CAB2026
FOR DECISION
WARD(S): ALL

CABINET - 24 JUNE 2010

THE REFORM OF COUNCIL HOUSING FINANCE

REPORT OF HEAD OF LANDLORD SERVICES

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RECENT REFERENCES:

CAB1904 – Reform of Council Housing Finance – 14 October 2009

PS419 – The Reform of Council Housing Finance – 14 June 2010

EXECUTIVE SUMMARY:

This report is an updated version of PS419 dated 14 June 2010 and provides additional information that was not available when PS419 was drafted. This includes an amendment to the recommendation, additional commentary on the new Government's thinking (para – 11.1) and additional commentary on how interest rate changes may impact on the Business Plan. This report also provides a detailed draft response as appendix 1. The response to the October 2009 consultation is also attached for information at appendix 2.

In March 2010, the previous Government put forward detailed proposals to replace the existing national housing revenue account (HRA) subsidy system with a form of self financing, allowing all councils to retain all rent income in return for taking on a share of the national housing debt. As predicted and in spite of challenges concerning weaknesses in previous assumptions, the City Council would be expected to take on more debt per property than most, as rents are high and assumed costs are relatively low.

The proposal allocates £156 million of the national debt to the City Council (maybe slightly less if the Council can use the difference to commence a programme of new build). Modelling indicates that this would provide additional resources overall, would allow the Council to maintain the Decent Homes Standard across its stock in the long term and potentially generate significant revenue surpluses in the later years of the 30 year business plan. It would not achieve the same potential investment levels as a stock transfer, although with the increased resources on offer through this proposal, it is very unlikely that such an approach would be supported by tenants.

The new Government has expressed a commitment to reform the HRA subsidy system and has said it will consider all responses before committing to the proposals and timetable in the consultation.

If the proposals are adopted, then early adoption is critical to the City Council. Recent efforts to address the previously reported shortfall on repairs have meant that the £3m annual shortfall has been reduced to £2.5 million. However, the backlog of work continues to grow. Any delays beyond 2011 could force the Council to consider alternative options ahead of a national system.

The Principal Scrutiny Committee agreed that Cabinet should be requested to include in their response to the consultation on the proposals challenges to the basis of the calculation of the total debt figure. It also agreed that additional analysis of the impact of interest rates and their links to inflation and rent income should be provided to Council to reassure members that associated risks are acceptable to the Council.

The challenges to the calculation have been included in the draft response and the additional analysis on interest rates has been added to this report (see paragraph 7).

RECOMMENDATIONS:

That, subject to any amendments it wishes to make following discussion and consideration of any comments from Principal Scrutiny Committee, Cabinet recommends to Council that the draft response as detailed in the appendices form the Council's response to the Government Proposals on HRA Reform.

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REPORT OF HEAD OF LANDLORD SERVICES

DETAIL:

1 Introduction

1.1 On 25th March John Healey, the then Minister for Housing, announced the detail behind the move to dismantle the current HRA subsidy system and replace it with a devolved Self-Financing system. All stock holding councils have been asked to formally respond to the consultation proposals by 6 July. It is unclear what the intentions of the new Government will be, although the reform of the HRA subsidy system was included as a clear commitment in the recent Queen's Speech. The Government has stated that it will consider all responses before making decisions on whether to keep with the existing proposals.

1.2 This new system would involve a new settlement between central and local government. The March announcement indicated that the total debt to be redistributed is £25.1bn i.e. an additional £3.6bn over and above the existing housing debt. It is intended to be a once and for all settlement which is intended to be neutral between central and local government.

1.3 In addition to the existing debt, the Government has identified that there is an outstanding requirement of £3.2bn for spend on decent homes backlog works; funding for these works may be available through a separate grant funded by the additional debt highlighted above, although this would be subject to the future spending review process.

1.4 It is proposed that councils keep all their rents that they collect and all receipts generated from the sale of land and houses, 75% of which has to be used for affordable housing or regeneration schemes. As now, 25% of receipts can be used to resource any element of the capital programme.

1.5 There is still provision for stock transfers but different arrangements where Government funding is needed and the continuation and calculation of the transfer levy is to be reviewed.

1.6 The model is based on a net present value calculation of notional expenditure and income assumptions with annual cash flows discounted back to a 2011/12 price base. The Government has increased base allowances for all councils to reflect the surplus generated by the current system. This provides an estimated 10% increased allowance for Winchester (approximately an additional £1m annually).

2 Potential Impact on Winchester

2.1 With high rents and a subsidy model which assumes management and maintenance costs in Winchester are relatively low, the reform proposal assumes the City Council should be allocated a £156,000,000 share of the national debt. The proposal suggests that the City Council is in a position to service approximately £30,000 debt per property. Whilst not the highest, this is above the average allocation of approximately £7,000 per property. The Council's ability to manage this proportion of debt is based on similar assumptions that have been used in the existing subsidy calculations, albeit adjusted to provide an additional 10% resource on average to all councils. Whilst this results in an above average debt figure, it is a better position than could be achieved through the current system and would provide additional resources allowing the Council to manage a sustainable housing service in the long term.

2.2 The response made by the City Council in October 2009 to the initial consultation on this issue made strong representations against the weaknesses of the existing subsidy assumptions. It is proposed that the representations be reiterated in the Council's response this time, although it is accepted that it is unlikely to influence any fundamental changes at this stage. It is also recommended that the response challenges the Government's overall debt calculation.

2.3 The latest proposals will mean more resources for Landlord Services. The increased resources could address much of the current shortfall in the Council's maintenance programme and it is likely that the proposal will allow the Council to maintain the Decent Homes standard in the long term. However, it is unlikely to provide for additional investment in other tenant priorities (internal decorations for older people, estate renewal, parking etc).

3 Debt Redistribution

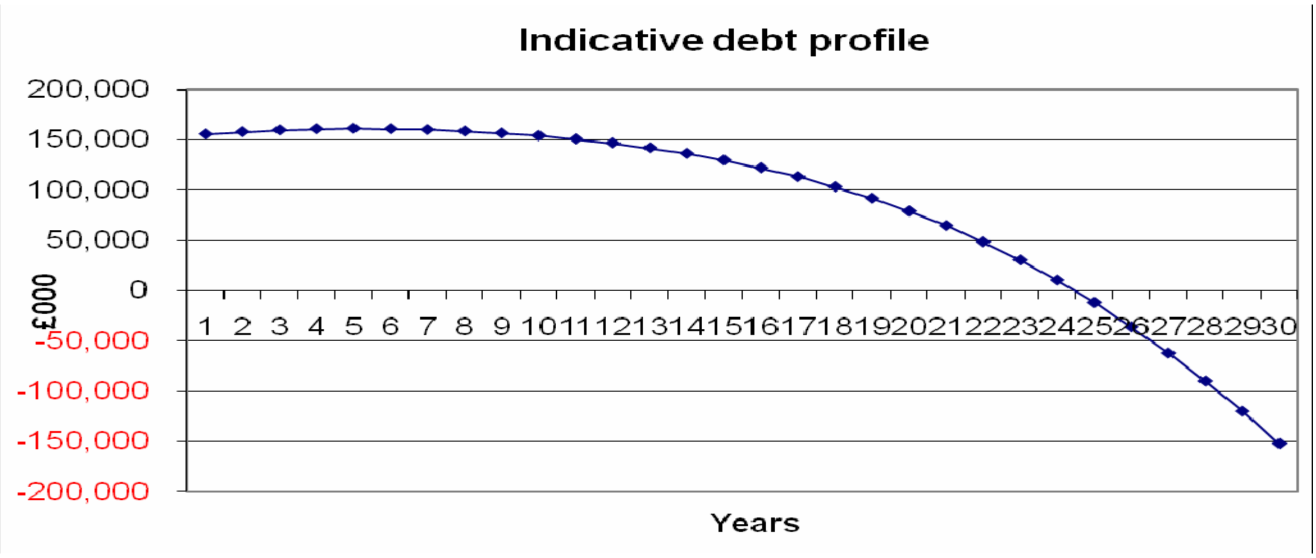
3.1 As detailed above, the debt allocation proposals are based on a national debt figure of £25.1 billion. This is based on adjusting the projected national debt at April 2011 (£21.5 billion) to account for current and future surpluses that the Government benefit from the existing system. The proposal aims to be neutral for both central and local government and it is this adjustment that achieves this. These surpluses would amount to nearly £13 billion if the existing system remains. However, in determining final debt figures, the Government have allowed for additional resources for local authorities, which in effect provide an additional 10% for management and maintenance for the City Council. Government research suggests this is the current level of under-investment in landlord services. They have provided the details of the research and this suggests increases for Winchester should be nearer 13% and comment on this will be included in the final response. However, an opportunity to increase resources for any public service in the current climate has to be welcomed.

3.2 Final debt levels may be based on a 6.5% discount rate or a 7% discount rate if councils commit to using any headroom this creates to fund new build social housing. Councils have been asked to specifically comment on preferences in their response. Because of borrowing limits described below, the City Council's scope for this will be very limited in the short term (see paragraph 7). Potential total debt allocations are detailed below:

	6.50%			7.00%		
	NPV	Current SCFR (assumed existing debt in HRA)	Addition	NPV	Current	Addition
Winchester (£'000)	£155,684	£9,764	£145,920	£148,578	£9,764	£138,814
Unit Figures	£30,706	£1,926	£28,780	£29,305	£1,926	£27,379

3.3 Assuming all surpluses achieved (rents less assumed service costs) are used to repay debt, the Government calculate the Council's repayment profile will be similar to that in the table below:

Figure 1: Winchester Indicative Debt Profile 6.5%



4 Limits on Borrowing

4.1 The Government has announced that it will set a limit on borrowing at the opening debt settlement. This limit will be in addition to that set out in the Prudential Borrowing Code and will be enforced via the item 8 determination. The consultation document states 'local authorities would have a long term incentive to reduce debt but there will be no obligation within the framework to do so'. This limit prevents the Council borrowing additional sums in the short term to address backlog works which is unfortunate. The Government's £3.2

billion set aside for additional grant to fund backlog is likely to be significantly oversubscribed and in reality is only likely to fund ALMO backlog programmes.

4.2 Another potential issue that the City Council will need to make representations on is in relation to its existing HRA debt. This is historic debt owed to the Council's General Fund on which the HRA pays interest each year. Government subsidy calculations assume this debt is £9.8 million. In reality it stands at £10.1 million. As actual debt is higher than assumed subsidy debt provision, the above limits on borrowing will create an immediate £300,000 shortfall in the HRA business plan. This has occurred as a result of previous decisions to service this debt rather than to pay it off. This is a relatively modest issue compared to many landlords, whose shortfall can run into millions. The self financing proposal is not clear how this will be treated and the Council will make representations stating that the difference needs to be added to borrowing limits.

5 Winchester City Council Business Plan

5.1 In order to assess whether the self financing proposal will allow the Council to deliver its 30 year business plan, modelling has been completed based on two key scenarios:

a) All stock to achieve and maintain decency, but accepting that some individual elements such as kitchens and bathrooms will be older than the standard lifetime for such components (20 and 30 years respectively). Priority given to the funding of Disabled Adaptations.

b) As above, but accelerating the kitchen and bathroom replacement programme to achieve a 20 and 30 year lifespan respectively by the end of the planning period 2010-2013. It also addresses works associated with "catch-up" repairs over a similar period (£251m over 30 years).

6 Business Plan Modelling

6.1 Both scenarios have been modelled in light of the self financing approach to test the impact on both capital and revenue funding. Assumptions include:

a) Inflation at 2.5% and rent inflation at 3% (current national rent policy sets rents at inflation plus 0.5%)

b) Borrowing at the current Public Works Loans Board rate of 4.5% and that debt is repaid consistently over the life of the loan

c) 75% Right to Buy receipts are reinvested directly into the HRA capital programme.

6.2 Against the first scenario (the existing Decent Homes Plus standard), service standards can be met and HRA revenue balances can be maintained throughout the 30 years. With regard to capital funding, the model almost works, with potential small overall shortfall (in total, not annual) of £3m throughout the first 10 years. Additional sensitivities have been run against this scenario, including the impact of additional revenue savings, the risk of increased inflation or interest rates etc. Modelling so far would indicate that this position is sustainable, but not without risk. For example:

a) Interest Rates - Increasing interest rates would result in significant capital shortfalls (although this can be avoided by “fixed rate” borrowing) (see paragraph 7).

b) Inflation - whilst increased general inflation would be positive for the model (as rents rise at inflation + 0.5%, it suffers if repairs inflation outstrips general inflation (as has been the case for the last 5 years, when building cost inflation has been significantly higher than underlying inflation rates).

c) Reducing Management Costs – Reducing operating costs by £200,000 makes the business plan far more sustainable. Whilst this sounds a high figure, it is considered achievable over the next three years. However, this would mean that discretionary issues such as internal redecoration may be difficult to reintroduce.

6.3 Overall, the risks are considered to be manageable and the proposal does offer the Council the opportunity to break free of the current system and deliver improved services to tenants.

6.4 With regard to the second scenario (Decent Homes Plus and all older kitchens and bathrooms being replaced within five years), the revenue budget remains in surplus in the first 20 years although capital shortfalls are massive. No reasonable sensitivities can be run that make this option affordable.

6.5 The table below provides an indication of the financial impact of self financing against each scenario and against key sensitivities. This first line shows the existing service funded by the current subsidy system. The revenue budget would be in deficit within five years and there would be large shortfalls in capital funding throughout the life of the Business Plan.

6.6 However, the second line shows that the Decent Homes scenario could be funded, subject to small capital shortfalls in the early years. Additional rows in the table show the impact of a range of sensitivities and the final row demonstrates how the second scenario (the accelerated programme) is not sustainable:

	HRA Revenue Account Working Balance				HRA Capital Account Cumulative Shortfall			
Year	**5 £m**	**10 £m**	**20 £m**	**30 £m**	**5 £m**	**10 £m**	**20 £m**	**30 £m**
Base– Current Programme & Existing Subsidy system	(4.51)	(12.63)	(42.94)	(101.92)	41.24	41.20	42.00	52.33
Scenario 1 – Achieving and Maintaining Decency Debt £155.7m & Debt repaid	0.99	0.94	1.17	142.37	3.02	2.92	0.00	0.00
As above, but interest rates increased by 2%	0.12	0.83	1.21	91.37	12.28	18.81	27.92	0.00
As above, but repairs real increase in RPI+2% years 2-5	0.83	0.83	1.16	145.08	3.02	8.58	8.10	0.00
As above, but debt not repaid & £200k additional savings	3.29	2.28	103.91	315.45	3.02	3.02	0.00	0.00
Scenario 2 – Accelerated Programme. Additional Debt £155.7m & Debt repaid	0.83	0.99	1.21	219.73	25.48	24.86	21.39	0.00

7 The Impact of Interest Rates on the Business Plan

7.1 The above modelling highlights the potential impact that an increase in interest rates could have on the HRA Business Plan. Whilst an increase in interest rates could result in reduced revenue to fund services, this could be protected by borrowing at fixed rates. Long term fixed rate loans are currently available at approximately 4.5% to 5%. However, much better interest rates can be achieved on shorter term loans, generating significant revenue savings. It may therefore be in the Council's interests to take a more proactive treasury management view. The fact that loans could be fixed at or near to rates used as the base assumption in the modelling would indicate that potential risks are manageable. It is likely that treasury management advisers would recommend taking a shorter term view and achieving much better interest rates. The Council will need to take a view on this, as the impact of increased interest rates could be damaging to the long term projections.

7.2 However, in reality there is a direct link between interest rates and inflation. Higher interest rates discourage borrowing and encourage saving and will tend to slow the economy. Lower rates encourage borrowing and have the opposite effect. Therefore, interest rate rises would more than likely to be accompanied by inflation increases and vice versa. As rents increase at inflation plus 0.5%, an increase in interest rates are likely to result in an increase in rental income above inflation, thus compensating for any additional costs of borrowing.

8 Potential for New Build

8.1 The self-financing business plan projections shown above are based on a discount rate of 6.5%. The Consultation asks all councils to respond on how they could fund additional new build if a higher discount rate was used. An increase in this rate to 7% would generate an additional £1.1m over the first 5 years of the business plan i.e. £220,000 per annum. This would be the headroom alluded to by the Government within its self-financing proposal and would be expected to be used for additional new build.

8.2 With the cost of a new property (not including land) estimated at £120,000, this additional resource would be sufficient to support the building of 4 properties per annum (if funding matched by HCA grant). Whilst not a significant programme, it would be a start.

8.3 If the £220,000 could be used to support additional borrowing, this could be significantly increased. However, with borrowing capped at the self financing limit, there would not be sufficient headroom for additional borrowing for some years. It is proposed that the Council responds positively to this issue, but encourages greater freedoms to allow a more ambitious programme to be developed.

9 Treasury Management Implications

9.1 Taking on £156 million of debt will have significant treasury management implications. As the Council currently has no external debt it will need to develop skills to manage the portfolio. The current treasury management consultancy contract is due for renewal December 2010. The major element of the invitation to tender will be on how the Council can be trained and supported on this issue.

9.2 In 2009-10 the General Fund received £46,000 of interest from the HRA under the current subsidy system. This is of course a function of historically low interest rates. The prospectus has nothing to specifically say on debt allocation between HRA & General Fund for debt free councils such as ourselves, which we will be commenting on. It is hoped that the issue will be a local decision and, subject to Council approval, the General Fund will receive interest at HRA borrowing rates which would more than compensate the General Fund for interest lost under the current subsidy regime.

10 Potential for Stock Transfer

10.1 The proposals indicate that transfers will remain an option, although any transfers would need to take account of the debt allocations rather than previous valuations. For Winchester, this would make any transfer post implementation of self financing almost impossible. A transfer ahead of the implementation could be possible, although any levy to Government would be significantly higher than previously reported. In effect, this would wipe out any receipt to the General Fund but could still be a viable option for tenants.

10.2 Such a transfer would result in a starting debt for any new organisation of approximately £60 million rather than £156 million. This would result in a very significant increase in the ability of the new organisation to invest in the stock, in improved services to tenants and in new build of affordable housing.

10.3 With the potential of increased resources offered through self financing, it is very unlikely that tenants would support a transfer. Initial discussions with TACT have confirmed this. However, any delays to reform of the HRA by the new Government could mean this option will need to be considered further in the future.

11 Timetable and Potential Impact of the Change of Government

11.1 As stated earlier, the recent change of Government and the forthcoming spending review will no doubt have an impact on the proposals. Whilst the new Government has yet to declare direct support for this proposal, it has announced its commitment to abolish the subsidy system and will be reviewing all responses very carefully. In light of the detailed work already completed on this subject by the Treasury and Public Sector Finance and Housing professions, it is likely that the proposals will go forward at least in a similar form to that proposed. If it is adopted in a similar form to this proposal, it will result in increased resources for tenants and it is recommended that the final response supports an early adoption of self financing.

11.2 The proposal suggests an April 2011 implementation. Any delays will result in real problems for the City Council. The current deficit on the repairs programme means that a backlog of work is building up. Delays beyond 2011 will almost certainly mean that some stock will become “non decent”, and key programmes which are due will be delayed for some time (such as replacement heating for high rise flats, kitchen and bathroom programmes etc).

11.3 If this happens, the Council will need to consider alternative management options ahead of any national change or accept increasingly poor standards of maintenance which the Council would struggle to address in the foreseeable future. It is recommended that this concern be stressed in the final response.

12 Conclusions

12.1 Whilst not as positive as had been hoped for, the proposals do indicate that additional funding to help maintain the Decent Homes standard and fund additional services to tenants will be available through self financing.

12.2 In effect, it provides the opportunity to address the annual shortfall previously reported. If the proposals come to fruition, the offer of any additional resources to fund public services has to be welcomed.

12.3 It must be said that the offer is far less attractive for Winchester than it is for the majority of authorities. The limitations of the old subsidy system with regard to calculating costs of operating services in this area have not been addressed sufficiently and some challenge to the formula used should be included in any response.

12.4 From a Value for Money viewpoint, the merits of the offer have to be questioned. A stock transfer would result in a final debt of £60m rather than £156m and would fund the accelerated programme (and significantly more). In effect, the price to tenants of accepting the offer is an additional £90m of debt and a lesser repairs programme compared to what a transfer could achieve.

12.5 The proposal is based on a 2011 implementation. Significant objections could well delay this and the Council will need to consider whether it can afford lengthy delays and what action it will take in such circumstances.

OTHER CONSIDERATIONS:

13 SUSTAINABLE COMMUNITY STRATEGY (RELEVANCE TO):

13.1 Achieving and maintaining council dwellings in accordance with the Decent Homes standard is a key priority within the Strategy.

14 RESOURCE IMPLICATIONS:

14.1 These are set out in the body of the report.

15 RISK MANAGEMENT ISSUES

15.1 The proposals in the Consultation Paper have significant risk issues that will need further consideration. A system of self financing assumes a transfer of risk from central Government to the Council. Currently, interest rate and inflation changes can be addressed and spread across all councils through adjustments to the national subsidy system. However, if the proposals are adopted, all such risks would need to be managed directly by the Council.

15.2 Initially modelling of risks through a range of sensitivity analysis would suggest that it is possible to ensure a sustainable HRA Business Plan through the proposals. The most significant risk facing the Council would be one of increasing interest rates. Such risks can be managed in a number of ways. Fixing interest rates would provide certainty but may result in a lost opportunity to achieve revenue savings. Further work will be needed on this if the proposals are adopted by the new Government.

16 TACT COMMENT

16.1 The TACT Chairs would like to thank Richard Botham for taking the time to present this paper to TACT.

16.2 The report tells us what the former Minister for Housing John Healey had in mind to be able to dismantle the current HRA subsidy system, and replace it with a devolved Self –Financing system.

16.3 The only problem being why was it left to just before the General Election, before releasing the details, after having been in power for many years? Councils have been forced into making quick decisions.

16.4 The coalition Government is now reviewing the review of the previous government. They have to decide to implement, revise, or scrap it, and come up with their own version, provoking further discussion, and further delaying the end result.

16.5 Defend Council Housing will be holding a conference on the whole issue in the near future, and like Richard Botham know Winchester has not come out of it as well as we would have liked, as indeed is the case for many other councils around the country.

16.6 However over a 30yr period it could work in the Council's favour, compared to paying ever increasing negative subsidy.

16.7 It can be argued, that Stock Transfer is still an option, but many councils and their tenants, including Winchester City Council, will take issue over this. Until rent restructuring came into place, and negative subsidy, many councils managed very well. TACT will challenge very strongly any proposals to consider stock transfer as a housing option for Winchester.

16.8 Limits on Borrowing: The report has clearly presented what pitfalls and benefits could lay ahead, being able to address backlog works, once again seems mainly to favour ALMO's.

16.9 Winchester City Council will be unlikely to share any of the £3.2bn set aside for this, as a once and for all settlement. TACT would like to be proved wrong on this point, but rather doubt it.

16.10 Until councils around the country know what the present coalition Government makes of the previous Government's review of the Housing Revenue Account Review, and state their findings of their review of the review, it is back to square one.

16.11 And lets face it we have all been there before, the tenants may have to say to the Government that tenants have been kept waiting for many years, for a fair review of the Housing Revenue Account, and we rely on the new coalition Government to get it right, rather than present a botched up job.

16.12 Show us what you are made of, and come up with something that is fair to council tenants, not just ALMO's and Housing Associations.

16.13 There is still much to be done, and TACT will support Richard Botham, and the new Council, in any way it can to get the best deal it can for our tenants, and strive to see new affordable council homes being built once more! TACT will continue to lobby Parliament and the Council if the need arises to ensure we get the best deal for tenants.

BACKGROUND DOCUMENTS:

Operational and financial records held in the Landlord Services and Finance divisions

APPENDICES:

Appendix 1 – Questions posed by the Self Financing Consultation (Response due 6 July 2010)

Appendix 2 - Response to the Initial "Reform of Council Housing Finance" Consultation – October 2009

HRA Self Financing Proposals – A Draft Response

With over 40% of all rent collected from Winchester tenants being paid into the national subsidy system, the City Council urges the Government to bring the current system to an end. Assumptions made concerning management and maintenance allowances hit the Council very hard. In reality, cost pressures are very similar for all housing organisations. Outdated assumptions that tenants who happen to live in more affluent surrounds will somehow need fewer services have to be challenged.

The City Council is currently debt free, has achieved Decent Homes and performs in the top quartile for many services to tenants. It has below average unit costs for both management and maintenance. However, many Winchester tenants have kitchens and bathrooms over 30 years old. The Council is under investing in its stock by between £2-£3 million annually and it will not be possible to maintain Decent Homes under the existing system. Also, the Council simply has no resource to fund much needed estate renewal and improvements.

Stock transfer would create an organisation starting with debts of approximately £60 million; it is difficult to accept proposals that would result in a starting debt of £156 million. It may just be possible to deliver a business plan aimed solely at achieving Decent Homes, but it would not be possible to address all backlog, estate renewal and improved services to tenants and in no way would it make any significant contribution to the reduction of housing need through new build. A stock transfer would achieve all of these but is strongly opposed by tenants locally.

Therefore, whilst self financing does provide more resources for Winchester, it also brings significant risks for only limited improvements. The significant difference between resources enjoyed by housing associations and local authorities, will remain. Winchester tenants will continue to suffer simply because they choose to remain with their Council and happen to live adjacent to more wealthy communities.

Without an immediate increase in resource from some where, the City Council's HRA balances will run out by 2012. The reform proposals do provide some additional resource and in light of the pressures the Council faces, it is likely to reluctantly accept the proposal if this is the only offer on the table.

This reluctant acceptance is conditional on an early implementation, no further increases to the debt figure and more certainty on future minimum rent levels. Any delays in reaching an acceptable conclusion could well force the City Council to have to consider other options that are currently unacceptable to tenants.

The City Council does urge the new Coalition Government to re-examine the points raised in the Council's response to the 2009 consultation. For any council, particularly those that are currently well managed and debt free, to be asked to take on £30,000 debt for every property they manage, when the average debt allocation is only £7,000 has to be questioned.

£156 million of debt is a very high cost to pay to achieve self financing and does not represent value for money for Winchester tenants. It is however significantly better than the status quo and will be accepted, subject to further clarification on a number of issues, including:

- Is the debt figure a final one or will it be further adjusted? Any increase would make the Council's business plan unsustainable.

- The original consultation referred to a national debt figure of £17-£18 billion. The latest debt allocation is based on a national figure of £25.1 billion, resulting in several million being added to Winchester debt. Whilst it is accepted this is partly due to net present value calculations, it must also include additional resource to support other programmes. Why should Winchester tenants fund this? If it is for backlog elsewhere, this has to be questioned. We have backlog, but in general have managed stock well over recent decades. The City Council would prefer a lower debt and no backlog grant (its unlikely that any bidding process can be allocated fairly).

- The Council currently has a slightly higher HRA Capital Financing Requirement than its subsidy Capital Financing Requirement. The prospectus is not clear on how this will be handled. It needs to be taken into account through an adjusted borrowing cap. Any other approach hits the Council's Business Plan from day one.

- It is assumed the borrowing cap includes any future borrowing for new build. If so, this is unfortunate. As borrowing for new build could be funded from new rental streams, it should not be included in the cap but covered by existing prudential rules. Including it within the cap effectively prevents any possibility of councils addressing unmet housing need in the short term.

- Greater certainty on future rent policy is essential before any council can sign up to self financing. For any proposal to be accepted, minimum rent increases or decreases net of inflation need to be clear from the start as does a commitment that any future surpluses can be retained locally throughout the 30 year business planning period.

In response to the specific questions raised in the Prospectus, the City Council would like to make the following comments:

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?**

   The Council has real concerns with the methodology which bases assumptions on the same flawed assumptions used to calculate existing subsidy. Attached is a copy of our response to the previous consultation (Appendix 2). The points made were ignored, but they are still valid.

The approach to valuation depends on certainty in relation to rent policy. The Prospectus gives little clarity on this. Business Plan modelling assumes the continuation of the inflation plus 0.5% approach for the next 30 years. Any changes to this will need to be considered carefully and could result in unsustainable plans in the future. The proposal is critically sensitve to rent policy and is only acceptable to the City Council if certainty on future minimum rent levels can be confirmed.

The actual increases in the allowances for Winchester are above those stated in the consultation document as the actual figures will include transitional protection and EPC adjustments. Using actual figures, the increase in resources for Winchester that should have been included in the model would be 13.5% rather than the 10.2%.

The proposal to ring fence the use of 75% of receipts to housing and regeneration is supported as it compensates for the loss of social housing units through the Right to Buy process.

Outstanding premium payable on early redemption of loans proposal to repay by reducing Public Works Loans Board loans seems reasonable.

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

Whilst in general the proposals for the financial accounting framework appear reasonable, many uncertainties remain, such as the treatment of depreciation. Further guidance is needed before the full potential impact on both general fund and HRA can be properly assessed.

Whilst acknowledging the reasons for the imposition of the borrowing cap, this action severely limits the City Council's ability to meet tenant aspirations as some small additional borrowing capacity in the early years, secured by future projected surpluses, would allow us to address all kitchen and bathroom backlog within five years, Also, the City Council considers borrowing for new build should fall outside of this borrowing cap (see next question).

Rate of interest – under the subsidy regime, with CLG covering interest costs, the rate of interest chargeable to HRA was governed by the determination, through the consolidated Rate of Interest (CRI). In a non subsidy regime the rate of interest is no longer a national issue but can be one based on local choice; there is no need to legislate.

Unpooling Housing Debt — this is not a national issue but can be based on local choice; there is no need to legislate

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

   A 7% discount rate approach provides an additional £220,000 per annum in revenue resources compared to a 6.5% discount rate. If this is combined with grant, it should be possible to build 4 properties per annum. The City Council is very supportive of any proposals which would allow councils to build new council homes for rent. It is unfortunate that the imposition of the borrowing cap has been proposed, as this move would effectively prevent the development of any serious building programme for many years.

   In saying that, 4 homes per year is better than nothing and a 7% discount rate is therefore supported. Additional borrowing freedoms in relation to new build provided they are covered by new rental income and within prudential rules would be a more forward thinking approach.

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

   We favour a self financing system. It is unlikely that any Council will support status quo as the existing system is universally considered to be unfair. Its continuation will be to the detriment of social housing, although would result in rents providing Government with increasing surpluses.

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?**

   In light of current financial shortfalls that the City Council face under the subsidy system, it is crucial that if we proceed, we proceed quickly. Delays in implementation will result in increased repairs backlog for Winchester. The City Council considers an April 2011 to be feasible, subject to a speedy determination by Government.

   Delays in announcements are likely to force the City Council to review alternative options for the management of its housing stock or alternatively will result in a number of Winchester properties falling back into “non decency”.

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?**

   As stated above and in the Council’s response to the October 2009 consultation (see appendix 2), the offer unfairly penalises high value affluent areas. Other options can provide significantly better value for money for tenants. However, unless the new Coalition Government can produce an alternative model that offers better value for money for tenants, the proposal *will be reluctantly supported by the City Council, subject to the conditions outlined in this paper and to an early implementation.*

Response to the Initial “Reform of Council Housing Finance” Consultation – October 2009:

The City Council broadly supports the proposals for self financing. However, it has very significant concerns about much of the detail, which could result in the Council moving from debt free status to taking on a much higher proportion of debt than most other authorities.

The Council supports the claims for full debt write off. If full debt write off cannot be achieved, partial write off (as would be available through a stock transfer) is essential if the proposals in the consultation are to be acceptable to councils that are currently debt free.

Whilst it is accepted the Council can afford a higher proportion of debt due to the higher than average rents in Winchester, it challenges the proposal to redistribute debt based on the existing "flawed" subsidy system, which assumes management costs in Winchester are 30% less than the average Council and up to 60% less than some. Whilst the district overall is relatively affluent, deprivation and crime rates on city estates are as high as any "average" social landlord. Also, other demands, such as a high proportion of older residents, pockets of rural isolation and a low density of social housing across a wide geographical area all add to the management costs but are not reflected through the current system. The tenants, caught in a system defined by Winchester’s so-called affluence, have very real problems which are not met by the current arrangements. This affluence penalises them when it reduces subsidy and support and is compounded when the proposals do not take account of the factors that detract from everyday, ‘real’ quality of life matters that affect tenants almost regardless of where they live.

To illustrate this, the 2007 Indices of Multiple Deprivation, which rated the Winchester district as being within the top 10% of “least deprived” areas, also highlighted that:

- The three main housing estates in Winchester, where a large proportion of the Council houses are located all fall within the above average classification for “Overall Deprivation”.

- The largest Winchester estate, Stanmore, falls within the top 40% for “Employment Deprivation”, the top 30% for “Income Deprivation” and within the top 12% for “Education and Skills” Deprivation nationally.

- The City’s Highcliffe estate falls within the top 25% for “Crime Deprivation”.

In addition, many of the rural areas of the district, all of which contain some Council housing, fall with the top 10% (with the Itchen Valley being within the top 3%) of areas with the “most barriers to housing and services” nationally. All of these factors add to the cost of managing social housing, although are completely ignored by the subsidy system due to Winchester’s top 10% “least deprived” rating.

The proposals could result in Winchester having to take on £130 million (£26,000 per unit) to £180 million (£36,000 per unit), depending on the discount rate (figures independent assessed by Tribal), whilst the average debt across the country will be £7,000 per property. This disparity is totally unacceptable for a Council that already pays £9 million each year towards this debt through negative subsidy whilst being debt free itself for many years.

A recent stock transfer valuation assessed the City Council's Landlord Service at £60 million (£12,000 per unit). A debt somewhere near to this level (whilst still being well above the £7,000 average per unit and still unacceptable) is at least more logical) and provide sufficient resources to meet current programmes which are severely under funded through the subsidy system. Whilst such an approach may not be sufficient to cover the whole of the national debt, it would reflect the demands for a "level playing field" with stock transfer organisations, many of whom have benefited from debt write off in recent years. It is difficult to see why some level of write off is not acceptable now. The Council accepts that there is enough money in the system to avoid the need for wholesale debt write off being argued by some. However, any changes must be sufficient to fund the enhanced level of services enjoyed by tenants of stock transfer organisations and to support new build development programmes which councils are well placed to deliver.

Specific Responses to 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?

   The Council supports the principle of the ring fence and agrees that further clarification and strengthening would benefit both the HRA and general fund, whilst ensuring that tenants can properly scrutinise landlords on how effectively their rent money Is used to fund services they receive.

2. Are there any particular ambiguities or detailed concerns about the consequences?

   One consequence would be the impact on the Council's general fund if services such as managing the housing register or grounds maintenance of estate areas were to fall wholly onto the general fund, as both of these areas are currently funded in part by the HRA.

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)?

The Council supports the inclusion of funding for lifts and common parts within the major repairs allowance. Provision should also be made for other capital works such as disabled adaptations and communal aerials when assessing asset management demands.

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 Council agrees that the principle of assessing debt allocation on based on meeting ongoing maintenance costs, with any backlog/catch up demands being met through separate capital grant is reasonable, although, as stated above, this should include all asset management demands and not just "Decent Homes, Lifts and Common Parts".

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?

The Council supports a voluntary approach to this.

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?

Whilst the Council supports demands for full debt write off, it is accepted that some limited debt redistribution may be reasonable. It cannot however accept the principles contained in the proposal for basing redistribution on current allowances, a system which the Government already accepts is flawed and which unfairly assumes social housing provision in the Winchester area is much the same as the more affluent private residences (as it uses district wide indices rather than area specific ones).

With the Council likely to pick up debt in the region of £130 million to £180 million (3 times the average debt allocation) if the proposals are adopted, the Government must consider alternative distribution models and ensure that any outcome offers tenants similar provision to that achieved by Stock Transfer. Basing debt allocations on stock transfer valuations could achieve this and result in significant service improvements. Some debt write off may be required, although this has always been acceptable until now. This would still mean an above average debt allocation for

Winchester of approximately £60 million. However, this is likely to be acceptable to the Council in reflection of above average rent levels in this area.

In addition to concerns about the Council having to pick up a disproportionately large debt based on flawed allowances, the Council is also very concerned that this may not be limited to simply a share of the existing national debt. It could be even larger, with the paper suggesting the potential to increase the amount of housing debt held by local authorities, either from deliberately creating a surplus to distribute as capital grant, or by covering the transactional costs.

The Council welcomes the intention to cover any costs, General Fund or HRA which arise from the reallocation of debt – but question the ambiguity of where the money is coming from. Paragraph 21 suggests the costs will be fully funded within the settlement (leads to additional local authority debt) but paragraph 24 suggests a separate settlement could be provided.

The proposed 5% and 24% uplifts in management and Major Repairs allowances are welcomed. However, this "average" in no way reflects the local position in Winchester. Our own assessment of under funding in relation to the MRA suggests a 40-45% uplift is more appropriate (more in line with the figures reported nationally prior to the consultation exercise. It is not clear why these have been reduced). As argued earlier, the 5% uplift in management costs still leaves the allowances far too low for Winchester compared to real need, which would be much more in line with average allowances nationally (i.e. 20-30% uplift for this area).

The transfer of risk must be considered in any debt redistribution. With the Council potentially having to fund significant higher debt than most, there is concern that the risk transferred from the Government to the City Council would not be acceptable.

It is critical that there is a very careful and open assessment of the Net Present Value calculation. In the absence of this, it is difficult to commit to a definite view on the proposals.

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

    The Council has real concern that should the assumptions upon which the NPV is based prove to be too optimistic, especially in the early years, it will be extremely difficult for these to be managed, and further help from the government would be necessary. It is accepted that with self financing comes some risk. However, it is crucial that this risk is minimised through very careful application of the NPV rate.

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?

The Council agrees with concerns raised by the Housing Quality Network (HQN) – "Question 8 appears to be premature. It's difficult to comment on how complex issues such as premiums and market debt need to be incorporated when it is not clear how a simple PWLB debt situation would be treated. With these complications and the assumptions mentioned in the settlement calculation, the chances of producing a sustainable debt level in the local HRA, which satisfies the non-impact rule on the General Fund and satisfies the Treasury requirement for fiscal neutrality does seem remote".

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 Council would require more clarity and worked examples before commenting on this but does welcome the commitment to ensuring no net impact on the General Fund, and the undertaking to pursue further work to achieve this.

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

If the proposals for debt redistribution are adopted, the Council would require the flexibility to take on additional prudential borrowing to fund short term programmes, funded by long term projected surpluses. The Council considers Prudential Code controls to be more appropriate than CLG borrowing controls.

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?

Initial projections suggest significant long term revenue surpluses could be generated through the proposals (£2-300 million over 30 years). The temptation for this to be pooled and redistributed must be avoided and the opportunity taken to promote estate renewal and to support new affordable housing to meet the very high demand in this area. Also, it may allow the opportunity for reducing social housing rents to a more affordable level, thus benefiting the whole community through reduced benefit costs.

Whilst some control limiting the use of the surpluses to housing related issues would be acceptable, it is important that reform is a "one-off" exercise, with clarity over future controls and more importantly freedoms and flexibilities from day one.

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)?

The Council supports the proposals to retain 100% of receipts from Right to Buy sales. However, it must be noted that in the Winchester area, sales have all but dried up and this change is unlikely to generate significant receipts in the foreseeable future.

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

Whilst the use of receipts should be restricted to housing, councils should be afforded the flexibility to decide exactly which areas require investment based on local situations.

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

The Council recognises the potential risk of this proposed change but considers the benefits from ending the pooling regime outweigh these. It would avoid costly bidding processes and allow more effective future planning of capital programmes.

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?

The Council has considered the proposals against the Impact Assessment screening for all Landlord Services and does not consider that the proposals would have a disproportionate impact on residents in terms of the factors set out above.

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

No additional comments

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

No additional comments