Committee/Meeting:	Date:	Classification:	Report No:
Cabinet	7th July 2010	Unrestricted	

Report of:	Title:
Corporate Director Development & Renewal/ Corporate Director of Resources **Originating officer(s)** Chris Holme	Council Housing Finance Reform Prospectus – Implications for Tower Hamlets and Proposed Response **Wards Affected:** All

Lead Members	Housing, Heritage and Planning; Resources
Community Plan Theme	One Tower Hamlets
Strategic Priority	Ensuring Value for Money Across the Council

1. SUMMARY

1.1 This report sets out the Government's prospectus for reforming the Council Housing Finance System, its implications for Tower Hamlets, and recommends a response to the draft "offer." Local Authorities have until the 6th July to respond to CLG. It also asks Members to agree a number of principles to facilitate medium term sustainability of the Housing Revenue Account.

2. DECISIONS REQUIRED

Cabinet is recommended to:-

2.1 Note the long term financial implications for Tower Hamlets of continuing with the current housing subsidy system and that of the current HRA self-financing offer, from the CLG "Prospectus" – Council Housing A Real Future, as set out in paragraph 7 of the report.

2.2 Note the response in Appendix 2 submitted to CLG in accordance with the deadline of 5 July 2010.

2.3 Authorise the Corporate Director Development and Renewal, after consultation with the Director of Resources and Lead Members Housing, Heritage and Planning, and Resources to provide any further responses to CLG that may be required in relation to the Prospectus.

2.4 Agree the financial principles set out in paragraph 9.2 to support delivery of a sustainable Housing Revenue Account.

2.5 Agree that all Right-to –Buy receipts are earmarked to support social housing and housing regeneration capital programmes (paragraph 7.10).

3. REASONS FOR THE DECISIONS

3.1 The Council must decide whether or not it is in favour of self-financing for its Housing Revenue Account or that it supports retention of the current system of housing subsidy. This decision will have significant financial implications for the Council.

3.2 Recommendations 2.4 and 2.5 are intended to support the delivery of a sustainable Housing Revenue Account in the medium term. Under either finance system, the Council will continue to have a statutory requirement to balance income and expenditure within its HRA.

4. ALTERNATIVE OPTIONS

4.1 With regard to recommendation 2.2, the Council could have determined not to support the principle of self-financing as set out in the CLG Prospectus. If sufficient other Council adopt this option then the current system could be retained or the Government could impose a new regime through legislation. The financial implications for Tower Hamlets of retaining the current system of housing finance are set out in paragraph 7.7 of the report.

4.2 Members could reject one or more of the principles set out in paragraph 9.2, and summarised as recommendation 2.4, but this would make achievement of our HRA Medium Term Financial Strategy more difficult and inhibit longer term stability.

4.3 If implemented, the new system of council house financing will facilitate retention of right-to buy receipts rather than the current national pooling system. At least 75% will be required to be applied for housing purposes, but the Council has flexibility with regard to the remaining 25%. To facilitate repayment of outstanding debt on dwelling assets no longer owned, and maximise housing receipts for capital investment purposes, full earmarking is recommended.

5. BACKGROUND

5.1 The Housing Revenue Account (HRA) relates to the activities of the Council as landlord of its dwelling stock. Income to the HRA is primarily derived from tenants' rents, service charges and government subsidy. Expenditure includes repairs and maintenance and the provision of services to manage the Council's housing stock. Expenditure not met by Housing Revenue Account subsidy must mainly be met from Council tenants and leaseholders.

5.2 Tower Hamlets has traditionally been a major recipient of housing subsidy. The system works by pooling the £6billion of council rents collected nationally and redistributes them on the basis of assessed need, measured through management, maintenance and major repairs allowances, and interest on each Council's assumed level of historic debt. The net position is that over 70% of local authorities pay £700million into the system, and the recipients of subsidy (less than 30%) receive £600million. The balance of £100m is retained by the Treasury.

5.3 The current HRA finance system has a number of problems:

- Because there is an annual subsidy determination, medium and longer term financial planning is very difficult
- It is complex, volatile and lacks transparency
- 75% of receipts from sale of right-to-buy properties are retained by central government

5.4 In recent years the Council's entitlement to housing subsidy has reduced significantly, both in total terms and per dwelling. In 2004 the Council received some £60million. This year the likely amount of subsidy received will be approximately £13million. Even allowing for changes associated with stock numbers this means a greater proportion of costs must be recovered from tenants and leaseholders. Furthermore the Council's consolidated rate of interest (i.e. the average rate of interest for all our actual HRA and General Fund historic debt) has reduced significantly over the last 2 years, in line with in prevailing economic conditions, and this has also had significant adverse subsidy implications for Tower Hamlets. This is because the subsidy entitlement calculation deems our notional debt to be higher than our actual level of debt, and therefore loss of subsidy is only partially offset by reduced interest charges.

5.5 Officers assessment is that Council annual subsidy entitlement, under the current system, will continue to fall year on year by between £1.3million and £2million to 2016 and some £500k per annum beyond. This means that by the mid 2020s the Council would become a net contributor rather than a recipient of housing subsidy. The existing council housing finance system therefore is not sustainable for Tower Hamlets.

5.6 At the end of March 2010, the previous Government set out a consultation document to dismantle the HRA subsidy system and replace it with new self-financing system, whereby all Councils would retain their rents and receipts from the sale of housing. In return, there would be a national redistribution of debt, and all future capital expenditure would have to be managed from within the ring-fenced HRA. The Coalition Government is pledged to reform the HRA and has not withdrawn the proposal.

5.7 The "prospectus" includes provision for strengthening the HRA ring-fence guidance (primarily through increased transparency) and there would also be a requirement to develop a 30 year business plan for management of council housing stock. Overall the prospectus offers the most radical change to council housing finance since the introduction of right-to-buy.

5.8 The deadline for local authorities to respond to the questions posed in the prospectus is the 6th July. If sufficient local authorities are supportive then provision exists within the Housing and Regeneration Act 2008 for the Government to make the changes without the need for further legislation.

6. OUTLINE OF THE HRA REFORM PROSPECTUS

6.1 The key elements of the offer, as it currently stands are as follows;

- The dismantling of the HRA subsidy system
- National council housing debt of £26billion is redistributed amongst the 177 local housing authorities, supplemented by increased allowances for management, maintenance and major repairs rolled into the debt adjustment over 30 years
- Additional interest rate "headroom" of ½% in the debt adjustment calculation which is intended solely for new supply housing, if local authorities confirm they are able to use it for that purpose
- Rents to be retained locally
- 100% of RTB receipts retained locally so long as the 75% which is pooled under the current system is utilised for social housing and regeneration
- Some £3billion of capital grants for completion of the decent homes programme (subject to future spending reviews)
- A strengthening of the HRA statutory ring-fence, and greater transparency for tenants and leaseholders
- The requirement for a separate housing balance sheet and a 30 year HRA business plan
- All future capital expenditure (with the exception of round 3 decent homes) to be financed locally through the HRA business plan and capital receipts
- The possibility of de-pooling HRA and General Fund debt

6.2 In addition to the level and uncertainty around the availability of future capital grants, as outlined above, the prospectus sets a cap on the total amount of future borrowing for each local authority.

7. IMPLICATIONS OF THE PROSPECTUS FOR TOWER HAMLETS

7.1 The debt redemption offer for Tower Hamlets is £277million based on the 7% discount factor, and caps future debt at £134million. This is based on uplifted management and maintenance allowances of 12.5% and major repairs allowance (MRA) of 7.8% - resulting in a consolidate uplift of 11.3%. The Council benefits from the management and maintenance uplift because of its high percentage of high-rise properties, but the MRA settlement is lower than the national average because capital expenditure per dwelling is deemed lower for blocks than houses.

7.2 The Council's notional debt for subsidy purposes in £410.5million, whereas actual debt for 2010/11 is £292.5million. This means £118m is retained as borrowing potential under the self-financing system. Officers' assessment is that this reduction of debt would facilitate, with prudent management of the HRA, the generation of sufficient revenue surpluses to finance the additional interest charges from new unsupported borrowing.

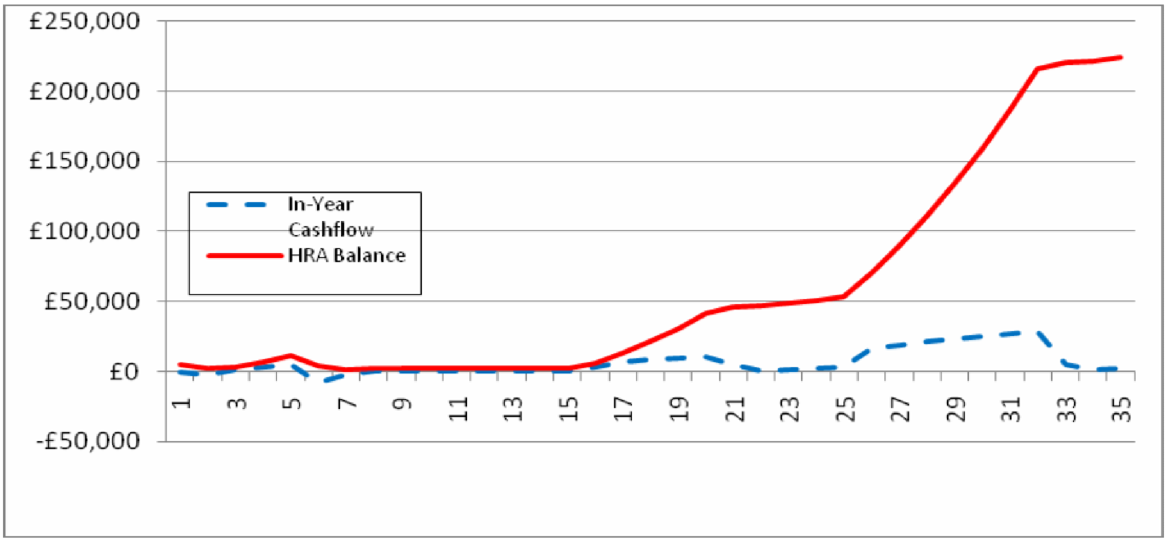
7.3 Repayment of debt at 7%, as set out in the offer would deliver some £6.6m "headroom" for provision of new housing, and officers initial assessment is that this could facilitate up to 60 new dwellings (based on average size and build cost) over the first 5 years of the HRA business plan, assuming combined with 30% social housing grant.

7.4 The introduction of self-financing and the 30 year HRA business plan puts a new emphasis on the management of assets and the relationship between capital investment and revenue maintenance of the stock. A critical assumption relates to the stock investment and capital expenditure needs over the longer term.

7.5 Based on a recent sample stock condition survey of 1500 properties by Savills in November 2009, the 30 year capital expenditure profile is some £56.3k per property (i.e. £650m for 11,500 properties). This excludes the Ocean, which is a separate housing regeneration scheme. However longer term capital investment assumptions for the Ocean Estate, over the 30 years of the plan have been factored back in, along with an allowance for disabled adaptations. The assumed average capital cost per dwelling is £54.9k per unit (based on some 12,500 dwellings) over 30 years with 9% added on to cover procurement needs. A business model based on these assumptions provides the basis for initial testing of the viability of self-financing given the debt settlement and the potential for £222m of capital grants to fund the ALMO decent homes programme.

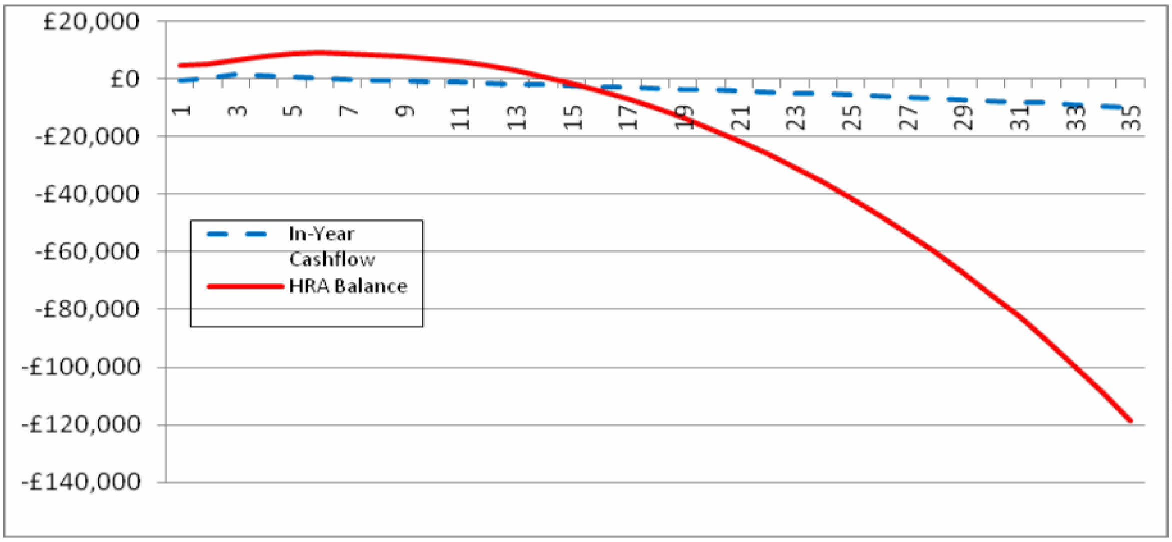
7.6 The capital investment need, as identified in the Savills report, is significantly higher than that assumed in the CLG's self-financing model (£32.8k per dwelling). Despite this the charts set out in Appendix 1 (and summarised below), demonstrate that the self-financing offer can work for Tower Hamlets, and if the ALMO investment is secured, it could deliver the assessed capital investment needs set out in the Savills stock condition survey, and begin to repay debt.

Chart 7.1 - Impact on HRA of self-financing offer, based on capital investment needs and assuming no set aside of debt (£000)



7.7 This is not the case under the current unreformed subsidy system. Indeed, using the same assumptions as those derived for the self-financing model, there would be a shortfall over the period of the business plan of some £323million, even with the ALMO investment of £222million, and that shortfall in capital resources would start occurring from year 5 onwards. HRA debt would rise to over £500million and increasingly as subsidy declines the Council will struggle to service this debt and maintain a capital programme. This is again demonstrated in Appendix 1 and summarised in the chart below.

Chart 7.2 - Impact on HRA of subsidy system based on capital investment needs (£000)



7.8 The adverse position under the current subsidy system could be further exacerbated if under the autumn spending review allocations of Supported Capital Expenditure for local authorities are reduced or withdrawn completely.

7.9 In conclusion, self-financing of the HRA, as proposed in the CLG prospectus puts Tower Hamlets in a significantly improved financial position than under the current subsidy system, and offers the potential for new build. This is primarily because;

- The Council will retain all rents and benefit from the annual increases so long as it follows rent convergence guidelines. Both scenarios outlined above assume rent convergence by 2015/16 as set out in the Prospectus
- The uplifts for management and maintenance, and MRA, are reflected in the debt adjustment and so the Council benefits from this immediately
- The interest charge on debt is lower than that set out in the offer

7.10 The viability of the self-financing offer and potential for new supply would be threatened if the Government are minded to amend the offer or withdraw decent homes funding. As a one-off offer it is also sensitive to significant inflationary pressures and interest rate changes. It is therefore important that capital receipts from future right-to-buys are retained to reduce debt and support the housing capital programme.

8. RESPONDING TO THE PROSPECTUS

8.1 The prospectus asks a number of questions, and seeks in principle to assess whether the offer is generally acceptable. Appendix 2 sets out the CLG consultation questions along with proposed outline responses. Cabinet is asked to note the submission to CLG. Cabinet is further asked to delegate to the Corporate Director Development and Renewal, after consultation with the Director of Resources and Lead Members Housing and Resources authority to deal with any further requests from CLG in relation to consultation on the Prospectus.

9. HRA FINANCIAL STRATEGY

9.1 Cabinet agreed the principles of a medium term financial strategy at its meeting of 10th February, which took account of the assumed level of subsidy loss during the next 3 years. The Government assume our current costs of management and maintenance, after the uplifts outlined in paragraph 7.1 above, to be £41.9million, whereas actual net costs for 2010/11 are £42.5million (without taking account of any notional uplifts.)

9.2 It is therefore essential that, pending introduction of the new system, we continue to deliver the required savings, particularly from management and administration. Furthermore, under self-financing what makes up rents and service charges will need to become more transparent, and long-term sustainable HRA business plan will require stable and effective treasury management. Members are therefore asked to agree the following principles to facilitate delivery of a long-term sustainable HRA.

- Income from the management of non-dwelling related HRA activities should aim to cover the total cost of providing these services to avoid being subsidised from tenants rents;
- Rents should not subsidise service charges, nor vice versa
- The Council aims to achieve rent convergence in line with Government guidelines (currently 2015/16)
- High emphasis on debt collection is maintained to minimise provision for bad debts
- Treasury management strategy for the HRA focuses on longer term stability at a rate below the CLG discounted net present value of 7%.

10. COMMENTS OF THE CHIEF FINANCIAL OFFICER

10.1 The report sets out the implications of the proposed system of local government housing finance as set out in the CLG prospectus issued at the end of March 2010. The analysis highlights the huge disparity between investment needs and likely housing resources that will be available in the future under the current subsidy regime. Initial assessment of the offer for Tower Hamlets appears to demonstrate significantly improved viability under the self-financing option. However the model is extremely sensitive to assumptions and further review of the business model is required, along with assessment of the General Fund implications and risks as outlined in paragraphs 14.4, 14.5 and 15.1.

10.2 At this stage, a positive response to the consultation does not commit the Council, but notwithstanding the autumn spending review, there is the possibility of a speedy introduction of the new financing system. Again further testing of the model and its treasury management implications would be required before acceptance.

10.3 Recommendation 2.5 seeks approval to earmark all RTB receipts for housing purposes. Under the proposed self-financing system at least 75% (i.e. that element pooled under the current system) must be retained for social housing and regeneration purposes. However earmarking all future RTBs will limit the flexibility of the Council to utilise the residual 25% of receipts for other strategic (non-housing) priorities. Currently the number of right-to-buys is very low, but this may change as market conditions improve.

10.4 The tighter ring-fence applied to the HRA may mean that some services currently lawfully charged to the HRA cannot be charged there in the future. The impact of this is still to be assessed but an additional cost to the General Fund, or savings to those services affected, is possible. However the tighter ring-fence would also clarify the financial arrangements around the HRA and make it easier to make long-term policy decisions about the stock.

10.5 Whilst the initial analysis indicates that the offer is advantageous compared with the existing the subsidy system as it is expected to pan out for the authority over the next few years, the long term maintenance and improvement of the current housing stock as financed through the reformed HRA is subject to assumptions about the funding likely to be available, including the allocation of funding from Decent Homes. The development of the 30 year business plan will shed further light on this question.

10.6. In order to take full advantage of the debt redemption offer of £277m, the authority will need to change its borrowing plans for 2010/11 to ensure that it has sufficient borrowing from the government on its books to gain fully from the offer. This can be accommodated within the Treasury Management Strategy agreed by the Council in March, although with less room for flexibility, and will increase borrowing costs for a short period, which again can be contained within existing budgets.

10.7 If implemented, the self-financing proposals would be likely to apply from 2011/12 and would need to be taken into account in the forthcoming budget process.

11. <u>CONCURRENT REPORT OF THE ASSISTANT CHIEF EXECUTIVE (LEGAL SERVICES)</u>

11.1 The report deals with the implications of ending the current housing subsidy system.

11.2 The Council is subject to an obligation under Part VI of the Local Government and Housing Act 1989 to maintain a housing revenue account. The Council is required to prepare proposals in January and February each year relating to the income of the authority from rents and other charges, expenditure in respect of repair, maintenance, supervision and management of HRA property and other prescribed matters. The proposals should be based on the best assumptions and estimates available and should be designed to secure that the housing revenue account for the coming year does not show a debit balance. The Council must keep those proposals under review and revise them if necessary to keep the HRA in positive balance. The consideration of the government proposals and their impact on the HRA is consistent with the Council's obligations.

11.3 The report proposes further that right to buy receipts are earmarked for housing and housing regeneration capital programmes. The Council is required to deal with capital receipts in accordance with Part 4 of the Local Authorities (Capital Finance and Accounting) (England) Regulations 2003. Pursuant to regulation 23, the meeting of capital expenditure is one of the permissible uses for capital receipts.

12. <u>ONE TOWER HAMLETS CONSIDERATIONS</u>

12.1 Under either system the Council is required to maintain a balanced HRA. This means the right balance has to be struck between maximising resources available to the Council for social housing and avoiding undue hardship on vulnerable tenants. It is considered that the approach proposed in the report strikes the right balance.

13. SUSTAINABLE ACTION FOR A GREENER ENVIRONMENT

13.1 There are no specific SAGE implications of the report.

14. RISK MANAGEMENT IMPLICATIONS

14.1 The prospectus has been issued at a time of considerable uncertainty with regard to public finances, and there is the potential for the proposals not to proceed under the new Government, particularly if a number of local authorities say “no” to the proposals. As outlined in paragraph 5 above, continuation of the current subsidy system will continue to have significant long term financially adverse implications for Tower Hamlets.

14.2 Moving to self-financing significantly alters the risk profile of the HRA and its business plan. The current system focuses on unpredictability of subsidy entitlement and inability to plan ahead. New risks will focus on Treasury Management, interest rate fluctuations and local decision-making around best use of borrowing, capital receipts and reserves. Robust risk management will be an essential tenet to support asset management decisions within the business plan.

14.3 Self-financing will mean breaking the link between MRA and depreciation, and the Council will be required to determine a fair depreciation charge for the HRA. Work is currently being undertaken by CIPFA and the Audit Commission to ensure, where possible this is revenue neutral. However there is a risk that depreciation could be higher than the uplifted MRA allowance allowed for in the debt adjustment.

14.4 The debt adjustment offer refers specifically to the redemption of PWLB debt. However the balance of PWLB debt held by the Council as at 30th March 2010 is less than the amount to be redeemed in the prospectus. Further clarification is being sought from CLG over how this issue will be resolved.

14.5 The reduction in HRA debt will impact on the Capital Financing Requirement of the Council (overall outstanding debt.) As a consequence the consolidated rate of interest charged to the General Fund could increase.

14.6 Under either system there is a risk to the Decent Homes funding. Whilst the self-financing model is significantly more resilient than the current subsidy system, failure to receive the ALMO decent homes funding of £220m would leave a capital shortfall over the 30 years of £330m. However, under the current system that shortfall would be some £600milllion.

14.7 Under the current system there is a risk of reduction or withdrawal of Supported Capital Expenditure allocations. The Council currently receives some £15million of borrowing approval. This is not a factor under self-financing as all borrowing is funded from the HRA. However there is a risk that Councils might not benefit from social housing grant for new supply. Under these circumstances it would be all the more important for the Council to ensure most effective use of right-to-buy receipts.

15. CRIME AND DISORDER REDUCTION IMPLICATIONS

15.1 Proposals to strengthen the statutory ring-fence of the HRA need further clarification, but could restrict the freedom of the Council to charge tenants for certain crime and disorder and general nuisance related services, with consequential General Fund implications - both financial, and service delivery.

16. EFFICIENCY STATEMENT

16.1 The report sets out the need to deliver the short-to-medium term efficiency savings as outlined in the Council's agreed HRA financial strategy.

17. APPENDICES

Appendix 1 – Detailed Assessment of the CLG Council Housing Reform prospectus for Tower Hamlets
Appendix 2 – CLG Council Housing: A Real Future – Prospectus: Consultation Questions and Proposed Response.

Local Government Act, 1972 Section 100D (As amended)
List of "Background Papers" used in the preparation of this report

Brief description of “background papers”	Name and telephone number of holder and address where open to inspection.
None	**N/A**

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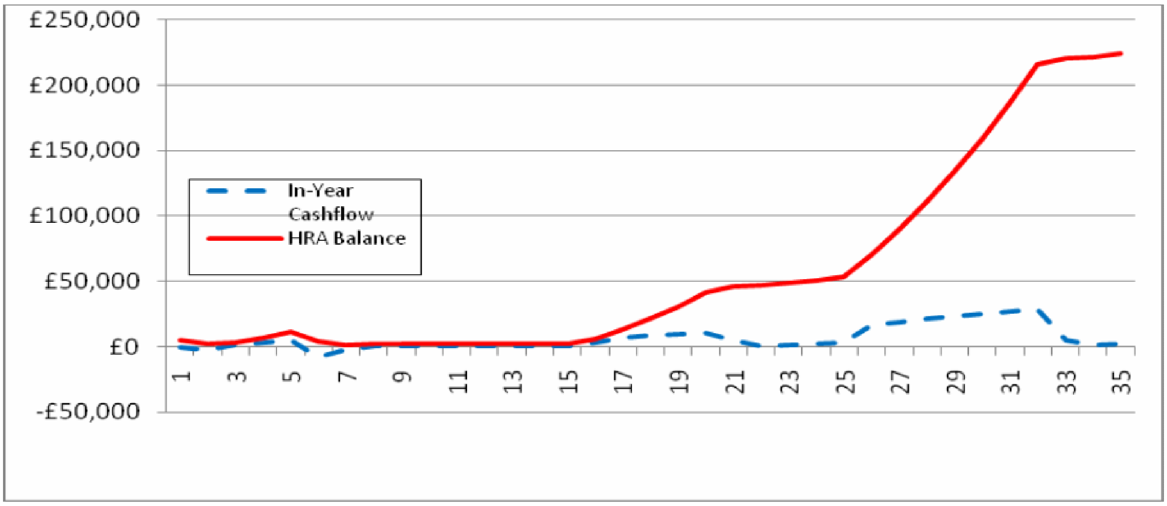
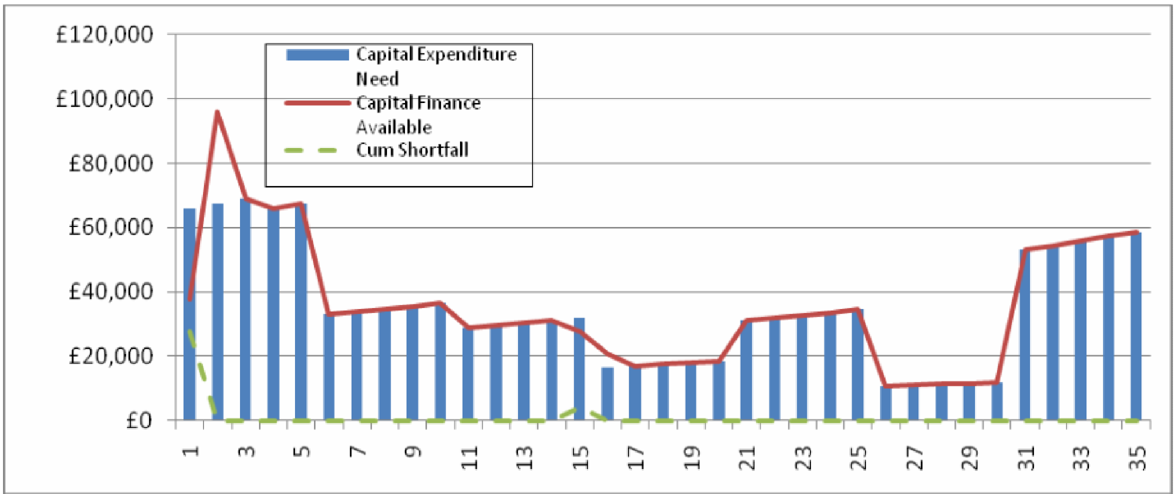
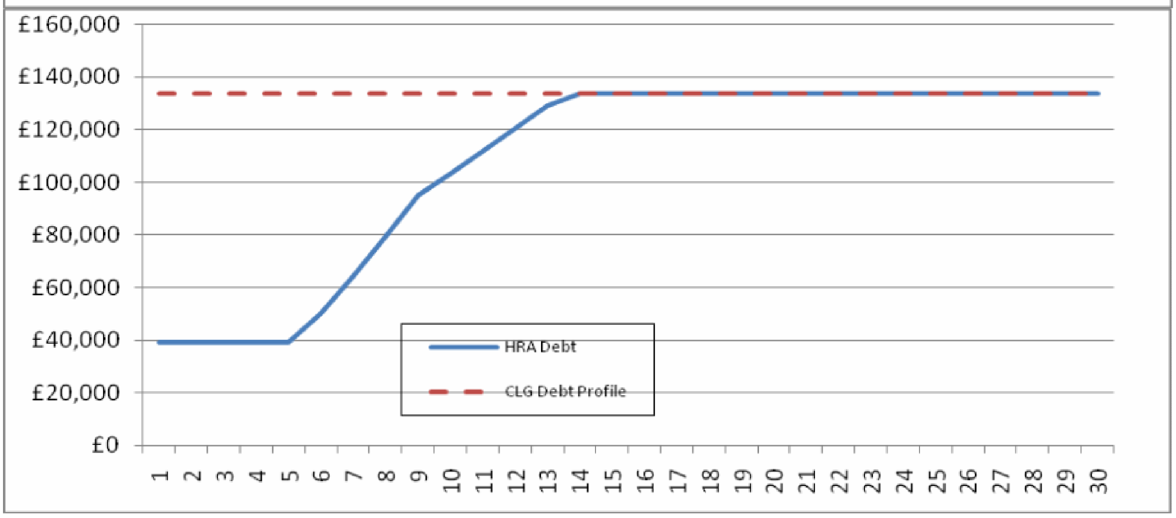
APPENDIX 1

DETAILED ASSESSMENT OF IMPLICATIONS FOR TOWER HAMLETS AND COMPARISON OF THE BUSINESS MODELS

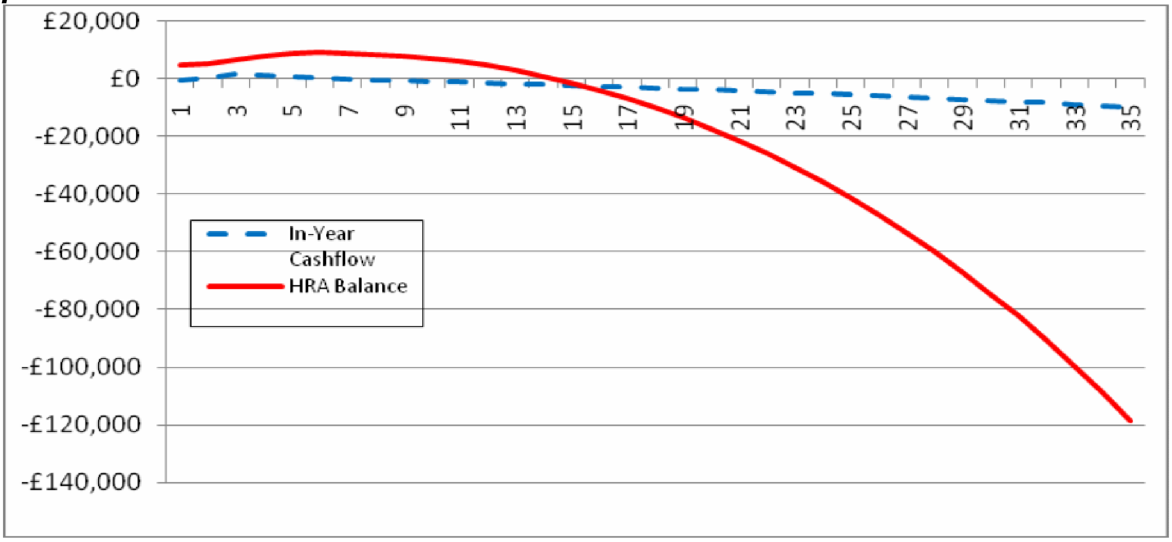
Charts 1a, 1b and 1c: Self financing revenue, capital and debt profiles £'000: no set aside

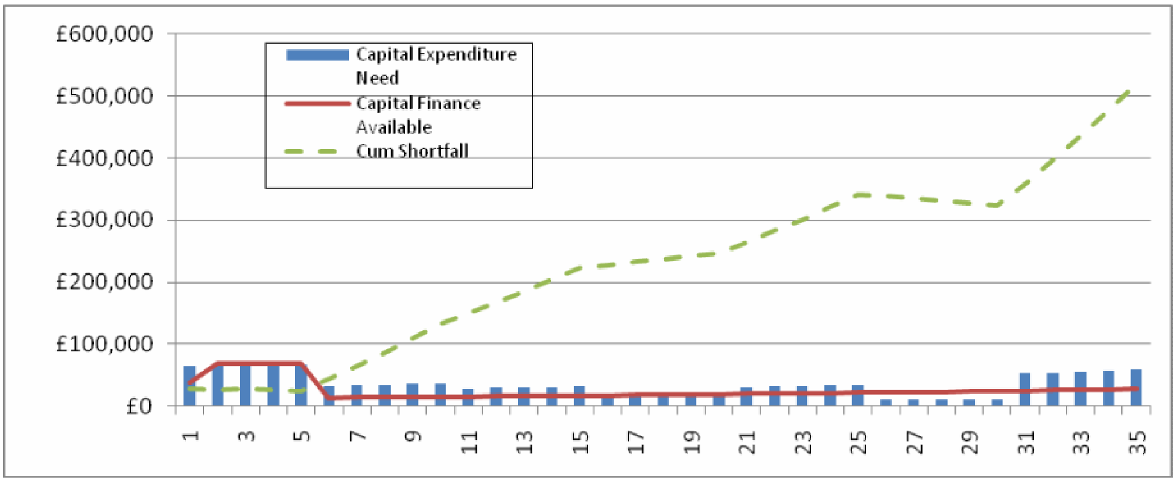


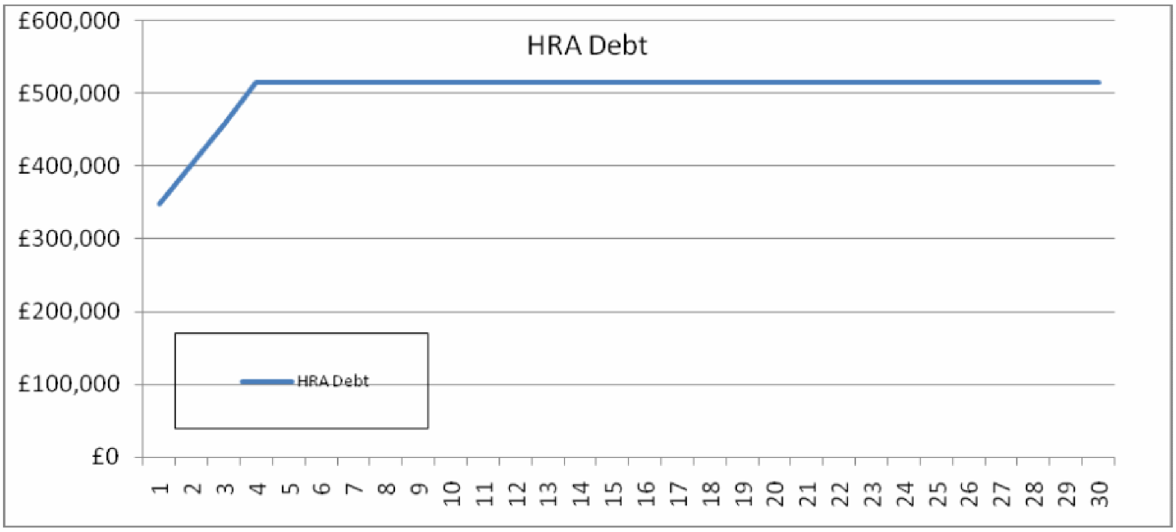




Charts 2a, 2b and 2c: HRA within Subsidy System revenue, capital and debt profiles £'000







APPENDIX 2

CLG CONSULTATION QUESTIONS AND PROPOSED OUTLINE RESPONSE

Question	***Proposed Outline Response***
What are you views on the proposed methodology for assessing income and spending needs under self-financing and for valuing each council's business?	The Council generally supports the methodology outlined in the prospectus and the basis for determination of the debt adjustment. However the Council does not agree with the assumptions for calculation of the MRA uplift as this significantly understates the investment costs associated with high rise properties and other flats compared to houses. Viability for Tower Hamlets is dependent on the availability of ALMO decent homes funding
What are your views on the proposals for the financial, regulatory and accounting framework for self-financing?	Clarification is sought around the debt limit, and the potential for future borrowing beyond the cap set in future years.
How much new supply could this settlement enable you to deliver, if combined with social housing grant?	An initial assessment suggests that the headroom proposal, if combined with social housing grant, could facilitate the delivery of up to 60 new supply units
Do you favour a self-financing system for council housing or the continuation of a nationally redistributive subsidy system?	The Council is in favour of a self-financing system for council housing, subject to retention of a debt adjustment that is fair and supports the delivery of a long term sustainable housing revenue account.
Would you wish to proceed to early voluntary implementation of self-financing on the basis of the methodology and principles proposed in the Prospectus? 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?	Yes the Council would wish to proceed based on the offer outlined in the Prospectus, and would be ready to implement self-financing from 2011/12.
If you favour self-financing but do not wish to proceed on the basis of the proposals in the Prospectus, what are the reasons?	N/A