

Report of the Cabinet Member for Place

Cabinet – 1 July 2014

CONSULTATION RESPONSE: REFORM OF THE HOUSING REVENUE ACCOUNT SUBSIDY SYSTEM (HRAS)

Purpose:	To consider and agree a response to the Welsh Government's consultation on the reform of the Housing Revenue Account Subsidy System
Policy Framework:	Local Housing Strategy
Reason for Decision:	For Cabinet to endorse a response by the deadline of the 10 th July 2014.
Consultation:	Legal, Finance & Access to Services
Recommendation(s):	It is recommended that: 1) The proposed responses to the individual questions as detailed in the report are forwarded to the Welsh Government by the due date.
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1.0 Introduction

- 1.1 The Welsh Government (WG) has published its formal consultation on dismantling the Housing Revenue Account subsidy system (HRAS) and replacing it with a Local Housing Authority self-financing system. A copy of the full consultation paper is at appendix 1. The consultation is taking place with the 11 stock owning Local Authorities in Wales and the deadline for a response is the 10th July 2014.
- 1.2 The WG is seeking responses in the form of answers to specific questions set out in the consultation paper and the purpose of this report is to consider each one and to put forward a proposed response for endorsement.

2.0 The Current System and the Changes

- 2.1 The HRAS is an extremely complex and bureaucratic system which currently results in the 11 Welsh Councils with a housing stock paying a combined total of around £73m in negative subsidy payments each year to the Government. The reforms aim to replace this with a system of 'self – financing' which would allow each individual Local Authority (LA) the freedom to retain the rent income in full and use it to fund their priorities for the existing Council housing stock and the provision of new housing.
- 2.2 In July 2013, the WG and the UK Treasury reached agreement on a 'buy out' figure that will allow LA's to exit the HRAS by March 2015. The key elements of the agreement for the 11 Welsh Councils as a whole are that:
- Local Authorities will need to buy themselves out of the HRAS.
 - The £73m of annual negative subsidy payments will be replaced by interest payments of approximately £40m. Councils are also likely to have to provide for repayment of the extra debt, which at the current rate of 2% per year will equate to £18.4m per annum.
 - The £40m annual interest payments will be converted to a lump sum settlement value shortly before the agreed implementation date (the current estimate of this is £919m).
 - The Treasury will require LA's to borrow from the Public Works Loan Board (PWLB).
 - The Treasury requires a housing related borrowing cap to be imposed on each LA in order to control public sector borrowing.
- 2.3 The Treasury also agreed that as the timescales for the necessary UK legislation to enable the reforms to take place are unclear, they could be implemented with the voluntary agreement of each LA. If a LA exceeded the voluntary borrowing cap there would be a resulting penalty via a deduction from RSG.
- 2.4 It is essential that all eleven stock owning LA's agree and sign the voluntary agreement as failure to do so will result in the HRAS remaining in place until the appropriate UK legislation is passed. This means that the £73m paid to the Treasury will continue.
- 2.5 The consultation paper sets out the various options for distributing the required additional debt for the settlement and for the distribution of the borrowing cap. The outcome of the consultation will then inform the terms of the voluntary agreement.
- 2.6 The consultation requires a response to specific questions posed by the WG, all of which are considered in detail in this report together with a proposed response.

3. **Question 1: ‘Do you agree with the proposal to distribute the settlement value based on negative subsidy amounts?’**

- 3.1 Two options have been modelled by the WG. The first is based on distributing the settlement value according to the current HRAS negative subsidy payments. A guiding principle underpinning the reforms has been that each LA would be better off as a result and under this option, the interest payments for the settlement figure for each LA would be 45.12% less than the current negative subsidy payments.
- 3.2 The alternative model was based on stock numbers and resulted in two LA’s (one of which was Swansea) paying more in interest payments than the amount of negative subsidy.
- 3.3 Therefore, the preferred option would be for the distribution to be proportionate to the current negative subsidy payments. This would be a good outcome for Swansea as the current subsidy payment is relatively low compared to other Councils and if stock numbers were used as the basis, Swansea’s share of the debt would be almost double to that being proposed. For Swansea, this would mean interest payments of £3.18m each year instead of the current negative subsidy amount of £5.79m (i.e. a difference of £2.61m each year). However, after taking into account potential debt repayments of around £1.4m per year, the net benefit would reduce to £1.2m per year.

Proposed Response to Question 1:

The Council agrees with the proposal to distribute the settlement value based on the current negative subsidy payments.

4. **Question 2: ‘Do you agree with the proposal to distribute the borrowing cap based on option 3 to allow for new build commitments whilst providing potential headroom for new build to every local authority?’**

- 4.1 The total borrowing cap agreed with the Treasury is £1.85bn but after taking into account the required borrowing to fund the settlement and existing HRA borrowing, this leaves ‘headroom’ of £471m.
- 4.2 The priority of the Welsh Government is funding the achievement of Welsh Housing Quality Standard (WHQS) by 2020 especially as this deadline will become a statutory duty as part of the Housing Bill. Therefore, after deducting the all Wales borrowing figure for WHQS of £358.1m, this leaves £107.4m of available ‘headroom’ (after allowing for a retained contingency by the WG) and three options as to how this could be distributed have been put forward.
- 4.3 It should be noted however, that the cap is a limit on total borrowing and not a distribution of cash. Whether the borrowing can be actually afforded and supported by HRA Business Plans is a matter for each LA. In the immediate term, Swansea’s current HRA Business Plan can only support the £74m of borrowing which is needed to fund WHQS and additional revenue would need to be found to support any borrowing above this. Generally, those Welsh LA’s that have already improved their stock up to the WHQS are able to support new

borrowing for items such as new build. However, for Swansea, whilst there isn't an immediate opportunity to increase borrowing, the HRA will be generating surpluses in the medium to long term allowing funds for more borrowing at that time.

- 4.4 Although the consultation paper focuses on the arrangements for the initial move to self-financing, a key aim of the reforms is to provide sustainable funding for the longer term and it is likely that there will always be headroom available for distribution in the future as debt is repaid.
- 4.5 For example, Swansea will create additional headroom of approx. £3m per year up to 2020 and then £4.5m per year if debt continues to be repaid at 2% per year. So by 2025 there could be additional headroom created of over £35m. There is also the possibility of the overall level of the cap being increased in future. In England, the cap was increased after 18 months, but only by £300m which is 1% of the total HRA debt. A 1% increase in Wales would equate to £18.5m, equivalent to £1.5m for each council. There is likely to be continued lobbying for further increases.
- 4.6 The figures used to model the options were taken from the most up to date HRA Business Plans which are submitted each year as part of the application process for Major Repairs Allowance (a capital grant from the Welsh Government which for Swansea, amounts to £9.1m each year). For authorities which have achieved WHQS, even though MRA can only be used to maintain and improve the existing stock, their Business Plans included provision for new build.
- 4.7 Therefore a key aspect of the options to distribute the headroom is the extent to which they allow all LA's to achieve WHQS and new build. The three options put forward are as follows.

Option 1

- 4.8 This option proposes that the distribution should mirror the Business Plan submissions. This would allow Swansea sufficient headroom within its cap to borrow the amount needed for WHQS, but no more than this in the immediate term. Although this option would allow the four authorities who are able to support additional borrowing for new build to proceed with their plans in full, there would be no capacity in the immediate term for the other 7 LA's to do so.
- 4.9 Therefore, as this option does no more than allow Swansea to meet its WHQS commitments it should not be the preferred option.

Option 2

- 4.10 This option prioritises the borrowing needed for WHQS and distributes the remainder of the headroom using a modified Social Housing Grant formula which includes affordability indicators and housing need.

- 4.11 This formula based option allows Swansea to meet its WHQS commitments and provides an increased cap to allow additional borrowing of £13.5m. However, even if it was made available it is unlikely to be used in the immediate term as the HRA could not support additional borrowing at this time unless additional revenue to repay the debt could be identified. The allocation would also be made at the expense of those other LA's with new build plans, not being able to proceed to the extent that they are able.
- 4.12 However, as this option allows the highest level of cap, this should be Swansea's preferred option.

Option 3

- 4.13 This is a compromise between options 1 and 2. It prioritises borrowing for WHQS and provides 50% of the new build plans submitted by 4 of the 11 authorities. The remainder is then divided across all 11 authorities using the formula approach of option 2.
- 4.14 This would provide Swansea with sufficient cap to meet WHQS commitments and provide some additional headroom of just under £7m to support an initial new build programme. Whilst the same issue about being able to support the additional debt repayments occur in this option, the cap is significantly less. New build plans would also take time to develop and the additional cap at this level, without significant detriment to those with specific new build plans already in place, provides a level of certainty to start the development of new build plans in Swansea.
- 4.15 Whilst option 2 should be Swansea's preferred option, option 3 is an acceptable alternative.
- 4.16 As mentioned previously, for the reforms to go ahead by April 2015, the voluntary agreement of each of the 11 Welsh LA's with a housing stock is required. For those that have already achieved WHQS, option 1 is likely to be their preference and for the remainder, the preference is likely to be option 2. On this basis, the voluntary agreement of all 11 will not be reached. However, it is likely that all will see option 3 as an acceptable alternative.

Proposed Response to Question 2:

Whilst the preference would be for option 2 since it is based on a transparent formula and provides a higher proportion of the headroom than the others, Option 3 is an acceptable alternative as it will provide for the borrowing needed to fulfil the Council's commitments to improve the stock up to the WHQS by 2020 and provide scope to commit the development of new build Council housing.

5. **Question 3: ‘Do you agree that the Welsh Government should retain a small proportion of the borrowing headroom as a contingency?’**

- 5.1 The WG is proposing to hold back approximately £5m of the estimated headroom as a contingency. This equates to just less than 5% of the borrowing headroom available for distribution.
- 5.2 Given the relatively small amount of additional borrowing available and the urgent need to increase the supply of affordable homes, there is an argument that all of the available headroom should be distributed to Authorities.
- 5.3 On the other hand, self-financing will be a new regime to operate within and as plans develop (particularly for new build), a contingency could be of use in the short term to an authority who finds it requires more headroom to meet its commitments.

Proposed Response to Question 3:

Whilst there is an urgent need to increase the supply of affordable housing and therefore the available headroom should be fully used to help meet this need, it is accepted that until the move to self-financing is fully embedded, a contingency may be of use to an authority which requires more headroom to meet its commitments (whether for new build or WHQS) than initially allocated.

6.0 **Question 4: ‘What are your views on how we allocate any unallocated borrowing headroom now or in the future?’**

- 6.1 As previously mentioned, the distribution options are based on indicative data provided as part of the HRA Business Plan submissions and the consultation paper puts forward a process for finalising the actual allocation of the headroom. Each LA would need to state whether they are able to take up their indicative allocation and whether the debt would be affordable within their Business Plans.
- 6.2 The paper suggests that where a LA is not able or does not wish to utilise their indicative allocation for new build, it could be redistributed to those who are able and wish to increase their borrowing capacity.
- 6.3 The paper proposes that this redistribution could either be achieved by allocation to those that could deliver more units or to all remaining LA’s using the modified SHG formula.
- 6.4 There is currently a mixed picture across Wales with some LA’s having well developed new build plans which can be afforded within their Business Plans and others only starting to consider this opportunity. Therefore, there is an argument that the initial re allocation should be on the basis of who is best placed to deliver rather than a general redistribution, especially if an increased debt cap may not be affordable.
- 6.5 The paper also proposes a planned review which is dealt with in the next question and there is an argument that at that time, when plans have matured,

WHQS is increasingly achieved and the prime focus of HRA investment shifts to new build, the allocation should then be on a formula basis that reflects local affordability and housing need.

Proposed Response to Question 4:

Given that it will take time to develop new build plans, any initial allocation should be on the basis of who is best placed to afford and utilise the allocation. However, as the self-financing becomes embedded and WHQS becomes increasingly achieved, redistribution should be on a transparent formula basis that reflects local affordability and housing need.

7.0 Question 5: ‘Do you agree that the borrowing cap should be reviewed every three years with the 1st review in 2018/19’.

7.1 Although the initial distribution aims to make full use of the borrowing up to the cap, it is likely that self-financing will generate additional headroom year on year as a result of rent increases and writing down debt. Also, the progress of each LA in terms of using their allocation may change with some requiring more than their cap and others less. A future review of the cap level by the Treasury is also possible.

7.2 As such, a review of the distribution is welcome and as to what period this should take, it needs to balance the need to enable individual LA’s to plan for the long term but also maximise the opportunities across Wales. A review within three years would appear to strike the right balance for the initial period to ensure those with firm proposals can make progress and to allow time for others to develop their plans. However, for subsequent reviews, as the new regime becomes embedded, a longer cycle of review (e.g. 5 years) should be considered.

Proposed Response to Question 5:

A review of the borrowing cap and the initial distribution of the headroom should take place within the first three years. However, for subsequent reviews, as the reforms become embedded and spending plans become firmer, consideration should be given to a longer review cycle (e.g. 5 years) to allow authorities to plan over the long term with a degree of certainty. Distribution and redistribution of headroom must be based on long term business plans and not solely around timing issues. Any redistribution between Councils should be consensual and facilitated under the auspices of the WLGA.

8.0 Question 6: ‘What action should the Welsh Government take on a LHA who has not delivered on their ability to utilise their borrowing cap?’

8.1 The consultation sets out a process for LA’s to confirm whether or not they intend to take up their indicative allocation and to submit details of any proposals. Those unable or unwilling to use their allocation will be invited to confirm this and their share of the headroom would be then be made available for redistribution.

- 8.2 From an all Wales perspective, it is vital that the headroom is fully utilised in order to maximise the opportunities that self-financing brings. However, it would be unfortunate if those Authorities with the ability to use additional headroom were denied this opportunity by the inability of others to use their allocation. However, whether 'sanctions' are the best way to ensure that such a situation doesn't arise is questionable.
- 8.3 Whether the allocation is fully used can be down to a number of factors one of which could be actual costs being lower than estimated. Also, new build plans will take time to develop and can be subject to delay by factors outside the Authority's direct control. The threat of sanctions could also disincentivise the creation of additional borrowing headroom by some authorities and introduce the perverse incentive of spending for the sake of avoiding a penalty.
- 8.4 The consultation does not indicate what sort of sanction would or could be applied but the rhetoric is counter to the ethos of the changes which is about creating long term sustainable investment and independent self-financing of an Authority's HRA.
- 8.5 As such, efforts should focus on a mechanism to facilitate co-operation between authorities, possibly under the auspices of the WLGA, rather than one based on sanctions which could undermine the core advantages of the reforms.

Proposed response to question 6:

Whilst it is acknowledged that the opportunities arising from the available headroom should be maximised, the introduction of a sanction based approach may provide disincentives to fully take up an allocation. Whether the allocation is fully used can be down to a number of factors. For example, new build plans could be the subject of delay by factors outside the authority's direct control. The threat of penalties may also undermine confidence in the long term sustainability of spending plans and run counter to the core advantage of the reforms. As such, this approach should be avoided and efforts to facilitate a more co-operative mechanism to future redistribution through the auspices of the WLGA should be considered.

9.0 Question 7: 'Do you have any further comments to make?'

- 9.1 Whilst there are issues surrounding the distribution of the settlement arrangements, future flexibility and the need for a co-operative approach, the reforms will provide the opportunity for Authorities to plan with certainty and for the first time in a generation, to develop a strategic vision for Council housing with access to resources over the longer term to increase supply. At a time when investment in public services is in decline, the self-financing of the HRA provides a real opportunity for investment in jobs, training and the regeneration of the local economy.
- 9.2 As such, details over the initial implementation of the changes need to be put into a longer term context and in overall terms, the reforms should be welcomed.

Draft response to question 7:

There are important issues concerning the initial implementation of the reforms which have yet to be clarified including the distribution of the headroom, flexibility, trading of headroom between LA's, Minimum Revenue Provision (Debt repayment), how the transaction is to be accounted for, how the revised self-financing is to be charged to the HRA and ongoing monitoring of the buyout finance. All are important and could have a material impact on the outcome of the reforms and the impact on the HRA. However, these need to be viewed in the context of the opportunities afforded by the reforms in terms of sustainable investment in the local economy and the ability to develop a strategic plan for Council housing with access to resources to increase supply. As such, the reforms are welcome and supported by this Authority.

10.0 Equality and Engagement Implications

10.1 A screening process has been undertaken and there are no equality and engagement issues in relation to this response to the consultation paper.

11.0 Financial Implications

11.1 Where applicable, the anticipated financial implications of the proposed reforms are set out in the report'

12.0 Legal Implications

12.1 The Housing (Wales) Bill will allow the Welsh Government to repeal the relevant sections of the primary legislation that sets the framework for the HRAS system in Wales. However, the Bill has not yet received Royal Assent.

12.2 As an interim measure the provisions of Section 80B of the Local Government and Housing Act 1989 will be used for a voluntary agreement to be made between the Welsh Ministers and Local Housing Authorities.

12.3 Separate legal advice will be required in relation to the terms of the voluntary agreement to be entered into.

Background Papers: Equality Impact Assessment Screening Form

Appendices: Welsh Government Consultation Paper – 'New Local Housing Authority Self Financing System (HRAS Reform). The distribution of the settlement value of HRAS buy-out and the Housing Related Borrowing Cap for individual Stock Retaining Local Housing Authorities'