Report to the Finance and Performance Management Cabinet Committee

Report Reference: FCC-025-2009/10
Date of meeting: 18 May 2010

Epping Forest District Council

Portfolio: **Housing**

Subject: **Response to CLG offer on the reform of the HRA subsidy system**

Responsible Officer: **Brian Moldon** **(01992 564455).**

Democratic Services: **Gary Woodhall** **(01992 564470).**

Recommendations/Decisions Required:

(1) To note the attached report provided by Consult CIH Ltd;

(2) To recommend to the Cabinet the rejection of the proposed offer from CLG on the reform of the housing subsidy system and to approve the draft response at appendix 2 (to follow) to the CLG consultation; and

(3) To note that a further report will be provided on the possible transfer to the General Fund of non-housing assets currently held within the Housing Revenue Account (HRA).

Executive Summary:

A prospectus was issued on 25 March 2010 detailing how the Government wishes to dismantle the current HRA subsidy system, replacing it with self-financing through a debt re-allocation settlement. The offer gives an opportunity for the Council to have full control and responsibility in running the HRA and initial workings indicate that it would benefit the HRA. However, the proposed offer does have an adverse effect on the General Fund which would require the Council to find over £2m to cover the interest and Minimum Revenue Provision (MRP).

Reasons for Proposed Decisions:

To be able to respond to the CLG consultation on the proposed dismantling of the HRA subsidy system.

Other Options for Action:

To respond in favour of the offer and / or to make changes to the draft responses in appendix 2 (to follow).

Report:

Introduction

1. In July 2009, the Department for Communities and Local Government (CLG) published a Consultation Paper "Reform of Council Housing Finance" following a review of council housing finance which began in March 2008. The problems with the current HRA subsidy system, addressed in the review, are many and varied. They include:

- Lack of transparency and accountability between landlords and tenants;
- Growing complexity in the way resources are distributed;
- Increasing volatility in funding allocations making planning very difficult; and
- Since 2007, the system being in overall surplus – so that an element of tenants rents supports other Government spending, not just (as was previously the case) spending by other housing authorities.

2. Following the conclusion of the consultation on HRA reform at the end of October 2009, CLG has been working on a prospectus (which came out on 25 March 2010) for a voluntary offer to local authorities to buy themselves out of the current HRA subsidy system.

3. At Cabinet on 1 February it was agreed that once the offer had been made by CLG that this Committee be requested to consider the issues and to recommend to the Cabinet a response from the Council. It was also noted that the appointment of Consult CIH Ltd would be made to advise the Council on all the issues relating to the offer.

Impact on the HRA

4. We have now received the report from Consult CIH Ltd this is attached at Appendix 1 for your information. The report primarily considers the consequences for the HRA and more briefly touches on the impact on the General Fund. The key findings from this report are:

(a) The debt allocation to this Council is £180m, for buying ourselves out of the current HRA subsidy system. However, the Government would expect the Council, through the General Fund, to pay back the HRA the money it has borrowed from it, so that it can off set some of this debt. This loan equates to £22m and would reduce the debt down to £158m.

(b) Management and Maintenance Allowance increase by 3.1% and Major Repairs Allowance by 25.6%, This is slightly below the national average uplift.

(c) The Council will be able to keep **all** of it's rents received, currently we pay over to CLG £10m in subsidy (for 2010/11), which is the difference between what we collect in and what CLG believes we need to spend on our housing stock.

(d) The annual cost to the HRA of servicing this new debt will be £9.5m (based on £158m).

(e) A revised HRA business plan has been created and its shows that the HRA remains viable, with the ability to meet the asset management expenditure requirement each year. Furthermore, it shows that our debt will be repaid in 18 years. The sensitivity analysis provided shows the maximum period of time it would take to repay the debt is 21 years if some of the variables prove worse than the base model.

(f) The offer also gives the opportunity for the HRA to build new homes.

(g) In the future all Right to Buy receipts will be kept by the Council, currently 75% (less administration costs) of our Right to Buy receipts are paid to CLG. However, there will still be a restriction of 25% that can be used for the General Fund, as before, the remaining 75% has to provide for "affordable housing".

5. The report suggests that the HRA would be better off under this voluntary offer, as the Council would have full control and be able to keep the full rents to spend on ensuring the housing stock are kept to a decent standard, with capacity to repay the entire debt within 18 years.

6. The prospectus however makes reference to a "full and final settlement" and it is evident that the subsidy system would be virtually impossible to put back together again if it is

dismantled. Nevertheless, there are references to circumstances in which the settlement might be revisited and this is a cause for concern.

7. The debt per property for this Council will be around £27,500, this is at the top end of the debt per property for Council's across the Country. It appears CLG assume we have a high surplus of cash, compared to some other authorities, where rents are lower and they have yet to achieve Decent Homes for their housing stock. So although the HRA will be better off under this proposal, we could have been much better off, if we had received a smaller debt per property.

8. A consequence of this high debt per property, is that our HRA will have less ability to take on other further debt if the Council wants to build new homes. This is relative to some authorities, who benefit from lower debt but do not face such high levels of demand for new housing. This could be viewed as this Council being penalised for having managed its housing stock and finances well in the past.

9. The proposal appears good when compared to the current subsidy system. However, there is a fundamental question of whether it is fair for this Council to have to take on £180 million of debt that has been created by the spending of other authorities.

Impact on the General Fund

10. Traditionally, local authorities have held all of their debt in one single 'pool' across all services within the General Fund. With the introduction of self financing for the HRA, the government is seeking to encourage authorities to separate the debt and therefore increase transparency around the costs of debt charges to tenants.

11. This Council is debt free and has a negative overall requirement to borrow, known as the Capital Financing Requirement, as the amount by which the HRA is negative (i.e. in surplus) outweighs the positive (debt) General Fund CFR as shown below:

- General Fund £22.019m
- HRA -£22.803m
- Overall -£0.784m

12. Should the Council take on this new debt, then the HRA CFR would change to £157.644m, the Council's standing would no longer be considered debt free with an overall positive CFR of £179.663m. Authorities' that are not overall debt free are required to make debt repayments, known as Minimum Revenue Provisions (MRP).

13. Currently our General Fund pays interest at 1.8% (the average rate of return on our investments for 2009/10) to the HRA on £22m, an annual charge of £396,000 (for 2008/09 this was 5.5% which totals £1.2m). If the proposed debt re-allocation takes place this internal borrowing will be replaced with an external loan, likely to be in the region of 6%, and a Minimum Revenue Provision of £880,000 (4%). This would produce a new combined charge to the General Fund of £2.2m, an increase of £1.8m on the current position (increase of £1m against the 2008/09 accounts).

Impact of the proposed system

14. The prospectus indicates that there would be a benefit to the HRA with the proposed new debt being repaid within 18 years and the Council able to meet the asset management expenditure requirement each year. However, the Council's General Fund would have a significant additional cost imposed on it by the current proposal.

Non Housing Assets within the HRA

15. Non Housing Assets within the HRA relates to the commercial properties, this includes

shops in the Broadway and elsewhere, petrol stations and pubs. The proposed model discussed above does not include any of the rental income from these commercial properties and it still shows the HRA is viable without including these rents.

16. In carrying out this exercise it has been highlighted that there is a possibility that these assets can be transferred to the General Fund thereby, the rental income would become income to the General Fund rather than the HRA. The market value of the asset being transferred would need to be added to the General Fund CFR increasing its positivity and taken from the HRA CFR increasing its negativity. The net result would be an increase in interest payable by the General Fund to the HRA.

17. A benefit to the General Fund would occur as long as the rent received, net of property expenses, exceeded the additional interest payable to the HRA. Further work will be undertaken on this exercise to establish the impact on both the General Fund and HRA, and a report will come back to Cabinet in the coming months.

Resource Implications:

Under the offer, the Council would no longer make subsidy payments in the region of £10m per annum. However, the HRA would need to make an interest payment on the new debt in the region of £9.5m. The General Fund would suffer significantly and incur additional costs of approximately £1.8m.

Legal and Governance Implications:

The Housing and Regeneration Act 2008 (S313) gives Councils the opportunity to voluntarily come out of the housing subsidy system. If a large number of Councils decide not to come away from the current system, the offer will probably be withdrawn and the government may then legislate. It is possible that any incoming government may not see this as a legislative priority or may revisit the sharing out of the debt to give greater headroom to Councils in areas of highest demand for new social housing.

Safer, Cleaner, Greener Implications:

None.

Consultation Undertaken:

Consult CIH Ltd has been appointed to advise the Council on all the issues relating to the proposed offer. The Tenants and Leaseholders Federation has also been invited to provide their views on the proposed offer. There are 170 local authorities within the subsidy system, however, there are only 9 authorities with negative CFR like EFDC. A letter has been sent to these 9 authorities drawing their attention to the affect on the General Fund and seeking their views and whether they would be willing to do a joint response through the Local Government Association or direct to the CLG.

Background Papers:

Cabinet 1 February 2010 “Response to an expected CLG offer on a proposed debt re-allocation or settlement to replace the Housing Revenue Account (HRA) subsidy system”.

Impact Assessments:

<u>Risk Management</u>
The offer, although in “full and final settlement”, includes a reference that the debt could be revisited and the allocation changed. The repayment profile within the model assumes that the debt is like a capital and interest mortgage, in reality the debt would be arranged in chunks and therefore to repay earlier would incur redemption penalties, or if we would need

to refinance during the course of the 30 year plan, interest rates may be different to those in the model.

<u>Equality and Diversity:</u>

Did the initial assessment of the proposals contained in this report for relevance to the Council's general equality duties, reveal any potentially adverse equality implications?	No
Where equality implications were identified through the initial assessment process, has a formal Equality Impact Assessment been undertaken?	N/A

What equality implications were identified through the Equality Impact Assessment process?
N/A

How have the equality implications identified through the Equality Impact Assessment been addressed in this report in order to avoid discrimination against any particular group?
N/A