CITY OF YORK COUNCIL

Executive **22nd June 2010**

Report of the Head of Housing Services

Council Housing: A Real Future

CLG Consultation Paper & Opportunities / Implications for CYC

Summary

1. This report outlines for the Executive the broad principals of the previous Government proposals to dismantle the current Housing Revenue Account (HRA) subsidy system and introduce a system of self financing from April 2011 and our proposed response to the specific questions asked. It also considers the opportunities available for the council to ensure, where possible, the continued delivery of affordable housing within the city.

What is the HRA Subsidy System?

2. The current HRA is a national housing finance account and HRA subsidy is the system for redistributing resources between councils based on a desk top assessment of each council's notional deficit or surplus. York is in negative subsidy in that its notional income exceeds its notional expenditure. As a result we pay the difference to the Government (expected to be £6.1m in 2010/11), which then redistributes this to those authorities who are in positive subsidy. York's level of negative subsidy is forecast to increase year on year.

Summary of the Prospectus

3. In summary the consultation paper proposes a number of changes to the current financing system for council housing which, if implemented, would have a significant impact on the Council's HRA business plan and it's stock retention strategy.

4. The key proposals which members need to be aware of are:

   - A notional reallocation of £25.1bn of debt between 177 authorities. This £25.1bn is made up of £21.5bn debt that other local authorities currently have and £3.6bn of anticipated debt to support local authorities who have not yet met the decent homes standard. It is to be allocated on the basis of an assumed business plan set out for each council by the CLG using an assumption of future rents and uplifted management and maintenance allowances. There is an option to use a discount rate which is 0.5% higher than is used for stock transfer valuations to allow for new build to take place. It is believed this headroom will allow councils nationally to deliver 10,000 new homes each year "from the end of the next Parliament" and the prospectus asks councils to set out their “ability and willingness to use this headroom”.

- The HRA ring fence continues and further guidance is to be issued to give greater clarity and transparency.
- The key assumptions about rents, discount rates and timing of implementation are all subject to confirmation at the next Spending Review.
- Local Authority landlords will still be required to follow national social rent policy, with estimated real rent increases of 2.2% in 2011 and 2.1% for each of the following four years.
- An end to pooling of all capital receipts as part of the self financing settlement. 75% of HRA receipts will have to be used for affordable housing and regeneration projects with the remaining 25% available for any capital purpose.

Options

5. Option 1 – Agree the proposed response outlined at Annex 1 and accept the offer for self financing.

6. Option 2 – Not to agree the proposed response.

Analysis - What does this mean for York

7. The headline debt settlement from CLG for York (CYC’s existing housing debt plus reallocation of debt from other LA’s) amounts to **£113.384m**, based on a 7% discount factor. A reduced discount factor of 6.5% would give a settlement of **£118.571m**, a difference of £5.187m. This would result in an increase of debt of either **£89.443m** or **£94.630m** dependant upon which discount factor is used.

8. The council would be expected to take on new debt and pay the money to the government (who will pay off the other LA’s old debt), not debt transferred from other authorities. This is an important point as it would mean that York were in control of the terms of the debt, i.e. interest rates, period of repayment etc.

9. The proposals also suggest an increase in the Management & Maintenance allowances that the council received and suggest that the minimum increase a council would receive is 10%. This could result in an increased income to the council in the region £1.2m per annum.

10. There are two main approaches to dealing with the debt, (i) maintenance of the debt with continued refinancing (i.e. only paying the interest) and (ii) the repayment of the debt from future surpluses. Considering the impact of the increase debt against both approaches shows that both plans are financially viable and meet all (current) expenditure needs in each year of the 35 years covered by the plans.

11. A critical assumption relates to the stock investment and capital needs for our stock over the longer term. These have been factored into the modelling based on the councils own asset management system. The 20 year capital profile amounts to

approximately £24k per unit, which is lower than benchmarks for similar authorities where a figure is in the region of £30k per unit. Work is underway to undertake some external validation of these figures to provide certainty.

12. The current level of HRA debt that the CLG are taking into account is £23.940m which is £4.241m higher than our actual debt. This combined with the current balance on the HRA and the lower than average investment needs suggests that if the repayment model was used the debt could be paid off earlier than the CLG's assumption of 23 years. The exact detail of how much sooner would depend on the rates of interest and verification of the future capital expenditure requirements.

13. If the council choose not to accept the offer, it is not yet clear whether the government would impose the self financing proposals if the majority of the 177 LA's affected accepted the offer.

14. What is clear, especially in the current national economic climate, is that the government will not write off the £25.1bn of debt, enabling self financing without a redistribution of debt. The current proposal will result in York receiving approximately £1.2m per annum increase in management & maintenance allowance meaning that we will have more money to spend on our homes. It is also clear that when the current negative subsidy payment is considered, £6.1m this year and forecast to rise year on year, the cost of repaying the redistributed debt is less than the negative subsidy, leaving York with an increased year on year surplus.

Options for New Build

15. Contained within the announcement of this "offer" was a statement that by reducing the level of debt council's will be taking on (via the increased discount factor of 7%) they should be able to deliver 10,000 new homes a year. At this stage we are not certain as to whether council's debt settlements are dependent on the ability to deliver new homes within the HRA

16. There are a number of deferent ways the financing of new homes could be achieved under the proposals, however if the council was minded to respond positively and indicate that it would wish to take advantage of the higher discounted rate and build new council homes, the modelling suggests that a minimum of 100 new homes could be provided and dependant upon the management of the HRA more could be delivered.

17. The council has, over many years, sold most of its developable HRA land to RSL's to build new affordable housing. However, there is still some developable HRA land, but it is unlikely that this would be sufficient. There may be opportunities for the council to consider the use of other land assets to build on, subject to planning etc. At the current time land prices for building plots are falling and selling council owned land at this point in time might not be the best option. However, accepting that through utilising land assets for new build homes the council is losing the opportunity to realise a capital receipt, it is also the case that we would not actually be losing the asset but changing the nature of the asset and with the support of HCA grant accessing significant funding into the city to increase affordable housing, and the councils asset base.

18. Discussions are taking place with Property Services colleagues regarding the potential for GF land assets that could be used for new council house provision. The consultation document is not asking authorities to say exactly what or where they will build, but they are asking if we would like to and if so how many do we anticipate that we could build. We therefore need to be clear that if we say yes and no HRA land is available / suitable, we may need to use GF land. The costs assumptions that the CLG are using for new council house building is that the land will be already in the councils ownership and therefore no land acquisition costs.

19. However, in our response to government we will be outlining that we would expect any local authority new build to be considered against the same criteria for existing RSL's including the potential to consider land acquisition as part of the development costs.

Comparing self financing to subsidy

20. Self financing business plans on the basis of the current proposals are almost universally better funded than plans based on an unreformed subsidy system. This is the case for York and principally arises as a result of the following key factors:

- The benefits of all net rent increases are available to the plan – i.e. surpluses are not captured nationally and redistributed; this is the critical difference between the two futures as rental surpluses are expected to be rise sharply in the future.
- The allocation of uplifts for M&M and major repairs allowances gives additional spending power from day one.
- The interest charge on debt is at a rate lower than the discount factor used in the settlement calculation.
- The opening debt is lower than that identified in the settlement (due to the difference between the CFR measures).

Corporate Strategy

21. Accepting the proposals for self financing support a number of themes within the Council's Strategy. Retaining more money in York will enable us to invest in our stock, supporting the Thriving & Sustainable themes. Having local control over the long term finances for the HRA also supports the Effective Organisation theme.

Implications

22. There are no direct implications arising out of this report as it is only a response to the consultation document. Should the government decide to implement the proposals in full or in part, further reports setting out the detailed arrangements for the council will be brought back to member as appropriate.

Risk Management

23. The plan is viable and resilient to changes in key assumptions. The following scenarios have been tested

- Interest rates increased by 1%
- Real inflation in capital costs of 1% pa for 10 years
- Real inflation in management and maintenance costs of 1% pa for 10 years
- Rent convergence unable to be achieved until 2022

24. In all cases the overall plan remains viable, but the debt repayment period would be extended by one year, so the viability of the plan remains virtually unaffected in the long term. The modelling assumes no income from right to buy receipts. If receipts from right to buy sales were included in the plan, then the viability of the plan would improve, but only on the basis that the level of receipt exceeded the debt per unit (£14k) attributable to the HRA.

25. Moving to a self financing system significantly alters the risk profile in HRA business plans and the council housing service. The risks of the current system focus on unpredictability and political intervention in the system (in the widest sense) and on the fact that significant revenue rental surpluses will leave York and go to other parts of the country.

26. New risks are around increased Treasury Management, interest rate fluctuations and the fact that the council will have local responsibility for all spending (revenue and capital).

27. Whilst the proposals are intended to be a once and for all settlement, council housing will continue to be "on balance sheet" for public expenditure purposes and therefore the government will retain the right to open up settlements in the future. The circumstances in which this might take place are not set out in the prospectus and this uncertainty increases the risk to the council.

28. A robust risk management strategy is therefore an essential strategic document to support the asset management decisions within the business plan.

29. However, given this is a response to a consultation document the risks arising from this report are minimal and score less than 16.

Key conclusions for the City of York

30. These are the key conclusions for York:

- The settlement of £113.384m results in a net debt take-on of £89.443m.
- The uplifts to the allowances to arrive at this figure are generally higher than the region and national averages.
- The resulting take-on of debt and withdrawal from the subsidy system result in revenue surpluses to finance the resulting interest charges and facilitate debt repayment.
- York could repay the debt repayment early, though various factors could extend this period.
- The HRA will remain viable throughout this period with balances accruing after debt repayment.
- The Council's assessment of its stock investment needs can be fully met throughout the duration of the 35 year plan.

- The key reasons for the viability and resilience to changes in assumptions is that plan starts with balances in reserves, interest rates that can outperform those allowed for in the settlement.
- The financial position under self-financing is significantly improved compared to remaining within subsidy.
- The settlement offers the potential for HRA new build.

Impact of New Coalition Government

31. The new coalition government included in the Queens Speech a commitment to continue, in some form, to review the HRA. More recently on the 8th June 2010, the Housing Minister, Grant Shapps announced that:

> " The council house finance system is a mess. For far too many years this unfair system has tied the hands of councils, stopping them from best meeting the housing needs of the communities they serve. I want to see a new devolved system that puts councils firmly in control and gives them the financial freedom they need to make the best long terms decisions about their housing. But it is important I hear from councils and other experts themselves that the current proposal genuinely allows them to do this. And in these tough economic times I need to be convinced this approach offers the best possible value for money. Following thorough analysis of responses I will then announce whether the current proposal will be taken forward in part or in full, or whether an alternative model will be considered.

32. Whilst the consultation document asks specific questions, and in reality is asking us if we want to accept the offer to move to a self financing system as proposed, the above announcement give us the opportunity to provide additional comments back to government which we would want then to consider as apart of their thorough analysis of the responses.

33. In addition to the response set out at Annex 1, it is recommended that we make the following comments:

    - That at a minimum only actual debt should be reallocated;

    - That when considering the potential to build, councils should be on a level playing field with RSL's when bidding for HCA grant;

    - That as much responsibililty as possible is develoved to councils to enable them to better meet the housing needs of the communities they serve;

    - That if the government implement the propsed changes they acknowledge that this is a once and for all settlement and remove the ability for them to reopen the settlement.

Recommendations

34. Executive are asked to agree:

    i. Option 1 – to approve the proposed response to the consultation paper as set out at Annex A.
    ii. Comment on the addition points outlined at Para 33

Reason: To ensure that the council is able to continue to deliver an effective VFM Housing Service.

Contact Details

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Additional Papers:

Annex 1 – Response to consultation questions.