Item No.	Classification Open	Date: 15 June 2010	Meeting Name: Cabinet
Report title:		Housing Revenue Account Reform – 'Council Housing: A Real Future' Consultation Paper	
Ward(s) or groups affected:		All	
From:		Finance Director	

RECOMMENDATIONS

1. That the Finance Director be instructed to respond to the consultation paper in the terms employed within this report, and with particular reference to the areas of concern highlighted.

BACKGROUND

2. The previous Government was of the view that the Housing Revenue Account Subsidy system was "***not fit for purpose***" (John Healey MP, then Minister for Housing and Planning). On 10 March 2008 his predecessor as Minister (Caroline Flint MP) and her Treasury counterpart (Yvette Cooper MP) jointly launched a review process to examine all aspects of the Housing Revenue Account (HRA) Subsidy system, and the means by which local authorities with retained or arms-length stock account for their landlord-related services.

3. The initial review concentrated on establishing a number of connected workstreams covering most aspects of the HRA, and gathering evidence from a variety of stakeholders for each. This resulted in a second consultation exercise following the publication in July 2009 of '***Reform of Council Housing Finance***'. Southwark's detailed response to this is attached to this report as Appendix B.

4. A timeline of the development of the proposals forms Appendix C.

5. The latest proposals are structured such that the proposed Offer is outlined, followed by consideration of the likely frameworks of operation post-Settlement, and finally some of the practical issues around implementation of the offer proposals.

6. At the time of writing, it is not known what the new coalition Government's attitude to the proposals as published is, beyond the commitment given in '***The Coalition: Our Programme for Government***': "*We will...review the unfair Housing Revenue Account*".

THE SETTLEMENT OFFER

7. On 25 March 2010, the day after the first 2010 Budget, the Department for Communities and Local Government (CLG) published more detailed proposals for reform under the heading '***Council Housing: A Real Future***'. The proposals and further consultation questions are set out in a '***Prospectus***', whilst supporting documents published simultaneously include an assessment of responses to the Reform Paper, a spreadsheet-based financial model developed by PricewaterhouseCoopers for CLG (together with a report and supporting notes) and an impact assessment of the Prospectus.

8. In this Cabinet report, any references to '**HRA Review**' relate to the original workstream specification and evidence-gathering exercise undertaken by CLG between December 2007 and October 2008; '**the Reform Paper**' refers to the consultation document '***Reform of Council Housing Finance***' and supporting papers issued by CLG in July 2009; whilst '**the Offer**', '**the Prospectus**' or '**the proposed Settlement**' relate to the current proposals as set out in '***Council Housing: A Real Future***'.

9. Whilst not as comprehensive as might have been hoped – for instance issues around Decent Homes backlogs are explicitly excluded, as is any full consideration of the national rent restructuring policy – the Prospectus does contain significant advances in terms of developing the "*self-financing*" model of local authority housing provision, and for the first time allows individual authorities access to a potential model of what a self-financed future might look like, in the financial and business planning sense.

10. Some other issues raised during the course of the review and reform process are also revisited within the Prospectus, such as the definition and operation of the "*ring-fence*", capital receipts retention by local government and leaseholder sinking funds, and these are considered in the context of Southwark's detailed response in the various sections below.

11. The rest of this report is ordered broadly to match the ordering of issues raised within the Prospectus for convenience, which may not necessarily dovetail with the ordering of the Reform Paper (or indeed the original allocation of workstreams).

12. The specific consultation questions contained within the Prospectus are reproduced as Appendix D.

13. In order to try and seek clarification from CLG on a number of issues identified by officers early on in the process of evaluating the offer, a 'pre-response' was submitted to CLG in May 2010. If a reply is received before the Cabinet meeting, this will be reported verbally. Whilst not necessarily "*deal-breakers*", the areas highlighted within the 'Pre-Response' give an indication of those items which Southwark might identify as barriers to outright endorsement of the Offer in its current form. The 'Pre-Response' is attached as Appendix E.

14. The main element of the Offer is replacement of annual housing subsidy transfers between authorities and Government with a once-only adjustment to authorities' HRA debt. The adjustment is designed to leave a level of 'affordable' debt based on the Offer elements, which are explored further below.

THE OFFER – INCOME

15. Instead of reliance on the complex calculations behind housing subsidy, the self-financing model assumes that councils will retain all their rental income; in Southwark the rent debit for 2010/11 has been budgeted at £156.7m.

16. Under the policy of rent restructuring, the Government has – by means of incentives and penalties built into the subsidy calculation – ensured that the overwhelming majority of local housing authorities are moving towards the setting of local rents according to a national formula. Since this would for the most part, involve significant increases in average rents above inflation, this has been both phased and subject to annual affordability limits in rent increases. Originally, the transitional period was set at ten years (2002/03 – 2011/12), but increasingly the Government has intervened to control the national level of average rent increase by both setting overall caps on increases and shifting the date by which actual rents are assumed to 'converge' with fully formula-derived rents. This convergence date has shifted from 2011/12 to 2016/17, then to 2023/24, and last year was brought back to 2012/13. The Prospectus <u>assumes</u> a final five-year convergence period, i.e. from 2011/12 – 2015/16. It should be noted that this is only an assumption for the purposes of the modelling exercise, and is by no means guaranteed.

17. There are particular concerns with this approach for Southwark. As the borough has had historically low average actual rents, it is extremely unlikely that average rents will converge by the Government's assumed date of 2015/16, leaving the borough (and similar local authorities) with a significant revenue gap from the commencement of self-financing. In 2010/11, key average rents for Southwark are set out in the table below – 'guideline' rent is the Government's assumed rent level for the calculation of housing subsidy for that year:

Actual Average Rent 2010/11	£80.60
Guideline Average Rent 2010/11	£83.98
Formula Average Rent 2010/11	£91.00
Percentage Gap Actual to Guideline	4.02%
Percentage Gap Actual to Formula	11.43%

18. In order to achieve convergence, therefore, average rents in Southwark would need to rise by 11.43% above inflation over the next six years, without being subject to any affordability limits. The gap between guideline and formula rents for Southwark at 7.71% is marginally above the national average quoted in the Prospectus of 7.5%, which CLG acknowledges "***would require real annual increases of 2.2% in 2011 and 2.1% in each of the following four years***" (Prospectus 2.6).

19. The Government has accepted in the past that there is a cost to local authorities of adhering to affordability limits, and has refunded the difference between guideline rent and an adjusted guideline figure one year in arrears; there is a commitment in the Prospectus that this will continue. It should be noted that the PWC model is designed to capture data on an authority-wide basis, whereas data on individual rents within boroughs will need to be used to determine actual outcomes. There is a limit on annual rent increases of RPI plus 0.5% plus £2.00 per week, and a cap on formula rent increases according to number of bedrooms per property. However, there is also an indication that the TSA will be empowered to enforce national rent policy (presumably including affordability limits) (Prospectus 2.9), which is likely to push convergence for Southwark into the medium-term, and most certainly well beyond 2015/16.

20. In our response to the Reform Paper, we argued:

"***We have a long way to go to reach target rents and also several redevelopment schemes creating rent losses, so rent income may not be at the expected level. We also have a high consolidated rate of interest so each £1m of debt is more costly and less affordable for us than other authorities***.

The Reform Paper notes that future rent policy is under review. The temporary changes in convergence dates announced in 2008 appeared to be HM Treasury-led and created confusion, not least because of the problematic timing of their announcement. However, whatever the convergence date, Southwark will have a significant minority of properties restrained by caps and limits for the foreseeable future." (L.B. Southwark – Response to the Reform Paper)

21. Disappointingly, the Prospectus gives little comfort in this regard, and so we have included this matter within the 'Pre-Response' submission to CLG for further clarification.

22. Southwark also has four tenant service charges, covering estate cleaning, grounds maintenance, communal lighting and maintenance of door entry schemes. In 2010/11, this is budgeted to raise £12.0m. These charges were 'unpooled' from base rents in 2003/04, and do not now form part of the subsidy calculations – hence, they are also excluded from the self-financing modelling process. The Government has included restrictions on annual tenant service charge increases in the past, and the Prospectus anticipates that the Tenant Services Authority will continue to monitor this after self-financing is implemented.

Summary: the proposal to retain all rental income locally is fundamental to the concept of self-financing, but the inherent funding loss within the rent restructuring policy has not been addressed, and is likely to have a detrimental effect on Southwark. We are seeking further clarification on this issue.

THE OFFER – SPENDING NEEDS

23. The Reform Paper included supporting research by the Buildings Research Establishment and the Housing Quality Network on allowances within the subsidy system and other backlogs, principally regarding major repairs, but also encompassing the Decent Homes Standard. Some substantial percentage uplifts were identified as a consequence (Management & Maintenance Allowances +5%; Major Repairs Allowance +24%), and Southwark, in common with other respondees sought to amplify these uplifts to more properly represent the reality of their situation regarding backlogs (uplifts of 10% and 43% respectively) – see Appendix B for details. Since the publication of the initial research, the average uplifts assumed within the Reform Paper have now moved to 8% and 28% respectively. The current stage of consultation, however continues to exclude the backlog position from consideration, and models individual local authority self-financing from the starting point of the Reform Paper uplifts.

24. This is of concern to Southwark, for two principal reasons. Firstly, exclusion of backlogs produces a situation far removed from the reality of Southwark's likely investment and spending needs in the short-term. This makes meaningful business planning more problematic. Secondly, the translation of average into likely uplifts as envisaged by the self-financing model as supplied alongside the Prospectus produces radically different results – the Southwark-specific uplifts are as noted in the table below. The weighting of the uplift across authorities reflects the high management and maintenance cost of our stock, but the major repairs uplift mainly benefits area with large numbers of houses as opposed to flats.

	Management & Maintenance Allowances	**Major Repairs Allowance**
Reform Paper Average (amended)	8.0%	28.0%
Southwark's own assessment	10.0%	43.0%
Prospectus model for Southwark	11.6%	10.9%

Note: Southwark's own assessment relates to comparability with RSL levels of management & maintenance and BRE needs assesments, including backlogs

25. Taking the Allowance figures utilised within the final HRA Subsidy Determination for 2010/11 as a base, these uplifts would extrapolate to:

	Management & Maintenance Allowances	**Major Repairs Allowance**	**Total**
Determination 2010/11	£102.97m	£37.57m	£140.54m
Reform Paper Average	£111.21m	£48.09m	£159.30m
Southwark's own assessment	£113.27m	£53.73m	£167.00m
Prospectus model	£114.92m	£41.67m	£156.59m
Shortfall (negative figure)	**£1.65m**	**(£12.06m)**	**(£10.41m)**

26. The self-assessment model as it stands produces a slightly worse outcome than the average posited by the Reform Paper of £2.71m (£156.59m down from £159.30m), it is below the figures that we would have wanted to properly address the underfunding that the allowance levels have engineered over the last few years.

Summary: the uplifts in allowances assumed by the self-financing model are inadequate in terms of providing the levels of funding required to address backlogs in major repairs and will lead to pressures on the viability of the self-financing business plan for the borough's housing stock.

THE OFFER – DECENT HOMES

27. There is an important commitment within the Prospectus regarding Decent Homes:

"***The Government is totally committed to completing the Decent Homes programme and recognises that £3.2bn of works are still needed to meet its Decent Homes commitment. Meeting this investment need will therefore be a central element of its deliberations on investment priorities at the next Spending Review***." (Prospectus 2.36)

28. Whilst welcome as a restatement of the policy objective, it is troubling that self-financing is treated in isolation from this, as a very substantial element of Southwark's (and others) 30-year business plans will need to be built around addressing this backlog and the knock-on effect of managing other investment as a consequence.

29. The Prospectus is opaque as to the mechanisms by which non-ALMO authorities (such as Southwark) may access further Decent Homes monies, and we would need clarification as to this as a matter of some urgency before the Offer could be wholeheartedly accepted. This therefore forms a key part of the 'Pre-Response'.

Summary: whilst the policy commitment is welcome, the expectation that business plans can be constructed and evaluated without reference to backlogs in Decent Homes works is impractical and difficult to reconcile with the actual scenario facing Southwark. The interests of stock-retaining authorities do not appear to be adequately represented within the Prospectus as it is currently laid out, and we have alerted CLG to our concerns on this.

THE OFFER – CAPITAL RECEIPTS

30. The Prospectus proposes an end to the pooling of right-to-buy capital receipts in order to assist local government in the creation of an asset management strategy covering both revenue and capital aspects. However, the arrangement under self-financing would not be entirely liberated, as there would be a requirement to certify that 75% of receipts had been or were committed to being applied for affordable housing or regeneration purposes. It is also likely that the national pot for capital grants would be reduced as a consequence (see below).

31. The value of right-to-buy receipts has declined precipitously in recent years across the local government sector, and this new freedom should be viewed in that context. Also, the loss of rent income following sale of properties may mean that we have to use part of the capital receipts to repay debt.

Summary: more freedom to manage assets effectively and efficiently is to be applauded, but the quantum effect of this change is currently much less than in the previous decade.

THE OFFER – DEBT ALLOCATION

32. In many ways debt allocation is the key of the proposed Settlement, and has certainly been its 'headline-grabbing' aspect. Southwark's Housing Subsidy Capital Financing Requirement (SCFR) figure as used in the Final Subsidy Determination for 2010/11 is £768.8m. This debt is supported, i.e. the annual debt charges are funded under the subsidy system. The historic build-up of this debt reflects past annual Government supported borrowing approvals, which were its main provision of local authority HRA capital funding for many years. Extensive and on-going regeneration of housing stock has meant that the direct link between the historic debt and the current stock in Southwark in many cases no longer exists. The cost of servicing this debt is budgeted in 2010/11 at £86.4m (including depreciation). Such high debt levels, and their separation from the original base is by no means exclusive to Southwark, in fact the majority of inner city housing authorities have very substantial historic debt commitments, as the table of the top ten boroughs in this regard shows:

Borough	Stock	SCFR
Sheffield	42,132	£879.8m
Hackney	22,815	£851.0m
Islington	25,967	£846.7m
Southwark	**39,827**	**£768.8m**
Newham	18,528	£758.2m
Birmingham	65,119	£682.5m
Newcastle-upon-Tyne	29,519	£645.5m
Lambeth	26,489	£573.7m
Camden	24,085	£542.8m
Haringey	16,336	£552.6m

Source: HRAS Final Determination 2010/11 (CLG)

33. In the self-financing model, these SCFR's have been extrapolated to 31 March 2011 figures, so as to be able to compare with the possible commencement date for self-financing on the following day. The model as employed by CLG takes these likely debt figures and compares them with the net present value of likely income streams available over the next thirty years to arrive at a debt adjustment position to be covered as part of the proposed Settlement. For Southwark, this is summarised in the table below:

Determination SCFR 2010/11		£768.8m
Projected SCFR 2011/12		£775.1m
NPV – Rental Income NPV – Management & Maintenance Allowance NPV – Major Repairs Allowance NPV – ALMO Allowance NPV – PFI Allowance NPV – Other Recognised Expenditure	£2,737.7m (£1,647.1m) (£599.3m) £0.0m £0.0m £0.0m	
NPV Total Self-Financed Debt		£491.3m
Change in Debt		**(£283.8m)**

Source: Modelling Business Plans (CLG/PWC)
Note: Net present value is the equivalent in today's money of the income streams spread over the thirty years of the business plan – the intention is to calculate how much borrowing could be supported by this income alone i.e. be self-financed

34. It should be noted that the figures in the above table relate to supported debt and that we have used capital receipts prior to 2004 to reduce actual debt by £124m to £651m as at 2011/12. In the '***Framework***' section below, both the historic debt figures used by CLG in their model, and the actual figures cited here are used to demonstrate that both the 'headroom' and commutation amounts are identical, no matter which base is employed.

35. Any PFI Allowance related to the later phases of the Aylesbury regeneration would, if agreed prior to Settlement, have a very direct impact on the table above (£181m has been approved to go forward for Outline Business Case submission to CLG later this year). If the scheme (as is likely, given the very short lead-in time proposed for the Settlement) is signed post-Settlement, then the Prospectus notes:

"***No costs relating to these schemes would be included in the self-financing model. The Department will pay PFI subsidy for these schemes alongside General Fund PFI subsidy. The PFI subsidy would be calculated using the same formula as is currently used. The amount that is paid would then be reduced to take account of MRA that has been included in the self-financing settlement in respect of properties covered by the PFI scheme. The annual amount will be fixed at the time the PFI contract is signed***" (Prospectus 2.29)

36. In one or two instances nationally, the effect of the PFI Allowance within the PWC model moves some authorities into a negative self-financed debt position, and since it is not clear how this would work in practice, this aspect of the model may be re-examined by CLG.

37. The singular effect of the Aylesbury PFI in the context of the Offer proposals is such that we need additional detail from CLG as to how its effects might be mitigated, both in terms of factoring into debt levels as part of the proposed Settlement itself; and also in terms of the underlying effects of high stock number volatility caused by such significant regeneration activity in the immediate years post-Settlement. Both these elements are reflected in the 'Pre-Response'.

38. As noted elsewhere in this report (the '***Unpooling Debt***' section below), the Government is minded to try and separate out HRA and GF debt as part of the Settlement Offer, whereas the arrangement under housing subsidy is that revenue costs of capital financing fall initially to the General Fund and are allocated to the HRA via the Item 8 Determination each year. Under the existing regime, Southwark is in positive subsidy, although this is declining and will fall out completely by 2020/21.

39. One of the key issues for Southwark is the mechanism employed to commute debt. As it stands, the proposals are vague, but appear to suggest a "top-slice" approach as there is precedent in terms of the CLG approach to Large-Scale Voluntary Transfers of stock, and the debt associated therewith.

40. The relationship between the HRA and the General Fund in terms of debt is extremely complex. The council has engaged external advisers to assist with the treasury management implications for Southwark of the model designed by PricewaterhouseCoopers for the Prospectus. However, no definitive conclusions can be drawn at this point as there is insufficient detail in terms of the debt commutation proposals to be able to model debt restructuring scenarios. Within their report the external advisers have also expressed some concerns regarding the treatment of debt premia and discounts, which appear to be dealt with separately and outside the self-financing Offer made to local authorities. For CLG, the cost of premia nationally is likely to be significant and a key consideration.

41. The 'Pre-Response' draws the issue of the high level of Southwark's CRI to CLG's attention, and seeks to explore the possibility of a more targeted commutation of current debt such that the CRI figure is reduced at the Settlement date. N.B. the 'Pre-Response' seeks to explore debt issues primarily from an HRA perspective, but the implications for the General Fund are equally critical and need to be re-assessed in the context of any specific amendments.

Summary: The Prospectus models a significant commutation of Southwark's debt in order to facilitate self-financing. There is merit from a HRA perspective in seeking to re-profile Southwark's debt prior to the Settlement taking place, but the consequences for the General Fund also need to be assessed. The council has highlighted this disadvantage for its HRA in the 'Pre-Response', and also sought clarification as to the status of the Aylesbury PFI process.

THE OFFER – A HOUSING BALANCE SHEET

42. Recent changes to the '***Statement of Recommended Practice on Local Government Accounts***' (SORP), which provides the template for local authority final accounts as published split the HRA into two separate statements – the Income and Expenditure Statement and a Statement of Movement in Balances. The Prospectus includes the notion that formal reporting of a Housing Balance Sheet as a separate entity from the council's consolidated Balance Sheet (which reflects both General Fund and HRA ring-fenced activity) be considered. This is principally to reflect the need to identify future HRA and non-HRA debt separately is an integral part of the debt allocation proposals (noted in the relevant section above).

43. Paragraph 3.5 of the Prospectus envisages the housing balance sheet as a subsidiary to the requirements to publish the council's consolidated balance sheet, rather than a replacement for it, and looks to the Chartered Institute of Public Finance and Accountancy (the authors of the SORP) and the Tenant Services Authority to develop this proposal further.

Summary: the proposal to require the publication of a separate housing balance sheet is as yet untested, and would require further professional development and commentary before its usefulness could be assessed.

THE FRAMEWORK – UNPOOLING DEBT AND DEBT FINANCING

44. Having set out the proposed Settlement, the Prospectus goes on to consider the financial, accounting and regulatory framework under which self-financing authorities would operate, beginning with arrangements for unpooling and financing debt.

45. Whilst currently HRA and General Fund debt is combined within individual debt portfolios, CLG wishes to see a clearer separation in future, whilst acknowledging that disaggregation of the current position might not be possible. For authorities taking on new debt, the way forward is relatively straightforward in this regard. However, for Southwark (and others) where debt is being written down, it is less clear.

46. Two options are considered; firstly that old debt be allocated between the HRA and the GF, though there is little consideration of the mechanisms that might allow this. Secondly, CLG may consider freezing the consolidated rate of interest on pooled debt as at 1 April 2011 (or any other day of commencement for self-financing) with a view to allowing the General Fund to appropriate both the risks and benefits of future movements until such a time as all the pooled debt had been written out of the authority's accounts.

47. There are merits to separation, mainly that future Prudential borrowing by either the HRA or the GF would not affect the debt charge costs of the other party.

48. In terms of repayment, prior to 2004 HRA debt was required to be repaid at 2% p.a. plus 75% of right-to-buy receipts but since then there has been no repayment requirement. MRA was originally envisaged as a proxy for depreciation in terms of an authority's housing stock, and the way forward in a post-MRA world needs to be considered. The Prospectus rejects the need for a proscriptive approach to debt repayment (as previously embodied by the Minimum Revenue Provision) on flexibility grounds, preferring to encourage authorities to "***develop a bottom-up understanding of their housing stock...to satisfy itself that its approach to depreciation and debt repayment meets the requirements of the Accounting Code***" (Prospectus 3.20). This would have the added benefit of (presumably) mitigating any tendency for backlogs in capital works to recur in the future.

49. On balance, the Government is minded to favour full separation of debt and leaves the door open to further analysis from interested professional and regulatory partners.

50. As noted elsewhere in this report ('***Debt Allocation***' above), both the size and historical nature of Southwark's SFCR mitigate against meaningful identification even prior to separation, and there is potential for uncertainty, particularly with respect to the effect on the council's General Fund.

Summary: The consultation document considers the technical background to the allocation of debt, but as yet is not in a position to give definitive guidance as to how this might be achieved to a professional standard.

THE FRAMEWORK – BORROWING

51. The Government is not prepared to allow self-financing to progress to what might be thought of as a logical conclusion by allowing authorities unfettered access to borrowing. Whilst there is recognition of the success in the last few years of self-regulation under the Prudential borrowing code, and also that the tying-up of monies due to the national rents policy and the virtual extension of the ring-fence to HRA borrowing via capital receipts will also act as curbs; there will be additional caps on borrowing (at the SCFR Offer debt adjustment level) under self-financing, such as the application of a higher discount date than previously indicated allowing for a degree of headroom in terms of the opening debt position.

52. The Government are mindful of the national position in this regard, and despite lobbying over a number of years, HRA debt remains within the reckoning of national public debt, rather then being held outside, as in other European economies. There are other justifications within the Prospectus for this position.

53. However, there are some positive aspects to the cap position. In instances where a local authority has a greater notional Capital Financing Requirement assumed under the subsidy system than the actual figure, this will automatically generate a degree of headroom within the cap established. This is the case for Southwark; as the table below illustrates:

	Notional	**Actual**	**Headroom**
Projected 2011/12 Subsidy CFR Estimated 2011/12 Post-Settlement CFR	£775.1m £491.3m	£651.4m £367.6m	**(£123.7m)** **(£123.7m)**
Proposed Debt Commutation	**(£283.8m)**	**(£283.8m)**	

*Note: The difference between 'Notional' and 'Actual' was explored in the '**Debt Allocation**' Section above.*

54. If the Discount Rate employed is changed to 7.0% to reflect the central policy objective of funding new-build, the headroom generated increases by a further £23m. Authorities in the reverse situation (actual CFR is greater than notional CFR) have been advised to consult CLG directly.

55. Even with the previously noted incongruity between the proposals on borrowing and the current Prudential borrowing system, it is likely that the same considerations that have mitigated against borrowing as a funding solution in the past, i.e. a lack of spare revenue to meet debt charges, will continue to apply in the early years post-Settlement.

Summary: Given the potential impact of other changes under self-financing, the imposition of borrowing controls appears to be an unnecessary restriction, which is incongruous with the overarching policy objective. The ability of Southwark to manoeuvre within the headroom generated by the borrowing cap is noted, but remains an uncertain means of financing social housing works.

THE FRAMEWORK – THE HRA RING-FENCE

56. The Reform Paper asked questions around the relationship between the HRA and the General Fund, which was particularly relevant given that central guidance had not been updated since 1995 by the then Department of the Environment. The council's response supported the notion of the ring-fence around the HRA, noting that '***DoE Circular 8/95***' had been issued fifteen years ago, and that the provision of social housing services had developed considerably since then, not least in terms of anti-social behaviour, and called upon CLG to issue revised guidance were any to have been formulated.

57. The Reform Paper sought to split housing services into either 'core' (HRA) or 'non-core' (GF) services, but encountered problems with this, which it endeavoured to solve by the creation of a new concept it described as 'core plus' – defined as "***a range of services where there is now a general expectation that landlords will provide a service, for example on anti-social behaviour and tenancy sustainment***" (Reform Paper 3.22).

58. Annex D of the Prospectus contains a draft replacement for '***DoE Circular 8/95***', and since the concept of 'core', 'core plus' and 'non-core' services is refined by the inclusion of a definitional list under each heading, this is to be welcomed. However, the main thrust of our concern remains, namely that there seems to be no real reason why this advice could not already have been issued.

59. Where any ambiguity remains in terms of a particular service wider than the HRA (i.e. it is provided to a client group not just comprising tenants and leaseholders), CLG has consistently intended to apply the "***Who benefits?***" criterion and suggests that local agreements cover the allocation of any such service between the HRA and the General Fund. This is broadly in line with current recharging policy but gives us the opportunity for periodic review and a requirement for service providers to provide usage information.

Summary: We welcome further certainty around the HRA ring-fence, and renew our call for Annex D to be formally issued as guidance for local authorities in this regard.

THE FRAMEWORK – RISK AND PERFORMANCE MANAGEMENT

60. In tandem with developments elsewhere in the social housing sector, the Prospectus anticipates the greater role of the Tenants Services Authority in regulation terms; however the TSA's relationship with the regional Government Offices and the Audit Commission and the need to avoid duplication is acknowledged.

61. The assertion by CLG that "***Local leadership must set and finance the right long-term council housing policies***" is particularly welcome (Prospectus, 3.63).

Summary: It is important to avoid duplication in regulatory regimes, and the council wishes to see more definition as to the requirements of the competing stakeholders in this regard.

THE FRAMEWORK – FULL AND FINAL?

62. The Minister has described the process of which the Prospectus forms the most recent part as a "***once and for all settlement***" with local housing authorities (Prospectus, Foreword). However, it should be noted that within the text, the government appears to reserve the right to intervene in the future should their policy objectives not be met. Whilst accepting that the expectation is for "***self-financing local authority landlords to plan for and manage...normal business risks without recourse to Government***", nonetheless "***If there were major policy changes then [the Government] would consider the consequences for council landlords and deal with these***". (Prospectus 3.68)

Summary: Whilst the intentions of the Government to replace the housing subsidy system "*once and for all*" are laudable, it is unsurprising that they wish to hold reserve powers to cover future eventualities.

THE FRAMEWORK – LEASEHOLDERS SINKING FUNDS

63. The Government were keen as part of the reform process to be seen to respond to widespread concern from leaseholders regarding the affordability of revenue service charges and major works to housing stock. With this in mind, the Reform Paper proposed the extension of sinking fund arrangements to cover leaseholder-related services, and even making their application mandatory. Southwark objected to this course of action for a number of reasons, not least of which was the practical obstacles in the way, and the likelihood of sinking fund contributions perversely contributing to the very problem of affordability that they had been set up to solve.

64. The council made detailed reference to this in its previous response, including: "***Through the use of the Sustainable Communities Act 2008 Southwark has proposed an alternative to sinking funds for local authority leaseholders; individual incentivised savings plans*.**" (L.B. Southwark – Response to the Reform Paper).

65. In the Prospectus, the bulk of our concerns are acknowledged, and it appears likely that sinking funds will remain an optional course of action for local authorities to consider (Prospectus 3.75).

Summary: We welcome the decision not to make the operation of leaseholder sinking funds mandatory, and continue to emphasise the imaginative use of alternatives to address the legitimate concerns of stakeholders regarding affordability.

IMPLEMENTATION

66. As might be expected for the third round of consultation, the Prospectus is focused towards implementation of the proposals, and several aspects of the consultation questions therein seek to gather information as to landlords preparedness.

67. Amongst these is a request for an indication as to how the council can contribute to the policy objective regarding new-build properties. As the Prospectus' model indicates a more generous application of discount rates in order to facilitate this, the nature of our response requires careful consideration. Since the council is committed to the Aylesbury regeneration being further driven by means of a Private Finance Initiative (PFI) credit, our response must reflect this priority, and seek to convince the Government that while the terms of the Prospectus assist us in meeting this objective, it is wholly consistent with new-build policy being pursued elsewhere.

68. Another question asks about the preparedness of the council in terms of “early” implementation. Capacity-building will be an issue across the sector, particularly in terms of the resources available to individual authorities to pursue this agenda. Southwark, as a member of the Association of Retained Council Housing Authorities (ARCH), and via London Councils has access to detailed analysis and consideration of the terms of the offer, and has engaged the consulting arm of the Chartered Institute of Housing (CIH) to consider our internal assessment of the model. They have also advised officers regarding the content and context of the ‘Pre-Response’ submitted to CLG. As noted elsewhere in this report, external advisers have also reported on the treasury management aspects of the proposed Settlement across the HRA and General Fund for the council.

69. Section 313 of the ***Housing and Regeneration Act 2008*** gives local authorities the power to voluntarily leave the subsidy system, and this is the mechanism by which the Government anticipates early (April 2011) implementation will be achieved. It remains unclear what would happen in the short-term to those unwilling or unable to take this step.

70. Given the lack of clarity around the immediate future, it would normally be the case that officers would be advising caution before such a significant commitment, even in principle. This is still true. However, there is something of a sense of “*the only game in town*” about the degree to which the Offer has been developed, and it is very likely that any compulsory scheme in 2012 or onward would be on a less favourable financial basis. Despite reservations about the short-term impact on revenue, and whilst requiring further clarity on rents, debt redemption and borrowing policies, the council must consider whether Southwark risks missing a golden opportunity to establish the financial basis of its social housing provision on a much more secure footing than the current arrangements.

Summary: We require considerably more clarity around certain aspects of the Settlement, but must weigh carefully the opportunities and risks associated with either notional acceptance or rejection of the Offer as it stands. The ‘Pre-Response’ has been designed to assist in this process.

CONCLUSION

71. In the broadest sense, the changes proposed within the Prospectus should be welcomed as a means of establishing further financial freedoms for local authorities as social housing providers.

72. Financial projections indicate that the self-financing proposals would be increasingly beneficial in revenue terms from around 4 – 5 years after the 2011 implementation date. Prior to that we have significant concerns over income levels and the high interest rate on debt. We have requested mitigating treatment in our ‘Pre-Response’ letter, and this will also be reflected in the final response.

73. If the proposals are assessed in the context of what remains for those authorities who do not voluntarily accept the Offer – it seems likely that either a rump (and rapidly diminishing) subsidy system would fail to meet Southwark's resourcing needs over time in comparison with what would **eventually** be the case under a self-financed thirty-year HRA business plan, or a degree of compulsion would be introduced at a later stage by the Government, which would very probably be at much less favourable terms than those outlined in the Prospectus.

74. Given the above, and conditional on some greater clarity being provided by the Department of Communities and Local Government on certain aspects of the Offer, officers are minded to recommend acceptance within the formal response.

CONSULTATION

75. In keeping with normal consultation procedures on HRA finance matters, this report has been provided in draft form to meetings of Tenant Council (on 7 June 2010), and Home Owner Council (9 June 2010). Any decisions and/or recommendations of those two bodies will be made known to Cabinet.

SUPPLEMENTARY ADVICE FROM OTHER OFFICERS

Comments of the Strategic Director of Communities, Law and Governance

76. Save for the provisions of Section 313 of the ***Housing and Regeneration Act 2008*** referred to at paragraph 69 above, there are no specific legal implications to this report. It should be noted that following the Government's consultation, if all councils do not sign up to the national Settlement it is likely that the new system will require primary legislation to give effect to it.

Comments of the Finance Director

77. The potential financial implications arising from the proposed changes to the financing of Housing services are covered within this report.

Background Papers	Held At	Contact
'***Reform of Council Housing Finance***' – CLG consultation documents	160 Tooley Street	Shaun Regan x57771
HRA Reform Paper – Response from LB Southwark	As above	As above
Debt analysis and strategy options under potential Housing Revenue Account self-financing – Sector	As above	Dennis Callaghan x54375

APPENDICES

No.	Title
Appendix A	Audit Trail
Appendix B	HRA Reform Paper Response
Appendix C	Timeline of consultation process
Appendix D	Consultation Questions within '***Council Housing: A Real Future***'
Appendix E	Pre-Response' to Department of Communities and Local Government (May 2010)

APPENDIX A – AUDIT TRAIL

Lead Officer	Duncan Whitfield – Finance Director	
Report Author	Ian Young – Head of Housing Finance	
Version	7 (final)	
Dated	3 June 2010	
Key Decision?	Yes	
CONSULTATION WITH OTHER OFFICERS/DIRECTORATES/ CABINET MEMBER		
Officer Title	**Comments Sought**	**Comments included**
Strategic Director of Communities, Law and Governance	Yes	Yes
Finance Director	n/a	n/a
Date final report sent to Constitutional Support Services		3 June 2010

Financial Management Services
Direct Line – 020 7525 7771
Officer Dealing – Shaun Regan

Rt. Hon. John Denham MP
Secretary of State for Communities
& Local Government
Zone 1/J9
Eland House
Bressenden Place
London SW1E 5DU

27th October 2009

By e-mail to: councilhousingfinance@communities.gsi.gov.uk

Dear Secretary of State,

REFORM OF COUNCIL HOUSING FINANCE – CONSULTATION REPONSE

Please find below the London Borough of Southwark's response to the above consultation paper. We have made some general points initially, but have then sought to address the specific questions posed by the Department within the Reform Paper.

Thank you for the opportunity to contribute to this process, which John Healey MP, the Minister for Housing and Planning was recently quoted in '***Public Finance***' as saying represented *"...the opportunity now to ditch the HRA [subsidy system] and to put in place a new long-term system. We can either seize this chance or spend the next few years reflecting on what otherwise will be a missed opportunity."*

Yours sincerely,

Duncan Whitfield CPFA
Finance Director
London Borough of Southwark

Financial Management Services – P.O. Box 64529, London, SE1P 5LX
Switchboard – 020 7525 5000 **Website** – www.southwark.gov.uk
Finance Director – Duncan Whitfield CPFA

APPENDIX B – HRA REFORM PAPER RESPONSE (OCTOBER 2009)

'*REFORM OF COUNCIL HOUSING FINANCE*'

RESPONSE OF THE LONDON BOROUGH OF SOUTHWARK

The London Borough of Southwark is pleased to have the opportunity to submit comments to be considered as part of the HRAS Review. We would like to make some general points regarding the Reform Paper before responding to the specific consultation questions.

Southwark supports the aims of the review of Council Housing Finance to seek a self-financing solution that gives authorities financial independence, stability and resources to sustain their housing stock.

As things stand, authorities with high levels of debt need subsidy to meet their debt repayments. Debt levels have arisen largely from past Government decisions over supported borrowing, minimum repayment, reserved receipts and abolition debt transfers.

Any solution without annual subsidy will therefore need to ensure that debt levels are not above that able to be serviced from the profit of rents over need to spend of each authority. The current proposals go as far as that and no further, i.e. debt is distributed to mop up any spare income not required to finance need to spend. The proposals thus give authorities no headroom for funding additional investment, nor contingency for future revenue pressures. We therefore have several concerns over the proposed 'offer'.

List of Consultation Questions

Core and non-Core Services

1. We propose that the HRA ring-fence should continue and, if anything, be strengthened. Do you agree with the principles for the operation of the ring fence set out in Paragraph 3.28?

Southwark agrees that a separate landlord account is desirable and that there should continue to be an HRA ring-fence. In addition, we would wish to see an agreed methodology for establishing which (element of) services is charged to the HRA. We broadly agree with the six principles set out in Paragraph 3.28 of the consultation and also with the principles of Paragraph 3.29.

Southwark supports moves for more clarity over the HRA ring-fence. Past guidance has been patchy and of limited practical help, and now suffers from being outdated.

If CLG has updated guidance ready for issue, it should be consulted on as soon as possible, and does not need to be tied into any other aspect of the Reform Paper, which might inhibit or delay its introduction.

2. Are there any particular ambiguities or detailed concerns about the consequences [of Q1]?

We are not sure what form of agreement is envisaged in Paragraph 3.29 but would be concerned at the practicalities of anything beyond a service level agreement.

Standards and Funding

3. We propose funding the ongoing maintenance of lifts and common parts in addition to the Decent Homes Standard. Are there any particular issues about committing this additional funding for lifts and common parts, in particular around funding any backlog through capital grant and the ongoing maintenance through the HRA system (as reformed)?

We welcome additional funding for lifts and common parts through revised weighting of an increased MRA; the detail of this higher standard and its application will need to be carefully considered, and appropriate for estates within the inner-cities with associated problems as well as more traditional council housing stock. As additional works have not been funded up to now, backlog funding is needed by capital grant or by uplifting the MRA by a further 19% suggested by the research. The questions imply separate additional funding to reach the Decent Homes Standard but this is not explicitly evident in the proposals and requires further elaboration.

4. Is this the right direction of travel on standards and do you think the funding mechanisms will work or can you recommend other mechanisms that would be neutral to Government expenditure?

The direction of travel towards improving standards to and beyond Decent Homes is welcomed, but it is only likely to be a sustainable move if the funding is made available to support it. Sustainability – including energy efficiency – is another area relevant to the standards issue. Funding for further work is limited and payback periods are lengthy.

Capital grant would appear to be the appropriate funding mechanism with a greater flexibility to carry over resources from one financial year to the next would be welcome. However, we are concerned that there is a lack of certainty regarding the methodology surrounding the extended operation of this funding type.

We are not sure that the solution will be revenue neutral, given the backlogs of non-ALMO or stock transfer authorities, particularly with the current low level of Right to Buy capital receipts. It is important that the backlog requirements for all retained authority stock is considered, including where properties will not meet the original Decent Home Standard by 2010/11.

Southwark tenants have recently suffered tragedy because of the fire at Lakanal, in Camberwell, and therefore health and safety beyond Category 1 '***Housing, Health and Safety Rating System***' measures, is uppermost in both the Council's set of priorities, and of those living in the borough. The need for this to be reflected in HRA landlord obligations along with, for example, a Sustainable Communities policy means that likely funding may have to be linked even more closely to measurable objectives.

Leaseholders

5. We propose allowing local authorities to set up sinking funds for works to leaseholders stock and amending HRA rules to permit this. Will there be any barriers to local authorities taking this up voluntarily, or would we need to place an obligation on local authority landlords?

Whilst the intentions of the Government to provide assistance to leaseholders in meeting their commitments is noted, there are significant factors which make the operation of sinking funds counter-productive in this regard:

- Sinking funds only work if all residents contribute. This means that equal contributions need to be paid by each secure tenant. If this does not happen the situation could occur where leaseholders have made contributions and communal works are needed but cannot be undertaken through lack of funding (for the tenant proportion). This has previously happened in Southwark resulting in sinking fund contributions have to be refunded;

- Historically, local authorities such as Southwark have not been able to fund their investment needs; so any sinking fund proposals can only be set in an environment where tenant rents can fund their share of communal repairs;

- The proposed environment needs to deal with an anomaly – sinking fund payments from leaseholders are payments in advance, whereas funding of tenanted repairs is based on borrowing and repayment in arrears;

- Sinking funds cannot be an 'opt in' – contributions from all residents need to be mandatory and enforceable so as to ensure adequate funds are available to meet the landlord's contractual duties. Most local authority (including ALMO) leases have no sinking fund clauses. Simply put, sinking funds will require retrospectively inserting covenants into local authority leases; and

- Sinking funds are costly to manage – monies have to be receipted; accounted for; invested; statements provided, and so on which increases management costs for leaseholders. All the current assistance for local authority leaseholders is based around payment in arrears. Sinking funds are payments (up to 30 years) in advance. But experience is that leaseholders cannot afford to pay in advance and could be in danger of losing their homes if mandatory retrospective covenants were introduced into their leases. Through the use of the Sustainable Communities Act 2008 Southwark has proposed an alternative to sinking funds for local authority leaseholders; individual incentivised savings plans.

The operation of sinking funds for leaseholders should not be a requirement of local housing authorities.

Debt

6. We propose calculating opening debt in accordance with the principles set out in Paragraphs 4.22 – 4.25. What circumstances could lead to this level of debt not being supportable from the landlord business at the national level?

It is difficult to comment on the principles, in terms of the allocation basis of extra need to spend for individual authorities, as they have not been fully described. We await detailed exemplifications of the debt transfer proposals.

Information on allocations and assumptions

The viability for Southwark of the proposed settlement basis crucially depends on the actual level of opening debt. Despite the self-financing pilots conducted by CLG in the recent past and national debt total tables being produced now, we have no official information on the current assumptions that would determine our own need to spend or rent income and hence the debt level we would start with. A recent indication from a senior CLG officer was that we would only see draft allocation figures in March 2010 – this appears to equate to the indicative 'offer' mentioned in the Reform Paper. This excludes authorities from the debate around allocation weightings and from being able to model their own data, severely constricting our ability to contribute in a meaningful manner to the process.

A timescale for the publication of full information on assumptions must be set, containing adequate provision for consultation and challenge early in 2010 prior to offers later that year.

We are concerned at the level of debt proposed nationally – around £25bn. This would not be sustainable as the need to spend has been underestimated and income will be lower in early years than the average for the next thirty.

Management and maintenance need to spend should be increased by 10% to match the RSL level and cover contingencies whilst **MRA should increase by 43%** as indicated by the research. At these levels the national debt total would be largely unchanged and would be closer to being affordable.

The Reform Paper recognises possible implications for individual authorities' General Funds, and proposes making settlements should these arise. The Government should ensure that any such settlement be made as full settlement and outside Revenue Support Grant processes, as the effects of floors in the grant allocation processes could mean that entitlements through RSG would disappear and the full burden of HRA adjustment could then fall on the Council Tax payer.

7. Are there particular circumstances that could affect this calculation about the broad level of debt at the district level?

We are concerned that the proposed settlement uses projected future subsidy entitlement with only two amendments and therefore perpetuates some previously ingrained problems within the subsidy calculation. The level of local authority HRA debt on the current proposals would rise from £18bn to around £25bn indicating that HM Treasury would gain and local authorities lose massively compared to the current situation.

Income assumptions

In particular we will not be able to generate the full proceeds of guideline rent (at its average over the 30 years of the Housing business planning process) because of the following factors:

- Southwark has a void loss above 2% arising from nationally-supported regeneration schemes covering the Heygate and Aylesbury estates;

- Stock loss arising from these (and other) regeneration schemes and Right to Buy sales (identified stock for regeneration comprises 12.3% of Southwark's current budgeted stock total, or almost 5,000 properties);

- Rent levels on high-value properties are restricted by affordability caps and limits and are likely to remain so for the foreseeable future; and

- Rent levels in Southwark are currently on average 10% below Formula and a further 7.5% in real terms below the likely Formula rent level in 15 years time.

We are also concerned that increasing future resources put in by tenants will be taken away in the initial offer by increased debt. This would consolidate one of the main problems with the current subsidy system – that HM Treasury and not landlords keep any real-terms rent increases.

Income assumptions need to be to be based on both a realistic guideline rent, i.e. abated for the effect of caps and limits continuing until at least 5 years after the convergence date and the reduction in stock levels concomitant with significant regeneration.

Expenditure assumptions

A 5% once-only increase in management and maintenance need to spend is proposed. However, the increased level only matches what authorities are able to fund at present and falls short of RSL spend levels. Throughout the rent restructuring process, tenants have been expected to converge to paying RSL rent levels for comparability purposes, and therefore consistency demands that they should enjoy comparably funded service levels.

In addition, the model does not allow for contingencies. Amongst future possible pressures could be:

- Additional responsibilities arising, e.g. better fire safety standards, which is a nationally-noted concern of this authority;

- Any loss on leaseholder service costs against charges;

- Any loss on tenant service costs against charges;

- Differing rent and cost inflation increases; and

- Effects of regeneration schemes.

Management and maintenance need to spend must be increased by a further 5% (to an increase of 10%) to match RSL spend levels and to cover contingencies.

A 24% increase in Major Repairs Allowance is proposed, covering current asset renewal with no backlog funding. Building element replacement costs are rising as standards of heating, wiring, kitchen and bathroom fittings improve. It is already widely recognised that another 19% is immediately needed to cover backlog works.

Whilst the proposed increase in MRA is welcome, another 19% p.a. needs to be permanently added to major repairs need to spend, to make the overall increase 43%.

We have a long way to go to reach target rents and also several redevelopment schemes creating rent losses, so rent income may not be at the expected level. We also have a high consolidated rate of interest so each £1m of debt is more costly and less affordable for us than other authorities.

The Reform Paper notes that future rent policy is under review. The temporary changes in convergence dates announced in 2008 appeared to be HM Treasury-led and created confusion, not least because of the problematic timing of their announcement. However, whatever the convergence date, Southwark will have a significant minority of properties restrained by caps and limits for the foreseeable future.

The convergence date should be confirmed as 2016/17, (i.e. 10 years after the 2006/07 changes to Target Rents), and caps and limits effects must be reflected in any revenue settlement.

8. We identified premia for repayment and market debt as issues that would need to be potentially adjusted for in opening debt. How would these technical issues need to be reflected in the opening debt? Are there any others? Are there other ways that these issues could be addressed?

Premia should be funded up front rather than spread over several years. Interest rate changes and variations between authorities are not covered in the proposals. There should be compensation for any adverse effects on authorities' General Funds, e.g. if the consolidated rate of interest rises.

In the absence of practical details we have concerns over the consequences of redistributing debt. There will undoubtedly be knock-on effects for local authority General Funds, e.g. in changed interest rates and possibly unfunded premia.

Southwark's current Consolidated Rate of Interest (CRI) is nearly 7% and therefore £1m of debt is less affordable for us than for most other authorities, which have lower CRI's.

We would anticipate the need for legislation or the issue of regulations to cover the Government's actions as proposed. We are concerned that the proposals contravene proper accounting practice. This needs to be evaluated, and the proposals amended in accounting terms to meet proper practices under the '***Statement of Recommended Practice***' (or Financial Reporting Manual Code in future), or issue further regulation to allow departure from accounting practice under the SORP/FReM. A recent example of the latter would be regulations to counter the treatment of premia under the introduction of financial instruments in the SORP from 2007/08.

Converting cashflows into capital sums have usually been at NPV rates disadvantageous to recipients. Once again, we would want further consultation based on exemplifications.

Debt adjustment should include some move towards equalising CRI's, possibly by prioritising paying off high-interest debt.

There is a need to ensure that proposed actions on debt premia are consistent with proper accounting practice.

9. We propose that a mechanism similar to the Item 8 determination that allows interest for service borrowing to be paid from the HRA to the General Fund should continue to be the mechanism for supporting interest payments. Are there any technical issues with this?

The proposals on interest transfer mechanisms are no different from that which exist at the moment. Responses on the equitability of the cost of transfers are dealt with elsewhere.

However, we particularly welcome any proposals that will allow the disaggregation of new HRA and General Fund debt from the pooling of debt for subsidy purposes per Paragraph 4.26 of the Reform Paper, as adverse notional interest rates, from debt mountains arising in generationally different periods, significantly hamper this authority and many others in carrying out new investment both under supported borrowing and prudential borrowing regimes.

The disaggregation of new HRA and General Fund debt from the pooling of debt for subsidy purposes is welcome.

10. Do you agree the principles over debt levels associated with implementing the original business plan and their link to borrowing?

It is not clear that debt levels would be linked to the business plan – rather to need to spend subsidy-type figures. The debt levels need to allow for some contingency and not merely mop up the whole of an authority's expected rent surplus. Debt levels linked to affordability could be a viable basis but we need more detail on how debt would be calculated for each authority.

Government subsidy over the period of a PFI scheme is important in providing certainty to providers and it would not be possible to provide a similar level of assurance from a 30 year local authority business plan.

PFI revenue subsidy must continue on its current basis rather than being abolished with the other subsidy elements.

11. In addition to the spending associated with the original business plan, what uncommitted income might be generated and how might councils want to use this?

Generally we would want to use any uncommitted income to support capital investment, possibly as annual revenue contribution or to support prudential borrowing. The need for restriction on prudential borrowing is neither clear nor justified and HRA's should be regarded as trading entities, with their borrowing not part of PSBR.

Increasing rent income could support prudential borrowing for future investment. However, current Public Sector debt rules require HM Treasury to limit the total national amount of borrowing undertaken. Any controls operated will inhibit investment and run counter to the over-arching intention of the Reform Paper to provide a framework for self-financing.

Local Authority Housing provision is a trading activity able to generate funds to support investment borrowing and therefore should not be controlled as part of Public Sector debt.

Capital Receipts

12. We have set out our general approach to capital receipts. The intention is to enable asset management and replacement of stock lost through Right to Buy. Are there any risks in leaving this resource with landlords (rather than pooling some of it as at present)?

Right to Buy sales are not generating significant resources at present but have done so in the past. Generally local authorities are best placed to decide on investment of their own receipts, providing that sufficient central funding is able to be otherwise provided to meet the decent homes backlog. Right to Buy sales create a revenue loss. Some authorities might wish to use RTB receipts to reduce debt and release revenue resources for services, rather than using receipts for capital investment.

With economic conditions reducing the level of capital receipts possible and supported borrowing coming to an end after 2010/11, investment funding has become a greater problem for Southwark than the revenue situation. Proposals within the Reform Paper are unclear on what funding for backlogs, the Decent Homes Standard and new build would be available. Biddable Government funding is only perceived as a contributor to costs rather than schemes being fully-funded centrally, so local authorities are normally expected to raise additional funds locally.

The proposal to let local housing providers retain all Right to Buy receipts is welcome.

However, it is not clear that this would provide significant investment funding in the future:

- The Council may need to use some of the receipts to repay debt to offset the revenue effect of stock loss, which is greater without the dampening effect of consequential subsidy change; and

- For HCA-assisted new-build and similar schemes local authorities are required to repay capital grants from Right to Buy receipts – this approach is inconsistent with the proposed treatment of other capital receipts and is likely to inhibit HCA-related bidding in the future.

It is evident that revenue surpluses could provide significant investment resources nationally yet these are being taken away by the proposed debt settlement.

The proposed need to spend must include an element of headroom for revenue support to capital expenditure (or to meet prudential borrowing costs).

13. Should there be any particular policy about the balance of investment brought about by capital receipts between new supply and existing stock?

It is difficult to specify this, given varying levels of social housing, its condition, and land availability etc. The HCA funding emphasis at present appears to be towards new, although not replacement, stock and their policy needs widening rather than imposing restrictions on local authorities.

14. Are there concerns about central Government giving up receipts which it currently pools to allow their allocation to the areas of greatest need?

To date, much of the pooled funding has been allocated by Government to ALMO's or to PFI schemes, not necessarily where there is the greatest need. There is some danger of Right to Buy receipts not reviving enough to offset any central funding reduction.

Equality Impact Assessment

15. Would any of our proposed changes have a disproportionate effect on particular groups of people in terms of their gender or gender identity, race, disability, age, sexual orientation, religion or (non-political) belief and human rights?

Although people from Black and Minority Ethnic groups are more reliant on social housing, we do not think that there is anything in the proposals themselves that would impact disproportionately on any specific community, or ethnic group.

However, there is a more general concern regarding the borough's very low income levels, particularly among council tenants as demonstrated by Southwark's Housing Requirements study, so any move to further increase rent levels would be likely to have a very serious impact on income levels amongst the most deprived residents of Southwark.

16. What would be the direction (positive or negative) and scale of these effects and what evidence is there to support this assessment?

Please refer to Q15. above.

17. What would be necessary to assemble the evidence required?

Please refer to Q15. above.

APPENDIX C – TIMELINE OF CONSULTATION PROCESS

23 July 2007	Housing Green Paper '***Homes For The Future: more Affordable, More Sustainable***' includes intention to "*examine the case*" for the review of HRA Finance
12 December 2007	Announcement of review process by Communities and Local Government
10 March 2008	Ministerial launch of review process
22 July 2008	Enactment of the ***Housing and Regeneration Act 2008***, which contains provision (s.313) for local housing authorities to remove some or all of their stock from the housing subsidy system
Summer/Autumn 2008	CLG conduct workstream groups and other consultation exercises
31 October 2008	End of first consultation period
21 July 2009	Publication of '***Reform of Council Housing Finance***' consultation document
27 October 2009	End of second consultation period
25 March 2010	Publication of '***Council Housing: A Real Future***' (the Prospectus) consultation document
6 July 2010	End of third consultation period
1 April 2011	Possible date of implementation of self-financing
1 April 2016	Proposed rent convergence date
2035/36	Modelled break-even date under self-financing proposals
31 March 2041	Proposed end of first 30-Year self-financed Business Plans

APPENDIX D – CONSULTATION QUESTIONS FROM '*COUNCIL HOUSING: A REAL FUTURE*

1. ***What are your views on the proposed methodology for assessing income and spending needs under self-financing and for valuing each council's business?***

2. ***What are your views on the proposals for the financial, regulatory and accounting framework for self-financing?***

3. ***How much new supply could this settlement enable you to deliver, if combined with social housing grant?***

4. ***Do you favour a self-financing system for council housing or the continuation of a nationally redistributive subsidy system?***

5. ***Would you wish to proceed to early voluntary implementation of self-financing on the basis of the methodology and principles proposed in this document? Would you be ready to implement self-financing in 2011/12? If not, how much time do you think is required to prepare for implementation?***

6. ***If you favour self-financing but do not wish to proceed on the basis of the proposals in this document, what are the reasons?***

APPENDIX E – 'PRE-RESPONSE' TO DEPARTMENT OF COMMUNITIES AND LOCAL GOVERNMENT (MAY 2010)

Finance and Resources
Direct Line – 020 7525 7771
Officer Dealing – Shaun Regan

Review of Council Housing Finance
Department for Communities and Local Government
Zone 4/H4, Eland House
Bressenden Place
London SW1E 5DU

27 May 2010

Dear Sir/Madam,

'Council Housing: A Real Change' – Pre-Response Submission

Thank you for the opportunity to respond to the Consultation document '***Council Housing: A Real Change***'. The council intends to respond formally before the closure date of July 6 2010, once a process of consultation with tenants and leaseholder representatives has taken place. As a London Borough, we have also had "all out" elections this month resulting in a change of political control, and therefore would wish to brief our members, some of whom are entirely new to the council, on this vital area of potential change.

Notwithstanding the above, I felt it important to make you aware of some potential areas of concern that I have, since in some instances they may be resolvable, and in others, you may be able to provide a view that will enable me to recommend broad acceptance of the Settlement offer.

The proposals appear to be adverse for us in the early years (we expect a potential revenue loss of £7.6m in Year 1, and further losses in years 2 – 4 totalling around £13m) and we are anxious to establish whether there is scope for change to mitigate this position. As things stand we might have difficulty in supporting the basic proposals because of the severe financial problems we would face in early years. The areas we wish to have clarification on are outlined below.

APPENDIX E – 'PRE-RESPONSE' TO DEPARTMENT OF COMMUNITIES AND LOCAL GOVERNMENT (MAY 2010)

Debt Modelling Assumptions

Southwark is in a particularly unique position regarding other social housing providers, as we are – under the PricewaterhouseCoopers model – likely to be offered a substantial commutation of existing housing debt, whilst having an average debt interest level higher than that mooted under the model. There is therefore a real danger that the Offer will underestimate the costs to us of any proposed new debt settlement level. Our consolidated rate of interest is currently around 6.9% and the understanding is that the proposals, which would reduce debt, would not affect that. If so, we have been advised that Southwark would be the only authority in the country with a CRI above 6.5% (others with high CRI's would be taking on new debt at prevailing market rates which, being near historic lows, will have the effect of reducing their average rate). This means that a debt level affordable at 6.5% is not so to us because we would be paying 6.9% interest. The 7% proposal would not provide us with the headroom intended, which would have the additional effect of preventing us from responding positively to the new-build proposals in the Prospectus.

If we were able to adopt a more targeted approach to commutation, i.e. to redeem higher coupon debt early, then this would have the beneficial effect of reducing our CRI which would then be in tandem with other high-CRI authorities. Otherwise, it would appear that the savings to be had in terms of the reduced cost of servicing the reduced debt level would be more than outweighed by the amount of subsidy foregone in the early years of self-financing. When consulting with our tenants, leaseholders and members, the fact that the current proposals would lead to a significant reduction in resources to Southwark in the first few years post-Settlement makes a recommendation to accept the Offer a difficult position to justify, even though there is the potential for greater support over the full thirty years of the HRA business plan.

It is appropriate that we draw particular attention to paragraph 2.51 in the Prospectus which specifically identifies this issue – we will be responding as one of the affected authorities in this regard.

APPENDIX E – 'PRE-RESPONSE' TO DEPARTMENT OF COMMUNITIES AND LOCAL GOVERNMENT (MAY 2010)

Rent Debit Levels

In common with most inner city and metropolitan areas, our average rents have been historically low, which has made rent restructuring a challenge. We have, however been supporters of these changes since their inception almost ten years ago. The assumptions of the model regarding convergence to the formula rent level by 2015/16 are unlikely to be met by Southwark, leading to uncertainty as to the robustness of the business plan in the medium-term. My staff will be able to quantify this further in time for the formal response, but a strict adherence to the parameters of formula rent-setting lead me to the inescapable conclusion, even at this stage, that we will not be realising the full levels of rental income that the model takes as given for some years after 2015/16. In addition the effect of caps is proposed to be ignored because it affects only a few authorities – we are one of those and cannot ignore it. Whilst it may be difficult to adjust for this it is yet another factor affecting outlying authorities. We are keen to explore the possibility of any form of individual calculation/transitional basis to assist us in recognising this issue.

Decent Homes Backlog

As you will recall, Southwark tenants decisively rejected a proposed large-scale voluntary transfer of stock (LSVT) around the Aylesbury Estate in 2002. This led the council to the conclusion that there was no appetite for any form of modified housing management vehicle amongst tenants, and so we did not pursue the creation of an Arms-Length Management Organisation (ALMO). Various avenues of additional central support for the Decent Homes policy objective were therefore closed off to us as a consequence. The Prospectus document notes the means by which ALMO's may access the committed £3.2bn that the Government accepts will be required to meet the policy objective, but there is little comfort for others in this regard. We require greater clarity regarding whether this nationally-modelled sum has been assessed for adequacy against the level of pending ALMO commitments and the substantial non-ALMO need on top of this.

The key for Southwark is that as a retained stock authority we have an absolute need to be consulted on any mechanism devised by yourselves to identify and access monies applied to target the Decent Homes backlog irrespective of our housing management delivery arrangements, and welcome further discussions either directly with you, or through representative bodies in order to achieve this.

APPENDIX E – 'PRE-RESPONSE' TO DEPARTMENT OF COMMUNITIES AND LOCAL GOVERNMENT (MAY 2010)

Private Finance Initiative

We have approval to submit an HRA Private Finance Outline Business Case this summer, so it is possible that this will be approved this year. We understand that Private Finance credits may take into account consequent subsidy changes over the life of the scheme. Will any such adjustment, relating to future subsidy and which might be negative for us because of falling stock, be taken out of the self-financing PFI adjustment? Despite poor economic prospects, we remain fully committed to the regeneration of the Heygate and Aylesbury estates, encompassing 1,212 and 2,758 dwellings respectively. Naturally, this is a very substantial part of our thirty-year HRA business plan, and we have particular concerns on that basis.

Stock Numbers

We are currently carrying out major regeneration schemes at Elephant and Castle (Heygate Estate) and Walworth (Aylesbury Estate), the latter being the subject of the PFI bid. We are steadily decanting these estates prior to them being redeveloped for new housing (private, RSL and council) and our stock is steadily declining by 300 – 500 units p.a. because of this. It would appear from the model that regeneration stock losses, arising as part of PFI or other major schemes, are not taken into account in the numbers used in modelling. The assumptions made around the rental stream, over the initial few years particularly, are critical and must be recognised if the proposal is to be sustainable at a local level.

As I noted above, we will also be providing a full and formal response to the consultation paper in due course, but I hope that you can give us some specific guidance in terms of the items outlined above to assist in formulating that response.

Yours faithfully,

Duncan Whitfield
Finance Director