

# Your questions answered – finance

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## About the authors

**Robin Tebbutt** is a CIPFA member, with 19 years' experience in HRA finance. He was formerly HQN's Executive Director (Finance). Prior to working for HQN he was Director of Finance and Resources at Enfield Homes, and contributed to a two-star inspection within ten months of going live. During nine years as a senior managing consultant, he gained extensive experience of working on HRA and ALMO business plans, ALMO new-build projects, self-financing assessments, option appraisals, stock transfers and various associated matters, as well as working with DCLG (and predecessors) on several projects. He was the senior HRA finance advisor to two London Boroughs, and worked for three separate councils for a total of 17 years prior to becoming a consultant. Robin has been a board member of an ALMO since 2005, and chairs its finance and audit committee and DLO Panel.



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## Introduction

This briefing is published in response to questions about finance issues from HQN members. It provides responses to the questions asked by members and records them in topic areas. We will be producing a follow-up paper on service charge depooling and will comment on public benefit entity announcements at appropriate times in 2011.

## Service charge ‘unpooling’

We received a number of queries here. The logical place to start is with this one:

***I’m not sure I know what you mean by ‘unpooling’, or whether it is something different to ‘depooling’. As a stock transfer housing association, we have some services for which we don’t make a charge. Most traditional associations would make charges. Would introducing a charge meet either of the descriptions ‘depooling’ or ‘unpooling’?***

There is no difference between ‘unpooling’ and ‘depooling’: they are different words to describe the same process. That process is the introduction of a service charge to cover (or contribute to) the cost of a service, which has hitherto been funded from rents. The monies available from rents are sometimes called the ‘rent pool’ and hence the reference to either ‘unpooling’ or ‘depooling’. We tend to use ‘unpooling’ just because it is the term used by the Department for Communities and Local Government (DCLG). So if you decide to introduce a charge for a service which already exists, this will be unpooling.

As your question implies, traditional housing associations tend to charge for services, and councils tended not to until recently. This means that most unpooling is undertaken by councils, or by associations whose stock was transferred to them by a council.

The following query is specific to councils.

***At your recent HRA subsidy event, you stated that 2010/11 is the last financial year where a proportion of unpooled service charges is taken into account in calculating rent rebate subsidy limitation. But the subsidy form asks for rents plus service charges to be entered?***

In order to answer this question, we need to delve into history! Prior to the introduction of rent restructuring, DCLG’s policy was to take unpooled service charges into account for the purposes of rent rebate subsidy limitation. This was achieved by requiring

***“There is no difference between ‘unpooling’ and ‘depooling’: they are different words to describe the same process”***

that average unpooling service charges were added back to the average rent, before it was compared to the 'limit rent'. The limit rent is the maximum average rent which can be charged without losing subsidy. Councils receive full subsidy on all correctly paid rent rebates if the average rent (plus unpooling service charges) is at or below the limit rent. If it is above the limit rent, they receive no subsidy on the excess. The impact of this was that potentially around 70% of the income from unpooling service charges would be lost.

***“The limit rent is the maximum average rent which can be charged without losing subsidy”***

With the introduction of the rent policy, the government found itself wishing to encourage unpooling and with an existing system which limited the benefit of such unpooling. It decided to phase in a policy of progressively disregarding service charges for the purposes of calculating rent rebate subsidy limitation. In the first year, 2002/03, 10% of any unpooling service charge would be disregarded in calculating the average rent, for comparison to the limit rent. In the following year, this increased to 20%, the following year to 30% and so on, so that in the current year, 2010/11, just 10% of any unpooling service charges are taken into account, and with effect from April 2011, they will be completely disregarded.

The reason that rents plus service charge expenditure needs to be entered on the form is that this is the basis of the claim! The cell in which the average rent to be compared to the limit rent is entered (cell 219) excludes service charges.

The final two questions and their answers will be of interest to all readers.

***I understand there is government guidance on unpooling, but can't find it?***

For councils, DCLG's *A Guide to Social Rent Reforms in the Local Authority Sector* (February 2003) can be downloaded here (note it is shown as February 2002 on the webpage, but the link is to the correct document).

<http://www.communities.gov.uk/publications/housing/guide?view=Standard>

Both councils and associations may wish to refer to the Housing Corporation's March 2007 publication *Service charges – value for money?* This is available on HQN's website at:

[http://www.hqnetwork.co.uk/scripts/get\\_normal?file=7117](http://www.hqnetwork.co.uk/scripts/get_normal?file=7117)

***We have some stock transferred from a council and have some depooling to do. What rules do we need to follow?***

If you are within the five-year 'guarantee' period, the transfer agreement will bind you to keeping the promises made by the council in its 'offer document'. Rents and service charges are usually prominent amongst these promises.

This subject was covered in more detail for councils in an hf:expert briefing in October 2010, *Implementation of tenant service charges by local authorities*:

([http://www.hqnetwork.co.uk/finance#Rent\\_policy\\_rent\\_restructuring\\_and\\_service\\_charges](http://www.hqnetwork.co.uk/finance#Rent_policy_rent_restructuring_and_service_charges)).

## **Housing Revenue Account (HRA) reform**

This is an area which has been well covered by HQN briefings and events, so it was not surprising that there were fewer questions here.

***I understand that there is a bill which will make three councils pilots for self-financing. Is it too late to be a pilot as well?***

The Localism Bill proposes powers to allow it to impose a settlement on all English councils with HRAs. DCLG has made it quite clear that it has no intention of allowing some councils to leave the system earlier.

The bill referred to is a 'ten minute rule' bill. This is a bill proposed by a backbench MP, and, as its name implies, they are allowed ten minutes in which to do so. Such bills rarely if ever make it to the statute book. This could only be achieved with government support, which it can be anticipated will not be forthcoming.

***There seems to be some confusion about whether the government has decided to continue to take 75% of Right to Buy receipts, or whether it intends to take 100%. Can you clear this up?***

The confusion arose because of some slightly loose wording in one of the tables underpinning the Comprehensive Spending Review. It is clear that the government intends to continue to take 75% of Right to Buy receipts. However, there is no intention to take 100%. The wording actually refers to which department receipts 'belong' to when received by government. Hitherto, some belonged to DCLG, and some to the Treasury. In future all the receipts will go to the Treasury.

***"The Localism Bill proposes powers to allow it to impose a settlement on all English councils with HRAs"***

## Government rent policy

***Especially given the new 80% of market rents, has the government's rent policy been shelved?***

***We have read in one of the housing magazines that the existing rent formula will be in place until 2013 (RPI + ½%), but haven't seen anything confirmed officially. Do you know if this is the case? What assumptions are being used for subsequent periods (CPI only, or a plussage on that?)***

At least for the time being, the policy continues. For councils, the draft HRA subsidy determination has included a calculation of guideline rent based on the policy, with a convergence year of 2015/16. For housing associations, the Tenant Services Authority (TSA) has issued its annual circular providing updated rent caps, etc, for 2011/12.

Beyond 2011/12, as the second questioner comments, it has been reported, but not officially confirmed, that the policy will continue for at least one further year. For councils, we know that the HRA reform settlement will be based on the existing rent policy, with 2015/16 convergence, which implies the policy's continuation.

Finally, housing minister Grant Shapps has made it clear that the new affordable rents will not be subject to the existing social housing rent policy.

***What happens to target rents after 2012? If you have a waiver to converge to a later timescale, does this still apply?***

It follows from the previous answer that target rents will continue to increase by RPI + 0.5% until the regulator or government advises otherwise.

***We are a council, and our tenants are outraged by the very high rent increase – 6.6% in our case. Is there any chance that there may be a late 'reprieve', with the government deciding on a lower increase as happened in 2009?***

With an average guideline increase of 6.8%, high actual increases such as yours can be expected around the country. We would consider it very unlikely that there will be a 'reprieve' as there was in 2009. The previous 'reprieve' was as administratively cumbersome for DCLG as it was for councils. We would expect that civil servants would have taken care to point this out to ministers and ensure they were definitely willing to stick with this level of increase. In addition, the government

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would need to find additional resources to fund a lower increase, and it seems highly unlikely this could be achieved.

***What's the likelihood of rent increases being linked to Consumer Prices Index (CPI) rather than Retail Prices Index (RPI)?***

The government has announced its intention to move to CPI as the measure of inflation to upgrade welfare benefits – including Housing Benefit – from April 2013. We would regard the likelihood that rent policy will also utilise CPI as high. However, there has been no official announcement.

***What's the effect of the cuts to Supporting People grant?***

We are already beginning to see the effect of the 10% national cut in Supporting People funding and the removal of its ring fence. However the effect of this will be very different for each local authority area.

Discussions with clients to date have shown that some were already ahead of the game in making cuts and feel that they are fairly well placed for securing continued funding for the foreseeable future.

In other places in the country we are aware of cuts over 25% for 2011/12 with a requirement for future cuts in subsequent years of over 10%.

The three responses of landlords to these funding pressures are to cut the service, to continue the service but ask the recipients to pay or to cover the unfunded cost themselves. Obviously there is scope for a combination of these but this will require some tough decision-making for landlords and their boards or councillors.

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## New focus for value for money

This is a very topical area at the present time with the pressure on costs coupled with tenant expectations and changes in regulation and inspection.

***What do you think the government's intentions are for achieving value for money from housing associations?***

***Should we still be looking at KLOE32 as a guide for value for money or is there anything replacing it that you could direct us to?***

At the outset we can say that the definitions of value for money have not, in themselves, changed and therefore KLOE32 still provides a guide to what value for money being achieved might look like.

However, KLOEs were written in the days when achieving 3% efficiency savings year on year was considered to be good. In the current economic climate, much larger savings may be required across the landlord's activities or in certain areas of the business. There will be a need to manage any reserves brought forward and control how they are used.

Moreover, the value for money agenda has clearly shifted with regards to involving tenants in prioritising expenditure and sharing with them details of efficiencies made and what has been done with them.

We can also see two further focuses on value for money from the government since 6 May 2010. The first is Sir Philip Green's *Efficiency Review* of central government, which gives us an indication of the kind of thinking that the government is engaged in at the present time. Tough questions are being asked about whether services should be delivered at all, and getting rid of waste. The report is eminently readable and can be found at:

<http://www.cabinetoffice.gov.uk/sites/default/files/resources/sirphilipgreenreview.pdf>

The second focus from government on value for money is around transparency, with the requirement for all public bodies including local authorities to publish details online of all expenditure over £500 on an ongoing basis from January 2011. In fact a number of government departments and authorities have already started doing this. We are now aware that housing associations wishing to claim Homes and Communities Agency (HCA) grant in the future may need to do this as well.

***“Tough questions are being asked about whether services should be delivered at all, and getting rid of waste”***

We know that it will be difficult in the future for landlords to continue to provide the same level of services and that tough decisions are already being taken. For the government, they are looking for more outcomes for the public funding made available, and this will flow through all services including grant made available by the HCA for development and Supporting People grant.

## **SORP 2010**

### ***What is the likely effect of International Financial Reporting Standards (IFRS) on housing associations?***

At the present time and following the publication of the Statement of Recommended Practice (SORP) 2010 for registered social housing providers, there is no requirement for housing associations to follow IFRS for their accounts.

However, we are awaiting an exposure draft on the public benefit entity standard which is due by the end of this year or early next. This will probably set out a timetable for implementing a simplified version of IFRS, probably by 2014.

Once we know the detail of these plans we can look to the future and consider the real impact on the sector of the accounting changes. We are sure that a new SORP will be developed alongside the implementation timetable to assist landlords.

In the meantime, it is worth being aware that the work involved in shifting to IFRS for both PLCs and local authorities was considerable and required a lot of additional data collection and conversion processes. Alongside this was the need for quite a bit of education in how to read and interpret the new accounts.

In over 3,000 pages of standards there are some key issues that would affect the sector, principally around financial instruments but also around holding assets at cost or valuation.

### ***We are struggling through where to start in implementing component accounting. Have you any advice?***

The starting point for component accounting is defining your components and working out whether you have the underlying accounting records for the costs of these elements.

It is worth having discussions with your auditors about what evidence they will require in making an assessment of the financial impact of the changes. Some landlords have discovered through doing the work that the historic effect is not material, but they will still be changing how they present their

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accounts and giving details of the component identified and their new depreciation rates.

The key issues therefore are record-keeping and developing an expanded asset register with the cost of components identified. How the historic grant received is treated is dealt with in detail in the technical note to the SORP.

Our advice is therefore to start working on this issue now if you haven't already started. Getting the information together will be the most time-consuming activity, but once this is done there are still calculations to do and then you need to restate the figures in the accounts. If it all seems too much, seek some help.

## The HRA ring fence

***The government is making much of its removal of 'ring fencing' of grants to councils. How safe is the HRA ring fence?***

The HRA ring fence is enshrined in the Local Government and Housing Act 1989. If the government wished to remove it, this would take primary legislation. From what we have seen so far in the Localism Bill there is no indication that legislation will be introduced to make changes in this way but we will watch this space.

What is more difficult to predict is the future of government guidance on the ring fence. The existing guidance is circular 8/95. There have been substantial changes to the services delivered by councils in the 15 years since that was issued. The ring fence was one of the subjects considered during the previous government's HRA review in 2008-2009. This resulted, in March 2010, in a fully drafted replacement circular for 8/95. This was contained within the HRA reform 'Prospectus' which can be found here:

<http://www.communities.gov.uk/publications/housing/selffinancingprospectus?view=Standard>

Whilst the government has made its intentions about the proposals to abolish HRA subsidy clear, it is not yet clear whether this draft circular will be issued. Alternatives to issuing it as drafted include issuing a re-drafted version, or leaving 8/95 in place.

***“It is difficult to predict the future of government guidance on the ring fence”***

***We need to have as much clarity as possible about which activities are funded from the HRA and which are eligible for General Fund contributions – either in full or partially. If partial funding is permissible, then clarity over the way the contribution can be calculated.***

***“There is going to be a shortage of funds, especially in the early years”***

The proposed ring fence circular would provide some of the clarity you desire, if issued. However, on other matters, what is reasonable in any situation will depend on the context. There is inevitably an element of subjectivity in that judgement.

***How is the ring fence meant to be enforced, since often it is the parent council's desire to reduce General Fund pressures that leads to charges to the HRA?***

Any elector can request the council's external auditor to examine the recharges. However, as noted above, because there is an element of subjectivity involved, the auditor may be reluctant to rule against the council unless the matter is clear cut.

The 'Ealing judgement' of 1993 demonstrated that the ring fence is enforceable in court. But as with any legal action, there are considerable costs to be incurred, at risk. In practical terms, the questioner's organisation (an ALMO) will not be able to challenge its parent in court.

## **Decent Homes funding from 2011/12**

***A colleague tells me that there has been a significant cut in Decent Homes funding in the next Comprehensive Spending Review period. I had thought there was more than £2bn – and that maintained funding.***

There is going to be a shortage of funds, especially in the early years. The amount available for allocation to councils is actually £1.6bn, as some of the £2.2bn is to be used for commitments arising from past stock transfers.

The following table compares the amounts which ALMOs which were due to receive Decent Homes funding expected to receive with available funding.

	2011/12	2012/13	2013/14	2014/15	Total
	£m	£m	£m	£m	£m
<b>NFA survey</b>	756	593	353	456	2,158
<b>Actual CSR allocation</b>	260	352	389	594	1,595
<b>Allocation as % of NFA survey</b>	34%	59%	110%	130%	74%

Source: National Federation of ALMOs (NFA)

This clearly emphasises the scarcity of funds in the earlier years. However, it does not take account of the investment needs of the 17 councils without ALMOs, who are eligible to bid for resources under the proposed arrangements. This will make the position significantly worse.

***Are there any plans for a new Decent Homes level or standards to incorporate ‘green works’?***

With the announcements made to date we do not think that there will be any changes to definitions for Decent Homes in the foreseeable future.

The government’s announcements on HRA reform will shift the burden to keep properties at an appropriate (and locally determined) standard to local authorities. For housing associations this has always been the case, with the TSA monitoring compliance against the Decent Homes standard, but with changes to regulation it is not clear how closely this will be monitored beyond 2010.

It is clear that the government will expect landlords to contribute to their agendas and this will obviously include the ‘green works’. We don’t think that standards are likely although there may be an expectation in the future to report on reducing carbon emissions, which we know that a number of landlords do already.