

Report of the Cabinet Member for Communities & Housing

Corporate Briefing – 21 October 2014

REFORM OF THE HOUSING REVENUE ACCOUNT SUBSIDY SYSTEM

Purpose:	To set out the planned reform of the Housing Revenue Account Subsidy system (HRAS) in Wales, the implications for the Council and the key actions required by the Council to implement the changes.
Policy Framework:	Local Housing Strategy
Reason for Decision:	To ensure all necessary preparations and key decisions have been made to implement the changes.
Consultation:	Legal, Finance & Access to Services
Recommendation(s):	It is recommended that: 1) The Council enters into the Voluntary Agreement to exit the Housing Revenue Account Subsidy system along the lines set out in this report and to undertake sufficient borrowing to meet its share of the settlement. 2) Authority is delegated to the Director of Place and the Head of Finance to enter into the Voluntary Agreement and to determine the accounting and debt management policy of legacy and additional borrowing.
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1.0 Introduction

- 1.1 The Welsh Government (WG) have set out their planned reform of the Housing Revenue Account Subsidy system (HRAS) in Wales which will take effect from the 1st April 2015.
- 1.2 This will have a significant and lasting impact for Council housing and will provide opportunities for increasing investment. The purpose of this report is to set out the planned reforms, their implications for the Council, the opportunities and risks, the key stages and the decisions and actions the Council will need to take in the period leading up to implementation.

2.0 The Planned Reforms and their Impact

- 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 Housing Authority (LHA) 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 HM Treasury (HMT) 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:
- LHA's 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 will also 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 precise amount will depend on the interest rate prevailing at the time of the transaction although the current estimate is £919m
 - HMT will require LHA's to borrow from the Public Works Loan Board (PWLB).
 - The Treasury requires a housing related borrowing cap to be imposed on each LHA in order to control public sector borrowing.
- 2.3 HMT also agreed that as the timescales for the necessary UK legislation to enable the reforms to take place are unclear, they could be implemented by way of a Voluntary Agreement with each LHA.
- 2.4 It is essential that all eleven stock owning LHA'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 For Wales as a whole, the cost of the agreed buy out between the WG and HMT is based on £40m of annual interest payments which will be converted to a lump sum (settlement value) a short period before the 1st April 2015. The estimated settlement value is considered to be in the region of £919.5m. The £40m of interest payments will be shared between all stock owning Welsh Councils and distributed according to the payment made by each Council as negative subsidy under the HRAS. Under this arrangement, each LA would pay 45.12% less than they currently pay in negative subsidy payments.
- 2.6 For Swansea, this would mean interest payments of £3.29m each year instead of the current negative subsidy amount of £5.79m (i.e. a difference of £2.5m each year). However, after taking into account potential debt repayments of around £1.5m per year, the net benefit would reduce to £1m per year.

2.7 In terms of the cap on overall borrowing by Welsh LHA's, this is estimated to be £1.85bn based on the following:

- Borrowing to fund the estimated settlement figure of £919.5m.
- Existing borrowing by Welsh LHA's which is estimated to be £459.4m
- Borrowing needed by some Welsh LHA's to fund the improvement of the existing stock up to the Welsh Housing Quality Standard (WHQS) by 2020 which is estimated to be £358.1m.

2.8 This adds up to a total borrowing of £1.737bn leaving 'headroom' below the overall cap limit of £113m for further distribution. The WG have adopted a method for distribution which allows those Welsh LHA's with firm plans for new build to receive 50% of their requested share and the remainder will be allocated to all LHA's on an indicative basis using a formula.

2.9 Although precise figures will not be known until closer to the settlement date, Swansea's share of the additional headroom is likely to be £6.8m which if added to the indicative borrowing needed to achieve WHQS of £74m, provides an initial cap for new borrowing of £80.8m.

2.10 The HRA Business Plan demonstrates that this level of additional borrowing is affordable over the longer term and headroom will continue to be available as repayment of the debt is made. Whether borrowing in the future will be affordable will depend on other factors in the HRA Business Plan such as rental income, interest payments and other expenditure. However, the available headroom below the cap coupled with revenue contributions could lead to significant sums being available for future spending and for the first time in a generation, allow the Council to consider building new housing.

2.11 This introduces a new dimension for the Council in terms of reducing the shortage of affordable accommodation in Swansea. Preliminary work has already started on a feasibility study for new build which will address in detail the funding issues together with measures that would need to be introduced to support an initial and continuing programme of new build.

2.12 This will take time to finalise but in order to secure the full distribution, it will be necessary to reflect a level of anticipated borrowing in an interim HRA Business Plan which will be used by the WG as the basis of the legally binding Voluntary Agreement.

3.0 Key Stages in the HRAS Reform Timetable

3.1 The WG also plan to introduce a reform of the way social rents are set in Wales from April 2015 which will replace the current process of Welsh Ministers setting guideline rents each year. The new policy will introduce a rent formula that will establish rent bands for each social housing provider. This change will be the subject of a more detailed report in due course. However, in the meantime, the WG required an interim HRA Business Plan to be provided from each authority by September 2014 setting out the long term financial effect following exit from

the HRAS to include assumptions on rental income. The key assumptions made in the interim plan have been as follows:

- Rent increases at a level that is at the mid point anticipated to be set under the new policy.
- Investment of £275m at current prices by 2020 to achieve the WHQS.
- Additional settlement debt of £73m charged to the HRA at the projected interest rate of 4.5%, with annual principal repayments of 2%;
- Continuation of the £9m per year major repairs allowance (MRA) from WG;
- Borrowing of £74m in the years to 2020 to fund the achievement of WHQS;
- Full use of forecasted borrowing headroom to enable a new build programme;
- Inflation on management and maintenance costs of 2% per year as prescribed by the WG, offset by assumed efficiency savings of 1% per year;
- Expenditure on responsive and cyclical repairs is assumed to remain constant over time subject to reductions for changes in stock numbers;
- Void and bad debts at 4% of the rental income due.
- No receipts from the sale of council houses have been assumed on the basis that a suspension of RTB will be granted
- Capital income of £200,000 income per year up to 2020 has been included to come from capital receipts from the sale of HRA land and capital grants (e.g. from eco schemes);

- 3.2 These financial projections indicate that significant surpluses will be made on the revenue account after 2020, particularly as a result of a significant reduction in annual spending on WHQS items after achievement. These surpluses are likely to be used to fund new housing but the extent and timing of this has not yet been included in the Plan.
- 3.3 At the time of writing, the WG were still considering the options for calculating the settlement amount for exiting the HRAS. One option is to set the interest payments at the end of December 2014 so there is certainty on the amount each authority will need to pay. However, the amount of the settlement may vary to reflect interest rates at the point of transaction (April 2015). The alternative option is to set the settlement figure itself prior to the transaction to give certainty on the total to be repaid. However, the interest payments will need to reflect the interest rates at the point of the transaction (April 2015) and therefore may be higher or lower than estimated as part of the settlement distribution.
- 3.4 Whichever option is eventually chosen will need to be reflected in the Voluntary Agreement (VA) which each individual authority will need to enter into. It is likely that such an agreement will need to be signed by the end of January 2015 in order to enable the exit from the HRAS to go ahead. Guidance is also being developed by the WG with options for Councils in how they manage and account for both the legacy and future HRA borrowing.
- 3.5 The WG will require the final 30 year HRA Business Plan in January 2015 which will also be used as the application for MRA.

4.0 Equality and Engagement Implications

- 4.1 An EIA screening form has been undertaken and concluded that a full EIA report will not be required at this time. Any specific matters / opportunities that arise in the future as a result of the reforms (directly or indirectly) will be considered at the time and will be subject to a separate screening..

5.0 Financial Implications

- 5.1 Where applicable, the anticipated financial implications of the proposed reforms are set out in the report but will result in a significant increase in the liabilities of the Authority in respect of the HRA. However, in summary, the ending of the subsidy system will mean an increase in the surplus in the Housing Revenue Account and greater freedom and flexibility for the Council in determining future housing provision.
- 5.2 Failure to enter into the Voluntary Agreement will result in the HRAS remaining in place and the continuation of negative subsidy payments by the Council which are significantly more than the anticipated share of the interest and debt payments of the settlement.
- 5.3 The proposals as recommended will result in significant additional borrowing (and hence debt) for the Council as follows:-

	£m
Swansea's estimated share of the settlement value	73.0
Additional debt re Headroom	6.8
Additional debt to achieve WHQS	74.0
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Total additional debt	153.8

As stated within the report the cost of financing and repayment of this additional borrowing falls entirely to the HRA and will not impact on Council Tax Payers as part of the General Fund of the Council.

Repayment of debt in line with normal practice together with interest financing costs can be met from within the projected HRA Business Plan.

- 5.4 However, this additional debt will appear as such on the annual Balance sheet of the Council and, as such, it is important that Members are aware of the reasoning behind the increase.
- 5.5 In terms of the additional headroom borrowing, commitment has to be given at an early stage in respect of the use if these funds for additional provision of Social Housing. However, the precise use of that borrowing will have to be the subject of further reports in terms of options to deliver best outcomes.

6.0 Legal Implications

- 6.1 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.
- 6.2 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 the Local Housing Authorities.
- 6.3 At the appropriate time, the Voluntary Agreement which will set out the financial implications for the authority in terms of exiting the HRAS will need to be signed and delegated authority is sought for this to occur. Separate legal advice will be necessary on the terms of the Voluntary Agreement.
- 6.4 Failure to enter into the Voluntary Agreement means that for all 11 Welsh Council's with a housing stock, there will be a delay in benefiting from the considerable opportunities that leaving the HRAS will bring and put at risk the reputation of the Council as a partner to the other authorities.

Background Papers: Equality Impact Assessment Screening Form

Appendices: None