

Liz Bisset, Director of Community Services, Cambridge City Council,
Hobson House, 44 St Andrews Street, Cambridge, Cambs, CB2 3AS,
Telephone 01223 457852.

INVESTOR IN PEOPLE

The exclusion of service charges and other income, with the assumption that charges are set to recover full costs is the only sensible approach to ensure that the assumptions made in the settlement are fair and consistent for all local authorities.

We have some concerns surrounding the methodology used to arrive at the proposed increases in management and maintenance allowances for each local authority, which in turn drive the calculation of the opening debt settlement. A far greater emphasis has been applied to allocating funding for local authorities with a high proportion of medium and high-rise flats. An increase in factors in the formula from 20% to 45% for management allowances and from 3.34 to 5.50 for maintenance allowances is proposed, channelling far greater resources into areas with significant high- rise flatted accommodation. This tends to be London and other inner city areas. Although it is recognised that there has historically been an increased cost to managing and maintaining this type of accommodation, the change proposed is considerable and does not take into account the opposing arguments. Landlords with high proportions of flatted accommodation should be able to procure services which deliver economies of scale, with access to a large number of units being possible with minimal relocation of resources. There are significant costs associated with the delivery of services across a wider, more rural locality, which appears to have had no bearing in the review.

Cambridge has also, for example, historically been disadvantaged in the subsidy system, where the measure of local building costs used, assumes the labour force in Cambridge is sourced from the East Anglian region. In reality the proximity to the capital means that labour is far more likely to be procured from counties in the South East and Greater London region.

The consultation does not redress such in-balances, with Cambridge City receiving only 1.2% compared to a 5% national average increase. The proposed re-allocation of resources succeeds only in re-allocating further resource into the areas where the greatest resource already exists and where the most economically advantageous procurement savings should be achievable.

In light of our concerns with regard to the calculation of management and maintenance allowances at a local level, the proposed 10% floor on overall allowance increase is obviously welcomed.

There is also concern, despite a clear intention in the earlier consultation, that there has not been appropriate adjustment made in respect of existing early debt redemption premia, which will cease to be supported if the HRA subsidy regime were to come to an end. Cambridge City Council are one of a number of authorities where financial decisions were made to repay debt based upon a guarantee that these costs would be met nationally. We would welcome the retrospective inclusion of this adjustment in any final settlement.

Assurance is also sought, that the over-recovery by government of the actual national housing debt, afforded by the methodology used for the initial debt settlements, will be re-directed appropriately into housing, predominantly to meet the identified backlog in decent homes. It is considered imperative that housing resources are retained for housing purposes, and should in no way be used to cross subsidise other areas of national spending.

Question 2 - What are your views on the proposals for the financial, regulatory and accounting framework for self-financing?

The proposal requiring local authorities to maintain a separate balance sheet for housing activities is strongly supported. This will allow us to demonstrate not only to the TSA as the regulatory body, but more importantly to the tenants and leaseholders in each local authority, how resources are utilised in managing, maintaining and improving housing assets locally.

As a debt free authority currently, the principle of taking on any new debt, let alone a share of the national housing debt, is not something that would be considered lightly. Although it is recognised that the benefits that self-financing may afford, can only be achieved if approached from a national perspective.

The proposal to allow local flexibility in balancing the level of investment in existing and new affordable housing with that of debt repayment, ensures that future decision making resides with those accountable for the services provided. This will enable the provision of a responsive service, with local priorities being met in a timely manner, where it is financially viable to do so. However, exposure to fluctuations in interest rates is obviously a risk that is of key concern to the authority.

With regard to future borrowing for self-financing landlords, clarity is sought over the level of the ‘cap on borrowing at the self-financing debt level’ that is proposed. It is our assumption that this is the overall opening debt level, and not simply the additional debt that will be required to be taken on after allowance for the Subsidy Capital Financing Requirement (SCFR). For many authorities, even assuming the reference is to the total opening debt, the cap leaves little or no initial headroom for additional investment in the early years of self-financing.

Continuation of the HRA ring-fence, with income and expenditure in relation to the Council’s housing stock accounted for independently of all other business activities, will ensure that rent is appropriately re-invested to meet the housing needs of both existing and future tenants of the authority.

Detailed guidance in respect of the operation of the ring-fence would be welcomed, with local authorities retaining reasonable flexibility, to enable a pro-active approach to service delivery to meet local need. Cambridge City Council support the key principles of allocation suggested, but would like to make the point that the costs of implementing, meeting and monitoring any new standards set by the TSA should be carefully considered in the context of the financial impact they may have for local authority HRA’s, and in turn for the tenants and leaseholders they serve.

Clearly it is important for all local authorities to feel confident that a decision to opt for self-financing voluntarily, with the inherent risks and responsibilities that would be associated with such a decision, will provide the financial stability, and required platform to plan for the longer term, that is absent in the current system.

It is recognised that CLG have taken on board comments made in the earlier consultation with regard to leaseholder sinking funds, and the view that this decision should be subject to local discretion, taking our specific circumstances into consideration, is welcomed.

<u>Question 3 - How much new supply could this settlement enable you to deliver, if combined with social housing grant?</u>

The level of new supply that the proposed settlement would enable local authorities to deliver will obviously be dependent upon a huge number of variables. There are numerous assumptions that need to be made in the financial modelling undertaken locally to arrive at any outputs in terms of new supply.

Based upon the financial modelling that we have undertaken, including some assumptions of additional need to spend on our existing housing stock, we anticipate that we may be in a position to deliver a programme of 100 units within the next 5 years, assuming Homes and Communities Agency (HCA) grant funding is available at the level at which it has previously been made available to RSL's and Housing associations locally.

Cambridge City Council were successful in securing HCA grant funding for 7 new affordable housing units as part of the first grant round for local authorities, and are well progressed in respect of identification and investigation of additional development sites within the city.

It should be noted that enabling Council's to invest in new housing will represent good 'value for money' for public funding beyond the number of additional new homes provided. For example, Cambridge City Council has assessed the feasibility of redeveloping 20 one bedroom, one person flats, replacing them with a mix of 20 one, two and three bedroom units including houses with bedspaces totalling 72. Although the scheme would generate no net increase in homes, it would provide a significant increase in size and type of home that better matches current needs and aspirations.

<u>Question 4 - Do you favour a self-financing system for council housing or the continuation of a nationally redistributive subsidy system?</u>

The current nationally redistributive subsidy system is clearly no longer fit for purpose. To facilitate continuation of such a national system, it is considered that significant change would be required.

With stock transfer not an option that tenants in Cambridge have supported in the past, the current self-financing proposal represents the only viable option available at present, to enable increased investment in both existing and prospective local authority affordable housing in the city.

To this end, Cambridge City Council support, in principle, the move to a self-financing system, dependent upon the exact terms of the final offer.

There are however, significant concerns that future governments / national decisions may change the basis upon which this decision has been made at a local level today.

<u>Question 5 - Would you wish to proceed to early voluntary implementation of self-financing on the basis of the methodology and principles proposed in this document? Would you be ready to implement self-financing in 2011/12? If not, how much time do you think is required to prepare for implementation?</u>

Dependent upon the certainty that can be given over the finality of the settlement, and subject to satisfactory assurances over some of the points raised in this response, Cambridge City Council would wish to proceed to an early voluntary implementation.

There is clearly significant detailed work to be undertaken at a local level, prior to implementation of any self-financing operational model, and as such, clarity after the close of the consultation would be welcomed in as timely a manner as possible.

To be in a position to implement self-financing by April 2011, it is considered that the Council would need a clear outcome from the current consultation by the autumn of 2010.

<u>Question 6 - If you favour self-financing but do not wish to proceed on the basis of the proposals in this document, what are the reasons?</u>

Not applicable based upon our response to question 5.

Yours faithfully

Liz Bisset
Director of Community Services

Councillor Catherine Smart
Executive Councillor for Housing

David Horspool
Director of Finance