REPORT FOR: CABINET

Date of Meeting:	15 December 2011
Subject:	Housing Reform and Housing Revenue Account Budget Setting 2012-13 to 2016-17
Key Decision:	Yes
Responsible Officer:	Julie Alderson, Corporate Director Finance Paul Najsarek, Corporate Director Adults and Housing
Portfolio Holder:	Councillor Bill Stephenson, Leader of the Council and Portfolio Holder for Finance and Business Transformation Councillor Bob Currie, Portfolio Holder for Housing
Exempt:	No
Decision subject to Call-in:	Yes
Enclosures:	None

Section 1 – Summary and Recommendations

This report provides an update on Housing Revenue Account ("HRA") Reform, the Housing policy changes which are being introduced by the Government and the next steps in relation to the setting of the HRA Budget 2012-13 to 2016-17.

Recommendations:

The Cabinet is requested to:

1) Note the changes to the way the HRA will be managed in the future;
2) Agree the key points that will inform the Council response to the Government's consultation paper on HRA reform (paragraph 9 refers);
3) Note the anticipated CLG self financing settlement (paragraph 7 refers) and the borrowing options (paragraph 14 refers) to fund the additional debt that the Council will need to borrow as a consequence of HRA reform;
4) Note the options for spending any additional resources that will be available as a consequence of HRA reform (paragraph 30 refers);
5) Agree to consult on a revision to the current rent strategy, including proposals to increase rent & service charges from April 2012 (paragraph 18-24 refers) together with borrowing options arising from self financing settlement (paragraph 14 refers) and potential investment options (paragraph 30 refers);
6) Delegate authority to the Corporate Directors of Finance and Adults and Housing and their respective Portfolio Holders to consult on the options and bring a February report recommending an appropriate borrowing option and revised rent strategy and recommended rent increases to be implemented from April 2012.

Reason: (For recommendation)

To enable further work to be undertaken to develop and subsequently recommend an appropriate approach to borrowing and a new rent strategy.

Section 2 – Report

Introduction

1. The Council has a statutory obligation to agree and publish the HRA budget for 2012-13. Historically a draft HRA budget for consultation, is agreed by Cabinet in December, however, given the scale of changes surrounding the Housing Service [the Housing Policy changes reported elsewhere on this agenda] and the delayed issue from Communities and Local Government in relation to the self financing settlement, it has not been possible to model all of the variables and complete the draft budget report.

2. As a consequence, this report updates Members on some of the key issues and considerations to be addressed by Cabinet in February 2012

Background

3. At the moment there is a very complicated and perceived unfair national system of funding for council housing, which sees the council having to make a large annual contribution to support other Councils through the subsidy system. From April 2012, following the enactment of the Localism Bill, this will change.

4. The Council's Housing Revenue Account will become totally within the control of the Council – basically this means we will collect rental and service charge income and control our own spending. In return for being able to keep all the income we collect in Harrow the Council will have to take on additional debt. This settlement is calculated by making assumptions around income and expenditure over the next 30 years and translating the annual cashflows into the amount of money required to exit from the current subsidy system.

HRA Reform

5. The Government published on 21st November 2011 the annual determination which details the major change in the way council housing is financed. The consultation closes at 5pm on 6 January 2012.

6. The consultation covers the following key areas:

    - The amount required to exit the current subsidy system and move to a self financed system from 1st April 2012 – the amount for Harrow is £89 million.
    - A cap on borrowing – the maximum amount of housing debt each council may hold. In Harrow this is likely to be in the region of £150 million.
    - Changes to HRA Subsidy for 2011-12 – to reflect the additional borrowing costs for the 4 days at the end of March 2012 in 2011-12 arising from the settlement payment at the end of March, which will attract subsidy.
    - Calculation of the HRA interest charges for 2011-12 and future years – to enable the appropriate charges to be made to the HRA and the council's General Fund ("GF").

7. The determination advises that the Council will have to take on additional debt of approximately £89m at the end of March 2012 to exit the current subsidy system. The HRA has current debt of approximately £60m, taking the total debt to approximately £149m and placing us at or very close to the maximum borrowing limit to be imposed by the Government. In arriving at the figure of £89m, the Government have assumed that future rental income will be in line with the national social rent policy and that the costs of managing and maintaining the stock will be greater than the current allowances for subsidy. The Government assume that all annual surpluses will be used to repay debt and as a result, that the debt could be repaid by year 18 of the 30 year business plan. Depending upon the

policies Harrow adopts and assumptions we use, the actual debt repayment position could be very different.

8. On 2nd October 2011 the Prime Minister announced his intention to raise Right to Buy discounts in order to make it attractive to tenants across England. This is expected to substantially increase sales. In making this announcement, the Government said it would ensure that these changes did not have an impact on the viability of self-financing landlords. Further clarity is required to understand how these proposals will be implemented, particularly in relation to the repayment of debt, and to quantify the potential impact of an expected increase in sales to the 30 year plan. A consultation paper is expected that will provide the details of this proposal.

Consultation Response

9. The proposed Council response in relation to the Government consultation on HRA Reform will reference:
   - That HRA reform is welcomed;
   - That the preferential Public Works Loans Board ("PWLB") rates to support the funding of the additional debt are welcomed (paragraph 12 refers);
   - Concerns on the borrowing limit (paragraph 6/25 refers) and the potential impact that changes in the Right to Buy legislation may have on the longer term HRA;
   - That the Government's model assumes that all additional resources will be directed towards debt repayment, but that locally, other priorities will need to be considered (paragraph 30 refers).

Treasury Management Strategy

10. The principles likely to govern the debt and interest structures under a self financed HRA are:

    - Proposals which are broadly equitable for both the HRA and the GF
    - A greater degree of independence for the HRA to enable certainty over the cost of borrowing and impact of treasury decisions over the term of the 30 year business plan, mindful of the investment requirements and strategy over debt repayment.

11. The Council could decide to separate out borrowing associated with the HRA which would mean two debt pools and potentially separate treasury management strategies. Alternatively, a single pool approach could be continued which would enable the GF to benefit from the preferential rates being offered to the HRA in relation to the settlement payment [see paragraph 13 below].

12. The PWLB announced in September special fixed rates to support these payments. In offering these rates the Government have reverted to the old borrowing formula, specifically for the HRA self financing settlement, and these are calculated at gilt plus 15 basis points, which results in rates in the region of 88 basis points below standard rates. Prior to this announcement a number of options were being suggested, including bond issues, however these preferential rates are extremely attractive and represent an opportunity not to be missed. Whilst these rates are

subject to daily fluctuations, the rates notified were as follows (figures in brackets show the current PWLB rates):

- 10 year loans – 2.78% (from 3.66%)
- 20 year loans – 3.45% (from 4.33%)
- 50 year loans – 3.59% (from 4.47%)

13. Internal Council funds could be used to reduce the amount of external borrowing required, rather than take on additional borrowing. This could be advantageous to the GF as the rate charged to the HRA for using the funds would be greater than that received from current investment rates. However, as the cost of external borrowing is expected to increase in the longer term, this is likely to be a short term benefit and would be an extremely risky strategy.

14. The high level pros and cons for the HRA each of the options are set out in the table below and will be the subject of further consultation and development.

Period	**Rate**	**Pros**	**Cons**
10 Years	2.78% (usually 3.66%)	- Short term, low rate - Interest costs £2.5m p.a. - Increased surplus for investment in service and stock	- Will have to refinance at the end of Yr 10 and climate uncertain and we will still have debt - Rates could be higher if further borrowing required - Less certainty over longer term costs
20 Years	3.45% (usually 4.33%)	- Mid term - Interest costs £3.1m p.a. - More certainty over costs - Increased surplus for investment in service and stock but not as great as 10 year option - If we only use the additional resource to pay off debt, it may be cleared by yr 18	- Higher annual interest costs for a longer period
50 Years	3.59% (usually 4.47%)	- Long term planning - Interest costs £3.2m p.a. - Increased surplus but not as great as 10/20 year option Greater certainty of interest costs over life of business plan	- Exceeds term of business plan - Unlikely to need debt for this length of time - Cost of carrying debt which is not required?

15. The strong view of the Interim Director of Finance is that it is likely to be beneficial Council wide to maintain a single loans pool and take on the additional debt at the 50 year rate. She considers that this would provide the maximum flexibility for the Council, whilst taking advantage of the exceptionally attractive PWLB rates of interest and minimising interest rate risk over the longer term. This view is supported by the specialist treasury management advice she is receiving.

16. In all options, the cost of the additional borrowing is less than the current annual payment back to the Government, enabling additional revenue investment in the stock, operational services, repayment of debt or building up reserves on an annual basis within the HRA. Early indications suggest that all options would result in the consolidated rate of interest for HRA debt being lower than the 4.59% budgeted in the current HRA MTFS.

17. Assets within the HRA are long term assets, with interest rate risk being a key sensitivity in the 30 year plan. Often small changes in assumptions can lead to significant shifts in resources, and this area is being reviewed closely with specialist advisors to ensure risks are minimised in the longer term.

Rent Strategy

18. Council, in March 2011, approved the rent strategy for the HRA and assumed rent increases for 2012-13 of 3.7%, however this assumed RPI at 2.5% to achieve convergence in accordance with the national rent policy by 2015-16. This anticipated the 2011-12 average rent and service charge of £98.10 to be increased to £101.75 with effect from April 2012.

19. The latest information from Government advises RPI at 5.6% for 2012-13, as at September 2011. This is a key factor in arriving at the settlement payment for Harrow and the level of debt that can be supported, indeed self financing assumes the continuation of the national rent policy which anticipates annual increases at RPI plus 0.5% real growth.

20. To ensure the 30 year business plan does not deviate from Government assumptions around the longer term viability of the HRA, to enable investment in the stock and operational services, and to build up reserves to mitigate against pressures particularly in light of the policy changes around Right to Buy, it is appropriate to review the current rent strategy to ensure the longer term financing of the HRA under the reforms.

21. There was a special Tenants and Leaseholder Consultative Forum to discuss financial issues held in September 2011. The meeting lasted two and a half hours and was well attended with the only item on the agenda being HRA reform and its implications. As part of this discussion, tenants, leaseholders and residents were open minded about a review of the rental strategy and said they wanted to maintain a differential with rents charged by registered providers. In conclusion, the residents view was that rent increases could take place providing those on low income or in receipt of benefit were not detrimentally affected and that the differential with RPs still applied.

22. Following national rent policy and reflecting the uplifted inflationary assumptions, would result in an average rent and service charge in the region of £104.73 for 2012-13, an increase of 6.75% on the 2011-12 average rent and service charge of £98.10. Even with these increases, Council rents will be below registered social landlord and private sector rents.

23. The wider housing policy changes are likely to influence the rent policy to be adopted. Approximately 70% of council tenants are in receipt of housing benefit and the housing and welfare benefit changes anticipated over the next couple of years will affect people differently. It is possible that benefit for some tenants will reduce and may make it harder for people to pay their rent.

24. Given the potential future challenges around rental income, an assessment of the likely impact on the HRA bad debt provision will need to be made to ensure that rental income is not overstated.

Investment in Stock

25. The Government will be placing a maximum borrowing limit on each Council from April 2012. For Harrow, having borrowed to make our homes decent, means we are likely to be near the top of this limit and therefore any future investment will need to be funded from annual revenue surpluses until some of the debt has been repaid.

26. The Council's stock condition data suggests that the level of investment required over the next 30 years is in the order of £200m, or approximately £6m pa, however this figure continues to be refined to enable the anticipated requirements over the life of the plan to be included at the appropriate levels. It is possible that, given the borrowing cap, investment in the early years may need to be restricted in line with the annual cash flows and surpluses. The extent to which this will be restricted will depend on the costs of borrowing and other operational costs within the HRA approved as part of the budget setting process. [The impact of the different interest rate options and costs are detailed in paragraph 12 above.]

27. The investment requirements in the non-dwelling assets such as garages and community centres will also need to be considered, particularly if it can be established that investment would lead to additional income being generated on an annual basis. However, given the borrowing limit, prioritisation of these limited resources may be required.

28. Early indications are that significant cost savings from a keen market are likely to be delivered from the re-procurement exercise of the Repairs Service. This will enable increased investment in services for the same level of annual budgeted expenditure and will be key to enabling the required level of investment over the life of the business plan. This exercise is likely to result in a whole new approach for the service and will require investment to ensure effective contract management over the life of the contract.

Use of Additional Resources

29. At the special Tenants and Leaseholder Consultative Forum held in September, tenants, leaseholders and residents made it clear that they wanted any benefit from HRA reform spent in a balanced way with consideration being given to investing in the stock, in the service and in reducing debt.

30. The table below suggests the potential use of any additional resources and the pros and cons in this respect.

Option	Pros	Cons
Invest in stock	- Direct benefit to tenants - Helps address historical under-investment and improve tenant satisfaction - Could increase rents to pay for specific improvements - Protects future assets	- There would less to fund other priorities or repay debt
Increasing supply	- Helps to reduce homelessness - Build new homes - Wider General Fund benefit	-There would be less to fund other priorities or repay debt
Invest in service	- Direct benefit to tenants - Getting Closer to the Customer to support them through potentially difficult times (Options could be helping into employment, debt counselling and more front line contact)	- There would be less to fund other priorities and refund debt - Tenants may not want to pay more for some additional services
Review charges for GF services	- Benefit to wider council position	- No visible benefit to tenants - Risk of legal challenge
Reduce debt	- Provides longer term ability to borrow for larger investment programmes ie; new build	- Borrowing at a later date may cost more depending on interest rate movements
Increase balances	-Mitigates risk ie; interest rates, RTB impact, welfare benefit reforms	- Reduces capacity to invest in visible benefits for tenants

Review of Central Support Service Budgets

31. The costs of central support charges are recovered by an internal charging mechanism, with costs set early in the annual budget setting process.

32. A review has been recently undertaken which has identified that these costs are not being fully recharged out to internal clients, including the HRA. This means that the HRA may not be receiving its full fair share of central support costs as the costs are being understated in the recharging process.

33. An exercise is currently underway looking at what the HRA ‘should’ have been charged in 2011/12 to determine the appropriate charges for future financial years. The result of this exercise will need to be built into the HRA Budget and 30 year business plan. Currently the cost to the HRA of SSC’s is in the region of £3m and represents approximately 11% of the gross expenditure budgets. There is a risk that substantial increases in this amount would absorb a significant proportion of any surplus

generated by the reforms, although the overall reduction in Council budgets will reduce these charges over time.

34. Housing is also reviewing the HRA/General Fund split with regard to staffing costs to ensure that costs are legitimately apportioned.

Consultation with Tenants

35. There has been some early discussion with tenants on these changes and we now need a more detailed discussion with tenants in the lead up to February Cabinet. We especially need to ask their views on any changes to the rent strategy, the borrowing options and investment options in the future.

36. The views of tenants will be fed back to Cabinet in the February report as part of the overall decision making process, and from the early discussions tenants and residents made it clear that their view was to ensure a balanced position.

Next Steps

37. We are preparing a business plan that will look at how much money needs to be spent on our council homes over the next 30 years and, based on the current rental strategy and other income and cost assumptions, the level of income available to support this.

38. The following issues will also require consideration:

- Use of annual surpluses - should these be used for capital or revenue investment in stock or services? Should debt be repaid? Should reserves be increased to enable risks to be mitigated?
- Treasury management - how will housing loans be managed? What is the basis for charging interest to the HRA?
- Business plan - understanding the risks and sensitivities around the 30 year plan, the likely impact of the Housing Policy changes referenced elsewhere on this agenda, particularly modelling around the impact of a significant increase in Right to Buy sales.

39. Cabinet will in February 2012 receive the detailed HRA MTFS 2012-13 to 2016-17, together with recommendations for rents. It is proposed that the report to Cabinet in May 2012 advises the impact on the HRA as part of the approval of the final policies regarding the wider housing changes, together with the 30 year business plan.

40. The final self financing determination is anticipated at the end of January, which will enable the assumptions made within the draft HRA budget to be considered by Cabinet in February to be finalised.

Financial Implications

41. Potential financial implications are referenced within this report. Further work is required to quantify the impact of specific considerations and will be reported to Cabinet as part of the February report on the HRA MTFS.

Performance Implications

42. Detailed performance measures for the HRA will be built into the Service Improvement Plans for 2012-13 to 2016-17 and progress will be monitored by Improvement Boards and reported on a quarterly basis.

43. Given the level of resources and increases in tenant expectation, it will be important to track the performance to ensure that any reductions in service levels are quickly reported and mitigating actions are put in place.

44. It is intended that the introduction of new and revised policies associated with the wider policy changes being reported elsewhere on this agenda will positively impact on performance in the long term.

Risk Management Implications

45. As part of the budget process the budget risk register will be reviewed and updated, to help test the robustness of the budget. The key risk are likely to be the sensitivities around the assumptions which will underpin the 30 year business plan, in particular, the impact of the RTB proposals, interest rate risk and the rental strategy.

46. The wider housing policy changes, which includes HRA Reform, are included on the Housing risk register.

Equalities Implications

47. An equalities impact assessment will be carried out to support the proposals to be recommended to Cabinet in the February 2012 report.

Environmental Impact

48. No direct impact at this stage, however a detailed capital programme will be included as part of the report to Cabinet in February 2012 which will enable further comments associated with environmental considerations.

Corporate Priorities

49. This report incorporates the corporate priorities of:
    - United and involved communities: A Council that listens and leads
    - Supporting and protecting people who are most in need

Section 3 - Statutory Officer Clearance

Name: Julie Alderson Date: 5 December 2011	x	Chief Financial Officer
Name: Sarah Wilson Date: 2 December 2011	x	on behalf of the Monitoring Officer

Section 4 – Performance Officer Clearance

Name: Liz Defries Date: 2 December 2011	x	on behalf of Divisional Director Partnership, Development and Performance

Section 5 – Environmental Impact Officer Clearance

Name: John Edwards Date: 5 December 2011	x	Divisional Director (Environmental Services)

Section 6 - Contact Details and Background Papers

Contact:
Donna Edwards, Finance Business Partner Adults & Housing
Telephone : 020-8424-1140

Background Papers:

- Report to Cabinet in December 2010 on the Draft HRA Medium Term Financial Strategy

- Communities and Local Government: Consultation on the draft determinations to implement self-financing for council housing

Call-In Waived by the Chairman of Overview and Scrutiny Committee	**NOT APPLICABLE** *[Call-in applies]*