

Wolverhampton City Council

**OPEN EXECUTIVE  
DECISION ITEM (AMBER)**

Cabinet / Cabinet Panel	<b>CABINET</b>	Date	<b>21.10.09</b>
Portfolio(s)	<b>REGENERATION AND ENTERPRISE</b>		
Originating Service Group(s)	<b>CUSTOMER AND SHARED SERVICES</b>		
Contact Officer(s)/ Telephone Number(s)	<b>DAVID KANE EXT 4423</b>		
Title	<b><u>RESPONSE TO GOVERNMENT CONSULTATION ON THE REFORM OF COUNCIL HOUSING FINANCE</u></b>		
		KEY DECISION: IN FORWARD PLAN:	YES/NO YES/NO

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**Recommendations**

- (a) To approve the document at Appendix A as the council’s response to the Government’s consultation ‘Reform of Council Housing Finance’;
- (b) To note the major financial implications that could ultimately result from this consultation, as outlined in section 3.

# **RESPONSE TO GOVERNMENT CONSULTATION ON THE REFORM OF COUNCIL HOUSING FINANCE**

## **1. BACKGROUND**

- 1.1 Central to the finances of the Housing Revenue Account (HRA) is the HRA subsidy system, a mechanism whereby HRA resources are pooled and redistributed throughout the country according to a formula determined by the Government. This formula makes assumptions about housing authorities' spending requirements and income. Where spending requirements are assumed to be greater than income, authorities receive a payment from the pool: where spending is assumed to be less than income, authorities pay into the pool.
- 1.2 The HRA subsidy system has been in place since 1990. During that time, the subsidy formula has been added to and modified many times, resulting in a system that has become extremely complex and hard to predict. In addition to this, over the last two or three years, the HRA subsidy system for the country as a whole has gone into 'surplus', meaning housing authorities as a whole are paying in more than they are getting back.
- 1.3 Subsidy has become the single biggest factor in preparing HRA budgets, with rent rises largely driven by the assumptions built into a given year's subsidy formula, and expenditure generally being a 'balancing item' after rents and subsidy are taken into account. The unpredictability inherent in the subsidy formula means that preparing HRA budgets in advance of the annual subsidy determination is impractical, and that medium term forecasts can never be prepared with any great certainty.
- 1.4 Since 2006/2007, Wolverhampton has been one of the authorities that pay into the subsidy pool. For 2009/2010, the council will pay over approximately £3.2m, rising to a forecast £6.1m in 2010/2011.
- 1.5 In recent years, a broad consensus has developed amongst housing and finance professionals that the HRA subsidy system is in urgent need of review. In recognition of this, in July 2009 the Government opened a consultation on the future of council housing finance. The following section sets out some of the key proposals contained within the consultation documents.

## **2. CONSULTATION PROPOSALS**

### Debt Resettlement

- 2.1 The most important part of the consultation is a proposal to abolish the HRA subsidy system altogether, in exchange for authorities accepting a one-off increase or decrease in their overall debt.
- 2.2 The increase or decrease in debt would most probably be calculated according to a Government formula: however the consultation does not provide enough information to know precisely what that formula would be, and therefore what value the debt would take. However, the formula seems likely to take the broad form of total subsidy for the next thirty years calculated in accordance with the existing rules, and reduced to reflect the time value of money.
- 2.3 In simple terms, this means that, instead of paying or receiving subsidy annually, authorities will be paid (or have to pay over) thirty years' subsidy at once. In the case of a receipt, they could use this to write down their existing borrowing: in the case of a

payment, they could take on additional borrowing to fund it. Thereafter, they would have, in principle, the freedom to manage their outstanding debt as they wished.

- 2.4 This could be understood as a once-and-for-all reapportionment of the total housing debt that is currently held separately by authorities, but serviced collectively between them by way of the allowance for debt costs in the subsidy formula.
- 2.5 It is crucial to note that, because the debt adjustment is likely to be based on something very similar to the existing subsidy formula, the two alternative scenarios of continuing with subsidy or accepting debt adjustment could be expected to be financially equal to one another when taken over the thirty year period, all other things being equal.
- 2.6 The debt adjustment scenario generally offers authorities increased autonomy to manage their HRA finances as they see fit, but some important constraints are likely to come with it. The consultation paper indicates that the Government would consider introducing new controls on borrowing (over and above that required to make the debt adjustment itself) in order to keep overall borrowing within what it considers to be reasonable limits.
- 2.7 In addition to this, the Government's current policy on rents is that authorities will ultimately calculate their actual rents according to a Government formula, and therefore not have control over their HRA's main income stream. This will come into effect once rent convergence is complete: when that will happen remains uncertain, but current indications are that it will be within the next decade.
- 2.8 The most valuable outcome of a debt settlement scenario would be vastly improved certainty and predictability around HRA finances. This would enable authorities to plan for the medium- and long-term with a much greater degree of confidence than is currently the case. A particularly important effect of this should be that that improved certainty flows through into capital expenditure planning and financing decisions, thereby ultimately improving asset management.
- 2.9 Whilst abolishing the subsidy system would take away the uncertainty and volatility that the present arrangements bring into HRA finances, the subsidy system nevertheless represents Government support of a sort. No longer having this support would introduce a new risk to Wolverhampton's HRA finances, which would have to be balanced against the existing risk of unfavourable changes in the subsidy formula.
- 2.10 The key point of this proposal is that authorities would experience a change in the nature of the risks associated with their HRA finances, in exchange for greater (but not absolute) financial autonomy and certainty.

#### Capital Receipts

- 2.11 The other proposal in the consultation that could lead to significant changes is that the current pooling arrangement for right to buy receipts (whereby authorities are only allowed to retain 25%) be abolished, and instead authorities keep 100% of their own receipts. As a principle, local retention of all receipts is fully consistent with local management of debt.
- 2.12 The consultation also raises the possibility that the Government may seek to exert some control over how part or all of those receipts are spent, in particular whether they are used to fund new housing or works on existing housing.

### The HRA Ring Fence

- 2.13 The consultation discusses the HRA ring fence (put in place to prevent cross-subsidy of rents and council tax). The proposal is that the ring fence continues in materially the same form as at present, with some detail changes.

### Changes to Maintenance Funding and Sinking Funds

- 2.14 The consultation proposes Government funding for additional maintenance items, but provides no further detail on what form that funding may take.
- 2.15 It also proposes clarifying the rules around sinking funds for leaseholders' works, to make clear that they are available to authorities should they wish to use them.

## **3 FINANCIAL IMPLICATIONS**

- 3.1 The work that underlies and will follow on from this consultation could have major financial implications for the council's finances, and the HRA in particular.
- 3.2 In the event of HRA subsidy being abolished in exchange for debt settlement, and the pooling of right to buy receipts ceasing, the following highly significant changes relating to the council's finances would arise:
- rents aside, the council would have more local discretion over its HRA than it would over its general fund (which would still be heavily dependent on Government support through revenue support grant);
  - the council would be able to forecast its HRA revenue expenditure and financial position, many years in advance, with much greater certainty;
  - HRA budget preparation and consultation processes would change fundamentally in the absence of HRA subsidy, which is currently central to those processes;
  - knowing that the council had greater control over its HRA expenditure could change its relationship with both tenants and service providers;
  - the council could see a significant increase or decrease in its total real borrowing, which could affect the general fund as well as the HRA;
  - the council might be able to finance more capital works to its housing stock than is possible at present, because it might be able to take on more borrowing than it can now;
  - the council would be entirely self-dependent in terms of generating right to buy receipts, and could not rely on the national pool to compensate for any local shortfalls.
- 3.3 The consultation documents do not contain enough information to reliably evaluate the most likely financial effects for Wolverhampton of the final outcome at this early stage. Sensitivity modelling of potential debt settlements has demonstrated that a wide range of scenarios is possible. It's particularly worth noting that these possibilities include both the council taking on extra debt, and the council being able to write down debt.
- 3.4 No financial implications will arise immediately and directly from responding to the consultation.

## **4 LEGAL IMPLICATIONS**

- 4.1 There may be legal implications to some of these proposed changes e.g. the provision of sinking funds although these are not quantifiable at present. There are no legal implications in replying to the consultation document itself.

## **5 EQUALITIES AND ENVIRONMENTAL IMPLICATIONS**

- 5.1 No equalities and environmental implications arising from the consultation proposals have been identified at this early stage. If the proposals proceed to a more detailed stage, a full assessment will be performed at that point.

## **6 RECOMMENDED RESPONSE**

- 6.1 The following paragraphs set out the key points raised within the recommended consultation response, each of which is explored in more detail at Appendix A.

### Debt Resettlement

- 6.2 The recommended response points out a number of things that must be in place for any debt resettlement to be financially viable for Wolverhampton, including:

- increases in expenditure allowances;
- no direction from Government on the authority's provision for debt repayment, total level of debt, or level of HRA reserves;
- clarity about future rents and rent convergence;
- a commitment not to re-visit the assumptions contained in any debt settlement, or the settlement itself;
- designation of the new debt as outside of prudential borrowing.

### Capital Receipts

- 6.3 The recommended response confirms that the retention of capital receipts would increase the risk of sufficient capital resources being available locally, and asserts that authorities should have flexibility over how they apply capital receipts.

### The HRA Ring Fence

- 6.4 The recommended response welcomes the continuation of the ring fence.

### Changes to Maintenance Funding and Sinking Funds

- 6.5 The recommended response welcomes the additional maintenance funding, but seeks clarification on how that funding would be made available.

- 6.6 It expresses the opinion that there would be no barriers to the operation of sinking funds, and that no action is required from Government to oblige councils to use them.

## COMMUNITIES AND LOCAL GOVERNMENT

### Reform of Council Housing Finance consultation questions

#### 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.

#### **Response:**

We strongly support the use of the ring fence, and welcome the proposal to determine what should be charged to the HRA by way of the principles set out in paragraph 3.28. We would emphasise the importance, as the consultation document touches on at paragraph 3.26, of retaining flexibility for authorities to configure their services, and allocate funding, in the way which best suits local needs.

#### Question 2

Are there any particular ambiguities or detailed concerns about the consequences.

#### **Response:**

The ring fence needs to be fluid enough to allow councils to provide services in the most efficient and customer-friendly means possible. Where this means, for example, one-stop shops, combining HRA and general fund services, the ring fence should not preclude or place administrative hurdles in the way.

The issue of detailed instruction concerning the allocation of costs, other than as set out in the principles, should be avoided wherever possible. Authorities should retain the freedom, in line with the principles set out, to allocate or apportion costs to the HRA in a simple and predictable way such that forward budget planning is supported.

We do not anticipate that the principles outlined at paragraph 3.28 will result in a material change in the total costs being borne by the General Fund or the HRA. Nonetheless, the list of requirements to be placed on landlords will be a matter of great interest to authorities as it will impact on our General Fund activities and forward planning.

#### 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).

**Response:**

Local calculations show that if the intention is to provide 24% immediate uplift in the MRA for the purposes of calculating the debt transfer, in lieu of common areas funding, this would leave 19% of the original 43% recommended by the BRE to fund the backlog. Even with this additional 19%, we anticipate that addressing our backlog would take many years. It is crucial that the backlog funding is made available as soon as possible, and that it is genuinely new resources.

It is also important that the council are not obliged to target / ring fence their capital expenditure according to central determination and can instead follow their strategic asset management plans in their capital planning. The council would therefore welcome further information on how and on what basis those funds might be made available.

**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.

**Response:**

We support the inclusion of the additional factors outlined in standards: however, we would have concerns about any assumptions about additional income, in particular tenant contributions, that might be made by central government under a reformed subsidy system.

**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.

**Response:**

We do not currently operate any sinking funds. There would, however, be no specific barriers to this council using them in future, the only concerns being those general matters set out in paragraph 3.37, any additional administrative burden, and having the support of leaseholders. We would emphasise that this last point is unproven in respect of leaseholders in Wolverhampton.

We believe that the proposed clarification on sinking funds, along with guidance on their application and operation, will be sufficient to encourage

authorities in conjunction with leaseholders to consider this option, and it would not be necessary to place any obligations on authorities.

We are however concerned that some of the methods suggested could make transfers of stock considerably more complex in the future (putting aside for one moment the other issues of financing stock transfer), as well as increasing the overall administrative burden on the HRA.

### **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.

### **Response:**

A new level of debt that, in total, exceeded the current notional debt in the national HRA would not be supportable. In practice, this will very much depend on the values used for some of the key parameters in the TMV/subsidy calculation. Our modelling has demonstrated that a wide range of debt settlements can be generated with modest changes in certain parameters, making it impossible to arrive at any definitive view of the future HRA (either locally or nationally) post-debt resettlement.

However, the modelling for Wolverhampton has demonstrated that the following are essential to ensure that the resulting level of debt would be sustainable locally:

The adjusting figure for the debt transfer calculation must be an adjustment to the supported debt level and not the actual debt level.

Management and maintenance allowances must increase by at least 10%. At Wolverhampton, our actual management and maintenance expenditure is 14% higher than our subsidy management and maintenance allowances. This is in line with BRE findings and those of the HQN.

Major repairs allowance must increase by the 24% outlined in the consultation, at the very least. And as it is intended to reflect a current under allocation in respect of common areas it should be applied in the debt transfer calculation in full in the first year. We would welcome modelling which takes into account the variation in the distribution of common areas geographically, for example, where housing is mostly multi-unit or high-rise we believe that increases above the 24% should be made available to reduce any inherent unfairness in the system.

It is important to bear in mind that the debt resettlement modelling assumes that the stock remains in good repair – this will depend on the availability of capital grants and new borrowing as well as the notional MRA allocation

available from rents. It is also worth remembering that as stock numbers decline through right-to-buy sales, the per-unit need to spend on the remaining stock, which is generally more expensive to maintain, and harder to let, increases. A thirty-year business plan that made assumptions about stock disposals and RTB receipts would also have to take this into account.

We would welcome the conversion of any outstanding ALMO supported borrowing entitlement at the point of settlement to capital grant, and further details on how it is envisaged this might work in practice.

We believe that, in the interests of sustainability and prudence, revenue provision for debt redemption should be determined in the same way as for other council borrowing (and not prescribed). This will allow authorities to ensure that the charges against rents best reflect the way in which resources are consumed, and enable them to make capital expenditure and treasury management decisions that are optimised according to local circumstances, whilst also ensuring that resources are identified to repay debt in a prudent manner.

In accordance with this, the existing mechanism whereby authorities are required to make a charge against the revenue account equal to the major repairs allowance should be abolished, and not replaced with a requirement of equivalent prescription.

Authorities should retain the discretion to determine for themselves an appropriate level of reserves. Prescriptive guidance on this point could lead to business cases becoming unsustainable due to lack of resources, or in rarer circumstances, having the opposite effect and leading to a level of uncommitted surpluses that was not anticipated in the original business case/debt resettlement.

The future direction on rents and rent convergence is key to the viability of any debt resettlement figure, and the consultation document does not provide enough information on this. We are concerned that any self-financing model could be undermined by additional controls on rents (particularly formulaic ones) that were either not factored into the original debt settlement, or that might continue to operate long after settlement in such a way as to form a system of equal complexity to subsidy itself. We believe this would contradict the principles of certainty and simplicity that the self-financing model could otherwise be expected to deliver.

We would like to emphasise that, for us, one of the key advantages of debt settlement is the certainty that it should provide in HRA financial planning. We would therefore be opposed to any arrangements that allowed for the re-visiting of the original settlement.

This would make it essential that any assumptions built into a debt settlement figure are not contradicted or undermined by subsequent events: for example, a limit on rents that prevented the rent convergence timetable reflected in the settlement from being achieved.

Once some of the underlying assumptions are known with greater certainty, more detailed modelling will be required to understand the timing of the benefits that might flow from self-financing: it is crucial for the credibility of the initiative that tangible benefits arise for most, if not all, authorities in the first few years.

It will also be essential to understand what controls the Government might put in place to protect individual authorities (and their rent payers) whose financial plans in the short and/or medium term are seriously adversely affected by the application of a formulaic approach to debt resettlement.

#### **Question 7**

Are there particular circumstances that could affect this conclusion about the broad level of debt at the district level.

#### **Response:**

We have incorporated our answer to this in our answer to question six.

#### **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.

#### **Response:**

We believe that premiums and other similar costs, taking into account discounts if applicable, that are incurred specifically because of the debt settlement exercise should be reimbursed on an actual basis in the year of settlement, and not reflected in the opening debt. Where an authority chooses not to redeem, or enter into new, borrowing immediately for treasury management reasons, the reimbursement should allow for a notional element purely in respect of this part of the overall increase or decrease in borrowing requirement. This treatment may require additional accounting guidance in terms of the timing of the recognition of these transactions.

#### **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?

**Response:**

Our preference would be to apportion and hold housing debt separately from other debt, with the charge to the HRA being the actual interest payable on housing debt. This would ensure that the amount met by tenants reflected as accurately as possible the actual costs of borrowing for housing purposes. We do not believe that this would have an adverse impact on treasury management, but may even improve it as charges to the funds individually would become easier to forecast.

Whilst we would prefer to discontinue the use of the item 8 formula for calculating interest charges to the HRA, we have not identified any technical obstacles to its continued use post-debt resettlement.

**Question 10**

Do you agree the principles over debt levels associated with implementing the original business plan and their link to borrowing.

**Response:**

We welcome the proposal to treat the debt adjustment as not counting towards prudential borrowing. In practice, we believe this should be reflected by allowing the authority to adjust its prudential borrowing figures by an amount equal to the debt resettlement figure, and not based on actual borrowing at the point of resettlement, which will also be influenced by treasury management decisions.

We believe that, in the event that additional revenue surpluses are generated that were not anticipated in the original debt settlement, it should remain entirely at the discretion of each authority as to how it uses those surpluses. It is important to remember that, even in this relatively positive scenario, an authority is likely to be faced with a wide range of calls on its financial resources, and prudential borrowing will not always be the first and only call on those surpluses.

We believe that the existing guidance on prudential borrowing is sufficient to keep overall borrowing within reasonable limits, and no further controls would be required. As referred to in our answer to question 6, we believe that the existing guidance on providing for the redemption of debt that applies to the general fund should also apply to the Housing Revenue Account in a self-financing scenario. This would make a significant contribution to keeping overall debt within acceptable levels.

**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.

**Response:**

Uncommitted income streams may include:

- rent increases above those in the original business plan;
- separated-out service charges which were not envisaged in the original business plan;
- surpluses arising from planned under spends on repair programmes;
- savings arising from treasury management activity that is different to that assumed in the original business plan.

It is difficult to forecast how councils might use these, as the financial landscape post-debt resettlement is likely to be very different to the current one. This council has not yet considered the possibility of having 'surplus' revenue resources, or formed any opinions on what it might do in that situation, however some possible uses are:

- putting in place service developments and enhancements;
- reducing rents, service charges and other income, where allowed by statute and accounting practice;
- making revenue contributions to capital;
- using to redeem existing housing debt;
- using to finance additional borrowing to finance housing capital expenditure.

In addition, income from sinking funds has been identified elsewhere in the consultation – is it the intention that this money could be used to support prudential borrowing? If so, more clarity should be provided on the circumstances in which that would be allowed, although in principle we would welcome the potential of a mechanism such as this to allow us to provide specific enhancements of value to tenants.

**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).

**Response:**

There is a significant risk transfer in this proposal to individual landlords. Authorities are being asked to accept that in exchange for losing the relative certainty of capital grants via pooling, we must accept the market volatility of housing sales locally as an alternative source of funding.

Most authorities are already facing a gap in their capital funding caused by the reduction in the 25% of capital receipts which support their capital expenditure. To expand this loss to 100% of capital receipts and extend it over 30 years significantly increases the risk to local government, at a time when, given that "Right to Buy" has been in operation for many years, the most saleable properties are already sold.

The council would welcome an analysis of the amount of receipts pooled by each authority, and their receipts back from that pool, and an indication of how the Government envisages any negative impact on those authorities that have been net gainers might be avoided or mitigated.

### **Question 13**

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

#### **Response:**

We believe that if the intention is to focus authorities on their asset management role, they should be allowed maximum flexibility in how they deploy their capital resources. There can be no benefit from controlling to a national standardised ratio of new to existing stock when local authorities experience widely differing problems and challenges in their stock.

### **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.

#### **Response:**

We do have some concerns, because the receipts will not necessarily return to the areas of greatest need, as referred to in our response to question 12. Pooling is the only mechanism which returns the receipts themselves to the areas of greatest need. However, we believe that this concern could be addressed by an enhanced capital grants regime that supplemented capital receipts and was targeted at areas of greatest need.

### **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.

#### **Response:**

It is not possible to provide a response to this question as it would require completion of a full equality impact assessment which would only be possible

when further details on the proposed changes have been clarified by Government.

**Questions 16**

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

**Response:**

See answer to question 15.

**Question 17**

What would be necessary to assemble the evidence required.

**Response:**

See answer to question 15.