Briefing Paper

Introduction to the Housing Revenue Account

November 2015

Cressingham Gardens in Lambeth, London.

Introduction

This briefing paper is designed as an introduction to the housing revenue account.

Basic Accounting

People sometimes find it difficult to understand Housing Finance because they have never come across basic accounting concepts. The way that local authorities have to account for their financial transactions, including housing, is not a lot different from the way that private companies prepare their accounts or a private individual might account for their own spending and income. It is only the size of the figures that change.

The simplest form of accounting is called 'Receipts and Payments'. This consists of recording all the money that comes in (receipts), and all the money that goes out (payments). However, this method is seen as being too simple for large organisations like public companies and local authorities. Consequently, they not only record receipts and payments, but also record 'accruals' so that they can prepare an Income and Expenditure account.

Accruals allow accountants to take into account things such as money that is due but not received, or money that is owed but not paid. This means that they can draw up an account that in a private company is called a 'Profit and Loss Account' and in a local authority is called an 'income & expenditure account' or 'revenue account'. The revenue account for a particular year therefore shows all the expenditure and income related to that year.

However, not all expenditure is included in the revenue account, because some expenditure is treated as Capital Expenditure.

Accountants also draw up a balance sheet. This is a list of all the assets and liabilities of the organisation and their values, and shows the organisation's net worth.

The Difference between Capital and Revenue Expenditure

If you buy a house, this is your capital expenditure. If you buy fish and chips, this is revenue expenditure. The justification for this simple classification is that the house you bought will hopefully have a long life and retain its value, whereas the fish and chips will be consumed immediately.

The same principle applies to local authority finance. If a local authority modernises a house, it is capital. If it unblocks a drain, it is revenue.

There are two main reasons why local authority spending is classified as Capital or Revenue. Firstly, capital spending results in the acquisition of a new asset or adds value to an asset and therefore it is necessary to record what the asset is worth if the Council's balance sheet is to be accurate. Secondly, the capital expenditure results in a long-term benefit over a number of years and so the cost is spread over those years. Governments also like to control how much local authorities borrow to pay for large projects, while ensuring that local authorities do not borrow money to pay for spending on minor items.

Capital Income (or Capital Receipts) and Revenue Income

A person's wage or salary is their revenue income. They will use this to pay for their daily living expenses (revenue expenditure). If a person sells a house or a car, they will get a capital receipt. This can be seen as having turned a physical asset into cash rather than having received some income.

The same principle applies to local authorities. When a local authority sells a council house it gets a capital receipt. The rent that is collected is revenue income.

Paying for Revenue and Capital Expenditure

A private individual can sell a house or car, get a capital receipt and use some of the money to pay for a holiday, or to borrow to pay for the holiday. However, a local authority cannot pay for revenue spending by borrowing or using capital receipts. It is not considered to be good financial management to borrow or to use capital receipts to pay for revenue expenditure.

However, revenue money can be used to finance capital expenditure. Just as a private individual may choose to use some of their salary to buy outright a car or holiday home a local authority can also choose to use its revenues to meet capital spending. Doing this is called making a Revenue Contribution to Capital Outlay.

Capital expenditure is also funded from government grants, borrowing and capital receipts, or revenue contributions from the Housing Revenue Account or the General Fund, as appropriate.

Borrowing and Capital Financing Charges

If an authority decides to meet capital expenditure from revenue income, then that is the end of the story. However, if it borrows to pay for capital expenditure it will have to meet loan interest and possibly make repayments. They will pay for this out of revenue income. If capital expenditure is met from a capital receipt the authority foregoes the opportunity to earn interest from investing that receipt.

The government introduced a new system called 'prudential borrowing' in 2004/05. This meant that councils were no longer given borrowing allocations, but can borrow as much as they want as long as they can afford the interest payments.

From 2012/13 the government has introduced a 'borrowing cap' as part of self-financing. This limits the amount that local authorities can borrow to invest in housing even if they would otherwise have been allowed to borrow under the prudential borrowing rules.

Budget and Closedown

Accountants often refer to 'budgets' and 'closedown'. A Council sets a budget, usually in February, for a financial year that runs from 1st April to 31st March. Preparation of the budget and calculation of all the figures normally starts in the preceding summer, with most of the work done from November to January. After the end of a financial year on 31st March, the accounts are 'closed down'. This means that all the final figures are calculated, entered into the accounts and reported. This usually takes place between April and June.

Any organisation needs to keep a record of expenditure and income. Local authorities have a greater need to account for their income and expenditure because they are dealing with public money.

The difference between a Local Authority Housing Revenue Account and General Fund

A local authority has to keep a 'Housing Revenue Account'. This records revenue income and expenditure in relation to council houses and providing services to tenants, such as rents and repairs. Any expenditure or income not to do with council houses and providing services to tenants is recorded in the authority's general fund.

The General Fund finances services provided by a Council to the general community such as Education, Social Services, Highways, Environmental and Leisure Services. Some of this expenditure is met by income from fees and charges or specific government grants. General Fund net expenditure is met in the main from Council Tax, Revenue Support Grant (a Government Grant) and National Non-Domestic Rates.

If an authority wishes to increase its expenditure (such as expenditure on Maintenance) on the Housing Revenue Account it must fund this from within the Housing Revenue Account.

If an authority wishes to increase expenditure on General Fund Services then it must fund this from general fund resources.

While the 'housing ring fence' prevents an authority from transferring resources between the Housing Revenue Account and the General Fund, there is nothing to stop an authority transferring resources between Housing General Fund and other General Fund Services.

Housing Revenue Account

The Housing Revenue Account records expenditure and income relating to council houses and the provision of services to tenants. This includes management and the repair and maintenance of stock and the rent and income from other sources. Until 2011/12 it also included housing subsidy.

The Local Government and Housing Act of 1989 came into force on 1st April 1990. This defined what transactions should be recorded in the Housing Revenue Account, and enabled the government to influence directly the finances of local authority housing. A 'New Housing Subsidy System' achieved this. This subsidy system continued until 2011/12. It has now been replaced with a system of 'self-financing' that is described in more detail below. However, the Housing Revenue Account continues to exist.

The legal position is set out in Part VI of the Local Government and Housing Act 1989 that requires local authorities to:

- Prepare a Housing Revenue Account showing certain debits (costs) and credits (income) and make it available to the public.
- Keep the budget under review.
- Take all reasonable practical steps to avoid a deficit on the account.

Authorities maintain Housing Revenue Account balances – made up of surpluses that have been carried forward from previous years. An authority can make a deficit in a particular year, but cannot make a cumulative deficit. The Act specifies what a local authority can charge to its Housing Revenue Account and what income can be credited there. This requirement creates the 'ring fence'.

The presentation of the Housing Revenue Account has undergone a number of changes since it was first introduced in 1990.

A summarised version of a Housing Revenue Account is shown below:

<u>Housing Revenue Account</u>

	£million
Supervision & Management	21.4
Repairs & Maintenance	12.9
Rents, rates, taxes and other charges	0.2
Depreciation	14.3
Impairment	44.1
Increased allowance for bad debts	0.3
Total expenditure	93.3
Dwelling rents (gross)	55.0 Cr
Non-dwelling rents (gross)	0.6 Cr
Charges for services and facilities	6.8 Cr
Contributions towards expenditure	0.6 Cr
Total Income	63.0 Cr
Net cost of HRA services as included in the whole authority Comprehensive Income & Expenditure account	30.3

	£million
HRA share of Corporate & Democratic core	0.3
Net Cost of HRA services	30.6
Gain on sale of fixed assets	2.8 Cr
Pooling payments regarding right to buy disposals	1.1
Interest payable and similar charges	6.7
Investment properties (income, expenditure, changes in value)	2.9 Cr
Capital grants and contributions receivable	15.8 Cr
Deficit for the year on HRA services	16.9

Statement of Movement on the Housing Revenue Account Balance

	£million
Balance at end of the previous year	13.9 Cr
Deficit for the year on the Housing Revenue Account	16.9
Adjustment between accounting basis and funding basis	15.7 Cr
Transfer from earmarked reserves	0.2 Cr
Balance at the end of the current year	12.9 Cr

Adjustment between accounting basis and funding basis

	£million
Reversal of Impairment charges	44.1 Cr
Reversal of revaluation of investment properties	0.7
Reversal of gain on sale of assets	2.8
HRA share of contributions from pension reserves	0.1 Cr
Capital expenditure funded by HRA	10.3
Transfer to capital grants unapplied account	15.8
Transfer from capital receipts reserve	1.1 Cr
Total	15.7 Cr

The following notes describe what these items contain in more detail.

Expenditure

Supervision and Management

Supervision and Management costs are sometimes divided into general expenses and special expenses.

General Expenses refer to costs relating to the whole housing stock or all tenants. It includes rent collectors, costs of letting properties, most of the management of the Housing Department, computer costs and support costs such as accountancy and legal.

Special expenses apply to only some of the tenants. They include cleaning communal areas of flats and maintenance of open spaces. The government is encouraging local authorities to make a service charge to recover some or all of this expenditure. Support costs relating to sheltered accommodation have been financed by Supporting People Grant from 2003/04 and since then have usually been accounted for in the general fund.

Repairs and Maintenance

This includes the cost of maintaining the Council's housing stock including the management of the maintenance function. 'Maintenance' includes repainting, responsive repairs and planned maintenance. It does not include major repairs - for example, replacement bathrooms, electrical rewiring or re-roofing.

Rents, Rates, Taxes and other charges

This includes rents, rates, leases and Council Tax paid in respect of empty council houses waiting to be re-let or for property used to provide services to tenants.

Depreciation

Depreciation represents the reduction in the value of assets over time. Until 2011/12 it was not a real cost to the local authority as it was received as part of housing subsidy and was paid into a 'Major Repairs Account'. With self-financing depreciation may become a real cost but there are transitional arrangements in place during the first five years. The calculation of Depreciation, the 'Major Repairs Allowance' and the operation of the 'Major Repairs Reserve' are considered below.

Impairment

Impairment is similar to depreciation in that it involves the writing down of the value of assets. However, whereas depreciation is the planned writing down of assets over their expected lives, impairment is where an asset is suddenly reduced in value following an unexpected event such as the discovery of contaminated land.

Provision for Bad or Doubtful Debts

Local authorities are usually owed significant amounts in arrears of rent or other income. Sometimes this income is uncollectible and has to be written off. It is good accounting practice to make a provision for such bad or doubtful debts.

Income

Dwelling Rents (gross)

This includes rents collected from the letting of council housing.

Non-dwelling Rents (gross)

This includes rents collected from garages and shops on council estates.

Charges for Services and Facilities

This includes any other charges made, including heating, cleaning, welfare services and payments by leaseholders. Leaseholders are ex-tenants who have bought their council flat on a leasehold basis.

Contributions towards Expenditure

Where benefits or amenities are shared by the whole community the General Fund makes a contribution towards the cost. This includes payments from social services authorities. Contributions towards expenditure also include contributions from leaseholders for rechargeable repairs.

Operating Expenditure

Corporate & Democratic Core

This is the housing revenue account’s share of the Council’s corporate and democratic core that includes the costs of the Chief Executive and civic functions.

Gain on sale of fixed assets

If fixed assets such as land or buildings are sold at a higher cost than their valuation on the balance sheet then the difference is shown as a gain on the sale of fixed assets. This entry is then ‘reversed out’ in the adjustments between the funding basis and the accounting basis (see below).

Pooling payments in respect of right to but disposals

When the Council disposes of a dwelling under the ‘right to buy’ it must pay a proportion of the proceeds to the government. This entry is ‘reversed out’ in the transfers to and from reserves (see below). This guide contains a section on the right to buy that considers this issue in more detail.

Interest Payable

This is interest that the Council pays on long-term loans that it has taken out to fund investment in the construction, acquisition, improvement or major maintenance of council housing or other capital assets.

Investment properties

Interest can be received by the Housing Revenue Account from a number of sources:

- Interest on Capital Receipts - Authorities receive this (sometimes called the ‘item eight credit’) where the amount of capital receipts invested is greater than the level of loans outstanding.
- Interest on Mortgages in respect of sold council houses
- Other Interest Receivable - There is a credit to the Housing Revenue Account where the average cash balance throughout the year is in surplus.

This council also holds some properties as investments. The expenditure and income connected with them and any adjustments to their capital value are also shown here.

Capital Grants and Contributions

These are capital grants from government or contributions from partners such as developers that are credited to the housing revenue account.

Movement on the Housing Revenue Account Balance

This statement shows how the balance on the housing revenue account has increased during the year due to the surplus on the housing revenue account, adjustment between the funding and accounting basis (see below) and transfers to and from reserves.

Adjustment between Accounting Basis and funding basis

When a local authority prepares accounts it is pursuing two slightly conflicting objectives. One is to prepare accounts in accordance with accounting concepts to show a ‘true and fair’ view of whether they are consuming or accumulating assets (or making a surplus or a deficit) and the other is to comply with local government finance legislation that requires them to take account of some cash transactions that would not usually be accounted for in an income and expenditure account and to ignore some transactions that accountants would usually show because they do not affect cash.

In this case the following adjustments are made:

- Reversal of impairment charges – the charges shown in the income & expenditure account (see above) are reversed out here.
- Reversal of revaluation of investment properties – the ‘credit’ taken from revaluing investment properties is reversed out here.
- Reversal of gain on sale of fixed assets – the ‘credit’ taken from the gain on the sale of fixed assets is reversed out here.
- The Housing Revenue Account share of the contributions to the council’s pensions reserve is credited here.
- Capital expenditure funded by the housing revenue account – the council has used £10.3million of its revenue money to fund capital expenditure on housing revenue account dwellings. This is debited here.
- Transfer to capital grants unapplied account – the capital grants that the Council has received (see above) have yet to be applied so are transferred to the capital grants unapplied account here.
- Transfer from capital receipts reserve equal to amount payable to housing capital receipts pool – the expenditure on pooling payments on right to buy disposals (see above) is reversed out here.

Self-Financing

Until 2012 there was a ‘housing subsidy’ system under which government re-distributed resources annually between local authority housing revenue accounts to ensure that all authorities had what the government regarded as an appropriate level of funding regardless of their resources. At the same time the government took resources out of housing revenue accounts to fund its own expenditure. In 2012 this system was replaced by a ‘self-financing’ system where there is no housing subsidy but where authorities had to make a ‘one-off’ payment to the government or benefitted from the write-off of some of their debts. After these payments were made authorities have been allowed to keep all their revenue income.

The Housing Revenue Account Ring-Fence

The principle that the housing revenue account should only fund costs associated with the Council being a landlord was firmly established in the 1989 local Government Act and Circular 8/95. However, there have always been complaints from people in the housing sector that some councils have interpreted the rules flexibly to increase the costs to the housing revenue account to the benefit of the general fund. Since 2010, with increasing pressures on local authority general fund budgets, there has been increasing criticism of the way that some local authorities account for their costs.

In April 2013 the ‘Local Government Chronicle’ revealed that local authorities had taken advantage of the flexibilities created by localism and self-financing to take ‘millions of pounds from their tenants’ rent account to fund support services for the government’s controversial welfare cuts and prop up their falling budgets’.

When I was a member of the Communities & Local Government / HM Treasury working party on self-financing in 2008 I had foreseen this possibility and had argued for a firmer definition of the housing revenue account ring fence to protect tenants. The former government included this in its proposals for self-financing but it was dropped by the present government when self-financing was introduced.

Examples include:

- Barking & Dagenham Borough Council transferring £0.6million of costs of street lighting.
- Brent Borough Council is creating a new welfare support team to prepare for universal credit and direct payments at a cost of £400,000 that will be charged to the housing revenue account.
- Lewisham Borough Council transferring £750,000 of costs of maintain and replacing bulk waste bins
- Portsmouth City Council transferring £2.1million of costs over three years from the General fund to the housing revenue account including the costs of libraries, youth clubs, a community centre and car parks.

Nick Golding, the Acting Editor of the ‘Local Government Chronicle’ commented that:

“Councils are increasingly using income from their housing revenue accounts for purposes largely unrelated to housing.

“At a time of rapid population growth, Britain is facing a housing crisis – we need more housing. And, while many improvements have been made, much of our housing stock is not up to standard. Rental income form housing should be spent on house building, maintenance and improvement – investment that will benefit those crying out for decent housing.

“So it is therefore undesirable that councils are spending the housing revenue account in a manner not in keeping with traditional landlord expenses. Street lighting, libraries and community centres are being funded using the housing revenue account – costs that would normally be associated with councils’ general funds.

“At a time when the government is providing money for the housing of the wealthy (the mortgage guarantee scheme), it is pursuing policies that are forcing councils to cut back their expenditure on housing for those on low and modest incomes. At a time when the government has been so desperate to help the building industry that it was prepared to allow inappropriate or unsightly house extensions, it has also presided over policies that mean council landlords have less money to support their local builders and maintenance staff.”

In January 2014, it was revealed that Islington Borough Council had changed its accounting policies in an effort to switch costs from the general fund to the housing revenue account. The story was included in 'Inside Housing' under the heading 'Islington dips into housing budget to aid general fund'. I am quoted in the article as saying:

"Everybody is trying to alleviate pressure on the general fund… One way of doing that is to try to find ways of charging the housing revenue account and councils are going further in finding ways to do that."

What is Capital Expenditure?

Accountants define capital expenditure as being on items that give a benefit and retain their value over a number of years. There is also an accountancy concept called 'materiality' that excludes items of small value from the definition. Capital expenditure in the private and public sectors is often financed by loan, firstly because resources are often not available 'up front' to finance it, and secondly so as to spread the cost of the capital expenditure across all the years during which the benefit is experienced.

However, in local government there is also a specific legal definition of capital. Capital expenditure is defined in section 16 of the Local Government Act 2003 and in Part 5 of the Local Authorities (Capital Finance and Accounting) (England) Regulations 2003 (S.I. 2003/3146), as amended.

Housing Revenue Account Capital Programme – an Example

What follows is an example of a capital programme.

		£m	£m
a)	Modernisation Schemes	2.5	
b)	Decent Homes Programme	2.5	
c)	Environmental Improvements	0.5	
d)	Energy Saving	1.5	
e)	Improvements to Sheltered Accommodation	0.5	
f)	Adaptations for the Disabled	0.1	
			7.6

a) Modernisation Schemes - Expenditure could include central heating, new windows, new bathrooms or kitchens, re-roofing or re-wiring. Most programmes include some expenditure under this heading. However, in some authorities scarcity of resources does not permit the more desirable expenditure and efforts are concentrated on more basic needs.
b) Decent Homes Programme – This is work that is required so that the authority can achieve the government's decent homes standard. Many authorities have already achieved the standard. This is discussed in more detail below.
c) Environmental Improvements – This is work that is not part of the fabric of a home. Provision for car parking and improvements to layout are included.
d) Energy Saving - Sometimes referred to as 'Affordable Warmth' the intention is to reduce the use of energy and running costs whilst ensuring that homes are kept warm. Expenditure may include new or replacement heating systems, cavity wall insulation or double-glazing.
e) Improvements to Sheltered Accommodation - Schemes that concentrated on bed-sit accommodation, making use of shared bathroom facilities, are now difficult to let. Expenditure includes updating accommodation and converting it to one or two bedroom self-contained units of accommodation.

f) Adaptations for the Disabled - Expenditure includes minor items such as widening doorways to give access to wheelchairs, or major extensions of the home. The objective is the same in both cases and that is to enable the elderly or disabled tenant to remain in their home.

The Financing of Housing Capital Expenditure

There are five main sources of Capital Finance in the housing revenue account as follows:

- Major Repairs Reserve
- Borrowing
- Capital Receipts
- Revenue Contributions
- Grants

The local authority in our example spent £46.8million on its housing revenue account capital programme in 2013/14 as follows:

	£million
Works to stock – decent homes	21.7
Works to stock – general	11.6
Leaseholder buy-backs	6.1
Grants to vacate	0.5
Community halls	0.1
Total	46.8

This expenditure was financed as follows:

	£million
Capital Grants and Contributions	24.2
Major Repairs Reserve	13.5
Capital Receipts	6.6
Revenue Contributions	2.5
Prudential Borrowing	0.0
Total	46.8

Government has always provided support to local authority housing capital programmes. However, the way in which this support is provided has changed over the years. From 2000 to 2012, the focus was on investing to achieve the decent homes standard. From 2012 with self-financing the major repairs allowance has ceased to exist as has supported borrowing although councils continue to make provision for major repairs through a major repairs reserve. In future government support to local authority capital programmes will be through capital grants. The paragraphs that follow describe each of these sources of financing.

The example illustrates how authorities can use a different mix of capital resources in different years.

Major Repairs Reserve

From 2001/2002 to 2011/12 all local authorities received a 'Major Repairs Allowance' that was paid as part of the Housing Subsidy. It was paid into the Major Repairs Reserve through the making of a depreciation charge. Funds that are in the Major Repairs Reserve were available for the authority to spend on Major Repairs.

The Major Repairs Allowance has been abolished with self-financing although councils still make transfers to their major repairs reserve to meet the costs of major repairs.

Borrowing

Councils can borrow to fund capital investment in the housing revenue account subject to various conditions and limits. In particular they must demonstrate that their borrowing is affordable and must not borrow more than a limit set by government commonly called the 'borrowing cap'. In practice the 'borrowing cap' prevents many authorities from doing any borrowing at all.

Capital Receipts

Capital receipts arise when a local authority sells a capital asset such as a council house or a plot of land. The amount of the Capital Receipts that can be used (known as the "usable part") is generally limited to:

- 25% of the money received from the sale of council dwellings
- 50% of the money from the sale of housing land, and other housing assets

There is no 'Ring Fence' round usable Capital Receipts – a local authority can use capital receipts in the housing revenue account or general fund regardless of where they arise. Councils commonly use housing revenue account capital receipts to fund the housing general fund programme. An exception to this is the additional resources arising from the government's right to buy initiative that are targeted at funding new homes. There is a complex formula for calculating how much of the capital receipts can be kept by a local authority, but what it can retain must be used to fund up to 30% of the cost of building new affordable homes.

Revenue Contributions to Capital Outlay

There are no limits on revenue contributions to capital outlay. A council can finance as much Housing Revenue Account capital expenditure as it wants from tenants' rent money, and General Fund capital expenditure as it wants from Council Tax or other general fund resources. However, the housing subsidy system limits the amount of 'spare' money that a council will have for this purpose.

Government Grants

Some capital expenditure that local authorities incur on housing is financed directly by the Government. This includes some expenditure on regeneration – in particular in connection with estate renewal and investment programmes. Government grants must be spent on the specific purposes for which they are given.

Recent Developments

The present government is making a number of changes that are having an impact on housing revenue account finances. In particular:

- Reducing rents by 1% a year for four years starting in 2016. This will have a significant effect as councils had been planning on rent increases of inflation plus 1% each year in accordance with previous government policy.
- Obliging local authorities to sell 'high value' council homes when they become vacant with the proceeds being transferred to the government to fund 'right to buy' for housing association tenants.
- Obliging local authorities to charge tenants with 'high incomes' a near-market rent with the proceeds being transferred to the government.
- The 're-invigorated right to buy' under which councils are obliged to sell council homes to sitting tenants at a substantial discount. Part of the proceeds are used to part-fund the building of new homes.
- Welfare Reform that is reducing the entitlement of many tenants to housing benefit and other benefits.

Adrian Waite
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Further information about local authority housing finance is available on our website at: http://www.awics.co.uk/LAHousingFinance.asp

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