The last lap: latest announcements around Housing Revenue Account (HRA) reform

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About the author

Robin Tebbutt, HQN Associate, 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.

Introduction

> *"We already knew that the government intended to largely follow the proposals which had been set out by its predecessor"*

The Department for Communities and Local Government (DCLG) published *Implementing self-financing for council housing* (referred to in this briefing as the DCLG document – http://www.communities.gov.uk/publications/housing/implementingselffinancing) on 1 February 2011. Although not specifically a consultation paper, the paper does invite councils to contact DCLG about a number of issues. The reader is also invited to raise queries or make suggestions. As in March 2010, in support of the main document, detailed figures are provided for each council, with explanations of how these are calculated.

The Chartered Institute for Public Finance and Accountancy (CIPFA) has concurrently published a consultation on accounting arrangements (referred to as the CIPFA document in this briefing). This can be downloaded at:

http://www.cipfa.org.uk/pt/download/HRA_Review_Consultation_2011.pdf

This briefing covers both the DCLG's proposals, and the CIPFA consultation. It assumes prior knowledge of the proposals. Our earlier briefings on the subject are recommended background reading (http://www.hqnetwork.co.uk/finance – scroll down to HRA subsidy).

We already knew that the government intended to largely follow the proposals which had been set out by its predecessor in the March 2010 *Prospectus*. The most significant changes from the prospectus are:

Right to Buy receipts

As had been announced as part of the Comprehensive Spending Review, 75% of receipts will continue to be 'pooled'. The document allows a glimmer of hope for the future, in stating that this is 'for at least the Spending Review period'. However, we would still be surprised were this to change in four years' time.

'Collar' on increases to assumed management, maintenance and major repairs

The Prospectus proposed that where the calculated need to spend on management, maintenance and major repairs was less than 10% higher than the aggregate of the existing subsidy allowances, a minimum 10% increase would apply. Because of the inclusion of an allowance for disabled adaptations, considered below, there are in any case fewer councils to whom a minimum increase of 10% would apply. However, the document states:

"We do not propose to include an arbitrary minimum uplift for a local authority, paid for by top slicing other local authorities' uplifts, which would override… evidence of spending needs."

The proposal contained in the Prospectus was not that the minimum uplift would be paid for by restricting other councils' increases. The removal of the minimum uplift has increased the government's net receipt by £50m.

Disabled adaptations

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One of the criticisms of the proposals set out in the Prospectus had been the omission of funding for disabled adaptations. The government had already announced its intention to include allowance for these costs in the settlement. The document states an annual allowance of £116m has been made at £60 per dwelling. This is based on work commissioned from DCLG from the Building Research Establishment. An annual allowance of around £113.7m nationally has been added. The modelling actually shows £113.7m and approximately £66 per dwelling. The total funding is to be allocated on a per dwelling basis, subject to the regional cost adjustment used in the Major Repairs calculation. The effect is that the allowance ranges from £58 per dwelling in the East Midlands, to £78 per dwelling in Inner London.

There continues to be no intention to make provision for other health and safety and related works in the settlement. These include those mentioned in the previous government's original July 2009 consultation paper: asbestos removal, and the Housing Health and Safety Rating System. Following tragic events since then, fire safety has assumed a higher profile, with many councils with multiple high-rise dwellings facing significant costs, not reflected in the settlement.

Private Finance Initiative (PFI)

The Prospectus had proposed that the subsidy allowance for PFI schemes should be included in the calculation of the debt settlement. Because of the nature of the calculation of the PFI allowance, when incorporated in the debt settlement, this did not work. It had already been pre-signalled by DCLG that they would abandon this proposal. Separate PFI subsidy payments will continue to be made. The government's net receipt is increased by £1.2bn as a result.

Planned demolitions

DCLG state that a number of councils raised the issue of dwellings planned to be demolished. The Prospectus proposed a settlement based on existing stock numbers. Where dwellings were to be demolished the settlement would be assuming net income, which would clearly not be achieved. It is now proposed that where a council has resolved by 1 April 2011 to dispose of or demolish a dwelling by 31 March 2012, these dwellings will be removed from the calculation. DCLG will also take account of firm plans for demolition in the early years. The term 'early years' is not defined. Evidence will be required that firm plans have been developed. As a minimum, this will need to be evidence of property specific consultation.

Right to Buy sales

The proposals set out in the Prospectus were that the debt calculation would assume that no dwellings would be sold under the Right to Buy. Whilst clearly some sales would occur, the proposal to allow councils to keep 100% of receipts would have provided sufficient compensation for the loss of net rent assumed in the debt calculation. Now that receipt pooling is to continue, DCLG has recognised that some provision should be made for the loss of net rental income. The accuracy of the assumptions will therefore be of significance.

At the national level the following assumptions are made:

Year	Assumed sales	Proportion of opening stock	Increase on last year
2011/12	2,410	0.14%	
2012/13	2,955	0.17%	23%
2013/14	3,458	0.20%	17%
2014/15	3,878	0.23%	12%
2015/16	4,046	0.24%	4%
2016/17	4,087	0.24%	1%

Thereafter, the number increases by 1% per annum. In total, 137,000 sales (just under 8% of the opening stock) are assumed over the 31-year period (2011/12 plus the 30 years of the debt calculation).

The national assumption has then been allocated to regions on the basis of the proportion of national sales in the last three years. The regional total has been allocated between councils on the basis of stock numbers.

The danger with this methodology is that were the assumptions to be significantly incorrect, either nationally, or for individual councils, it could have a significant impact on viability. However, this is an area which is notoriously difficult to predict. An example is the recent announcement that sales in 2009/10 increased by 16%.

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Treasury management

Although an allowance for treasury management is included in the current HRA subsidy system, this had not been included in the opening debt calculation set out in the Prospectus. This was of particular concern to councils who are currently debt-free, and will need resources to manage the new debt. An allowance is now to be made within the debt calculation, calculated in a similar way to the existing subsidy allowance. Each council is assumed to need a fixed amount plus a variable amount per £1m of debt outstanding, each year.

A further item which the Prospectus had not included was the cost of debt restructuring in earlier years. Under the current subsidy rules, these costs are charged over a number of years, and are allowable for subsidy purposes. It is now proposed that the remaining costs to be charged in future years will be included in the debt calculation.

A final problem for some authorities was the proposal in the Prospectus that only premiums on early redemption of Public Works Loans Board (PWLB) debt would be covered by the government. The DCLG document states that four councils have insufficient PWLB debt to be redeemed, and they will discuss the position with them with a view to securing a 'fair arrangement'. This does appear to ignore the issue, raised by one or two councils, of the need to restructure their market debt portfolio following redemption of PWLB debt in order to maintain their treasury management strategy.

'Other reckonable expenditure'

This is an allowance for the rental of dwellings or equipment on long leases entered into before October 1990. It would normally be expected that these leases will be reaching their conclusion and the cost 'falling out'. The Prospectus had proposed that this be disregarded for the purposes of the debt calculation as it was a relatively small amount at the national level. However for a small number of councils it had a large impact. In 2011/12, a total of 21 councils will receive allowances, with a national total of £6.4m. However, one council will receive just under £5m, another £700,000 and three more in excess of £100,000. The failure to take these payments into account would be significant for the councils concerned, and DCLG has accepted this.

New build

The Prospectus set out a calculation using a base discount rate of 6.5%. It also put forward a proposal, which the then government favoured, to use a discount rate of 7%. This would have produced a lower debt level for each council. The 'headroom' created by the lower debt level would have been used to build new social housing. This is not being pursued and the discount rate will be 6.5%.

"There are two matters on which we had hoped for change where there has been little or none"

Rent restructuring 'caps and limits'

'Caps and limits' are the restrictions placed by the government on setting rent increases. If these are applied by councils they result in rents being set at a lower level than they would otherwise have been. Councils need the cost of applying the caps and limits reflected in the settlement. The Prospectus proposed calculating the costs on an average rent basis. This will result in the cost being understated for many if not all councils.

The DCLG document appears to suggest that they will make use of dwelling-by-dwelling calculations. However, the supporting modelling continues to use the same average calculation as before. We have obtained clarification from DCLG that the calculation will be based on the average rent.

There are two matters on which we had hoped for change where there has been little or none, and these are considered below.

Debt cap

It remains the proposal that there should be a debt cap (or more formally a 'Borrowing Limit') for each council. For most councils, this will be equal to the calculated debt level for the self-financing calculation. There are two exceptions.

The first will be where the council's actual HRA debt exceeds the assumed debt for subsidy purposes. In this case the cap will be set at the actual HRA debt after the self-financing settlement.

The second is where a council has used some of its 'headroom' to finance new build schemes supported by grant from the Homes and Communities Agency (HCA). Provided that actual debt is lower than assumed debt for subsidy purposes, the 'headroom' used will be added to the borrowing limit. However, if actual debt is higher than assumed debt, the 'headroom' will not be added, unless it is 'slightly higher'. Perhaps surprisingly, 'slightly higher' is not defined.

There are worked examples within the DCLG document which set out the position in more detail.

Re-opening the settlement

Another proposal which has survived, and is specifically included in the Localism Bill, is the ability of the government to ‘re-open’ the calculation. This has caused wide concern, not least because of the difficulties in making plans to make effective use of financial freedoms, if over-performance against the assumptions used for the debt calculation may be ‘clawed back’. The DCLG document seeks to reassure on this point. It says that the power would only be used if there were a change with a substantial and material impact. We are not sure that this will meet councils’ concerns.

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Administrative arrangements

In line with the DCLG business plan, it is confirmed that a return similar to the subsidy base data return will be required during the summer. This will collect the normal information on stock numbers, rent levels and so on, plus some additional information needed for the calculation. Examples are premiums net of discounts and lease rentals, in the years beyond 2011/12. A detailed timetable for the rest of the process is included in the DCLG document.

The ring fence

The Prospectus contained a fully drafted circular to replace the existing circular on the subject, which is now over 15 years old. The DCLG document states that no guidance will be issued, ‘in line with our emphasis on localism…’. However, the existing legislation (and presumably the existing 1995 guidance) will remain.

Disposals

The government intends to remove the requirement for secretary of state consent for disposals at market value (unless tenanted).

Sales of new town dwellings

In a move which will affect only Basildon and Milton Keynes, the current requirement for those councils to pay 95% of sales receipts to the HCA is to be scrapped.

Stock transfer

That paper states that should councils wish to pursue transfer in advance of the settlement date, such proposals will be considered against the costs assumed for self-financing. There will be an expectation that councils will provide significant financial support for transfer proposals. They will be subject to a ‘rigorous value for money assessment’. In the short to medium term, we should be surprised if many whole stock transfers prove viable.

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The government is minded to abolish the transfer levy: the 20% of net receipts after repayment of debt which are paid to the Exchequer. This has tended only to apply to full stock transfers as estate transfers rarely leave a net receipt. The proposal is reasonable, since the levy was effectively to pay for the transferring council’s exit from the HRA subsidy system.

The government will consult shortly on a ‘right to transfer’ for tenants. This, and the encouragement of an asset management approach inherent in the proposals, will potentially see the continuation of estate-based transfers.

Accounting arrangements

The DCLG document refers to the CIPFA document for detail on these matters. As previously mentioned, this is a consultation document, with a response date of 28 February. The key issues it covers are now considered.

Management of debt

The CIPFA paper states that the government has signalled an intention not to impose a single solution to the issues in this area. The paper proposes the best solution as an apportionment of debt into two pools, and exemplifies this in detail. It considers the alternatives: continuing with a single pool, or maintaining the existing pool and setting up new pools for future HRA and General Fund borrowing. It explains the disadvantages of these approaches.

Depreciation

The proposals here take account of the need to introduce component accounting in accordance with International Financial Reporting Standards. Of far more significance to the success of self-financing, however, is the proposal for how depreciation should be accounted for, once calculated. In commercial accounting, depreciation is locked in the balance sheet, effectively keeping cash in the business to allow for eventual replacement of assets. The current approach in the

HRA is that depreciation is available to fund capital expenditure. It is debited to the revenue account, and credited to the Major Repairs Reserve. This reserve can only be used to fund capital expenditure or debt redemption. It is proposed that this should continue.

"There are no shocks in the two papers considered"

Summary

There are no shocks in the two papers considered. The shape of the final deal is taking shape, and councils are certainly now in a position to undertake business planning from a position of knowledge. The DCLG paper makes it clear that they have a clear expectation that detailed planning should be underway. There will be no choice for each council about entering the system, and we would argue that councils and ALMOs have a fiduciary duty to be planning now. HQN's team of financial experts can assist, either undertaking your modelling, or providing a 'due diligence' of your modelling and planning. We can also provide tailored briefings for councillors, board members, residents and staff. For more details on how we can help, contact Russell Helms on 0845 4747004, or russell@hqnetwork.co.uk.

HRA reform

Are you ready to go?

Tuesday 29 March 2011 | Leeds

Thursday 31 March 2011 | London

The detailed proposals from DCLG have now been published. They set out how the final figures are to be calculated and are a major step forward on the road to HRA reform, which is now approaching completion.

Are you ready to act on these proposals? Do you know what they mean and what you need to do?

To coincide with the announcement, our timely workshops will take an in-depth look at three important elements of the proposals:

- **The proposals in detail – breakdown and analysis**
  Robin Tebbutt, HQN Associate, will analyse all the components of the full and final proposals, help you to identify where issues or questions may still remain, and suggest possible responses

- **Governance – there's more to it than just the figures...**
  Good governance is key to looking behind the figures, and with new risks and responsibilities coming into play, this area cannot be ignored. Until now we have all been focusing on the numbers, but it is time to look at the wider issues that reform will bring. **Steve Wood**, HQN's Director (Finance Services), will cover the approach to good governance, the future actions needed, and the issues that you will need to consider

- **Treasury fund management – what are the implications?**
  How have the issues raised following last year's Prospectus been dealt with? What are the implications from these proposals? The day features a session that will look at the proposals and the treasury management issues.

WHO SHOULD ATTEND?

This is an essential workshop for all ALMO and local authority housing finance specialists; from directors and heads of finance to accountants, HRA accountants, and heads of housing or ALMO chief executives with a key interest in HRA finance.

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To book a place, please telephone: **0845 4747 004** *or see booking form on reverse*
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HRA reform

Are you ready to go?

4.5 CPD hours Registration: 10.00am Start: 10.30am Finish: 4.30pm

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By post: Complete this form and send it to: HQN Limited, Rockingham House, St Maurice's Road, York YO31 7JA

By fax: Fax us on 0845 4747 006 *(a fax transmission will secure a firm booking if places are available)*

Please do not send any payment! We will confirm your booking and send an invoice to you.

We are considering introducing credit card payments for delegate places – would you be likely to use this option? Yes ☐ No ☐

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The cost of this event is £262 plus VAT at the applicable rate for housing professionals - discounts are available to members of The Housing Quality Network and hf:tech – please tick here if eligible ☐ . The fee includes refreshments, lunch* and a detailed electronic information pack.

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Please state which venue(s) you wish to book for *(tick boxes required)*

Leeds | 29 March ☐ London | 31 March ☐

		Fee payable (incl. VAT)
Delegate name	Position	£ :
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To enrol additional delegates, please photocopy this form.	**TOTAL**	£ :

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* Please let us know if a delegate has any particular needs, including dietary, and we will do everything possible to meet their requirements.

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