Briefing Paper

Self Financing – Planning the Transition

July 2011

1. Introduction

1.1 Communities & Local Government published a policy document: 'Self-Financing – Planning the Transition' on 28th July 2011. This paper updates the policy and implementation arrangements set out in the document 'Implementing self-Financing for Council Housing' published in February 2011 and follows papers issued by the former Labour government as well as the current coalition government. Briefing papers on these papers are available on the 'AWICS' website at http://www.awics.co.uk/BriefingPapers/ViewCategory/housing/ :

- Housing Revenue Account Review – July 2009
- Reform of Council Housing Finance – July 2009
- Council Housing: A Real Future – April 2010
- Council Housing: A Real Future – AWICS response – July 2010
- Implementing Self Financing for Council Housing – February 2011

1.2 The purpose of the policy document is to:

- Provide local authorities with the detailed information they need to prepare for and achieve a successful transition to self-financing
- Provide an update on the wider policy and accounting context within which self-financing will operate

1.3 The policy document also contains:

- A summary which could be used to explain the reforms to tenants or other interested
- Refreshed Demolitions Guidance (this had already been issued via email on 1st July 2011)

1.4 Also accompanying the policy document are working drafts of the legal 'determinations' necessary to bring self-financing into effect, the powers for which are in the Localism Bill. Communities & Local Government intends to consult formally on the determinations in November 2011 but would welcome views from the sector on the current versions. These determinations comprise:

- Settlement Payments Determination - the calculation of the self-financing valuation and the settlement payments
- Limits on Indebtedness Determination - the limit on the amount of housing debt that each local housing authority can hold under self-financing and the formula by which this will be calculated

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- Calculation of the sums to be credited or debited to the Housing Revenue Account. This sets the framework for the operation of the Housing revenue Account 'ring-fence'

1.5 Copies of the policy document and the associated documents are available on the Communities & Local Government website at: http://www.communities.gov.uk/publications/housing/selffinancetransition

1.6 The purpose of this briefing paper is to summarise these documents and to provide comment as appropriate.

2. Overview

2.1 The policy document contains sections on:

- The Valuation
- Limit on indebtedness
- The payment arrangements
- Closing down the subsidy system
- Accounting and regulatory framework
- Improving accountability and the decent homes standard
- Related policy developments
    - Transfer policy
    - Consents and disposals

2.2 Key milestones in the project are now as follows:

- Early July 2011 – 2012 B1 form available on LOGASNET for local authorities to submit data to Communities & Local Government on their stock.
- End August 2011 – Uncertified data for self-financing submitted by local authorities to the Department.
- August 2011 onwards – Local authority certified data provided.
- September 2011 – Local authorities making a payment complete a questionnaire on plans for raising the payment sum. This questionnaire will be jointly issued by the Chartered Institute of Public Finance and Accountancy, the Local Government Association and Communities & Local Government.
- October 2011 – Final auditor-certified data submitted by local authorities.
- November 2011 – Consultation on self-financing determinations.
- January 2012 – Final self-financing determinations published.
- February 2012 – Local authorities set budgets and agree borrowing.
- 28th March 2012 – Payments between Communities & Local Government, the Public Works Loans Board and local authorities to enable the start of self-financing.
- 1st April 2012 – Self-financing goes live.

3. The Valuation

3.1 This section answers the outstanding issues raised in relation to the valuation methodology.

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3.2 The key points include:

- The data inputs to be used in the draft determinations.
- Confirmation of the position on demolitions following the advice circulated to Councils on 18th May 2011.
- How Communities & Local Government is adjusting the model to compensate Councils for the continuing pooling of Right to Buy receipts.
- Caps and limits compensation
- A description of the treatment of new build properties.

3.3 Communities & Local Government state that:

*"We encourage all local authorities to begin developing their business plans for self-financing based on the indicative valuations published in (the) February document. The indicative figures **will change** before the draft self-financing determinations are issued in November 2011… We therefore advise authorities to stress-test their business plans. In particular this process should involve examining the potential for new data to change the value of the settlement payment."*

3.4 There is therefore a possibility that the level of debt at self-financing will be increased in November 2011 in comparison with the figures that were supplied in February 2011.

3.5 However, Communities & Local Government go on to say that:

"Between the draft and final determinations numbers, it is unlikely that any of the macro-economic or regional adjustment data inputs will alter."

3.6 While the financial model published in February 2011 used data from the 2011/12 housing revenue account subsidy determination, the actual self-financing determinations will be based on a 'shadow' 2012/13 subsidy determination. This 'shadow' determination will use updated input data including the BCIS price adjustment factors (used to adjust building costs regionally) the area cost adjustment factors and crime statistics. The retail price index inflation figure will be the out-turn for September 2011. The gross domestic product deflator used for setting costs will be a forecast for 2012/13.

3.7 This updating is likely to increase the tenanted market value and therefore the level of self-financing debt.

3.8 On right to buy sales the policy document states that:

"A national forecast of Right to Buy sales has been developed, based on an extrapolation of current Right to Buy volumes. This will be disaggregated between regions based on the proportion of national Right to Buy sales in the region over the last three years. It will then be distributed in proportion to the stock levels of local authorities within the region. This is estimated to be worth £862million on current data.

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"Due to the inherent difficulty of producing accurate projections, given the relatively low numbers of sales involved and volatility between years, we decided that a standard methodology should be applied in making forecasts. This is consistent with the approach taken to many of the other factors affecting the valuation.

"The Right to Buy forecasts will be updated based on outturn 2010/11 Right to Buy sales data. The forecasts will begin from 1 April, 2011."

3.9 If the actual level of right to buy sales differs from that forecast either at national level or at local level this could have a significant impact on local authorities either nationally or locally.

3.10 On rent rebate subsidy limitation the policy document states that:

"The housing benefit 'limit rent' will continue to ensure the Exchequer does not meet the extra costs of rents which are set above policy levels. Government does not have any plans to change the national rent policy set out above. It will however continue to collect data on actual rents charged to help inform the development of any future rent policy. In addition, the Department retains the power to direct the regulator to set a rent standard, but in the council sector, unlike the housing association sector, it has no plans to do so."

3.11 This confirms that rent rebate subsidy limitation is to continue as expected and also gives a clear statement that the government is not intending to alter its policy on setting local authority rents.

3.12 On rents caps and limits the policy document states that:

"In line with social rent policy, the valuation assumes constraints on increases in individual rents as they move towards convergence with the formula rent. Under the subsidy system, councils are compensated for lost income in applying this policy through 'Caps and Limits' compensation. The compensation in the self-financing model is based on an extrapolation of the average difference between constrained and unconstrained rents.

"Some local authorities have expressed concern that the compensation in the model does not adequately reflect the position of their housing stock. The alternative would be to attempt to take into account the difference between actual rents charged and the potential unconstrained rent for every property in the country. A forecast built this way would be impractical and very complex to audit. It would also be likely to over-compensate councils. This is because as tenants move on, re-let properties can be immediately charged at formula rent for the new tenants. We have therefore decided to retain the approach set out in 'Implementing Self-financing for Council Housing' i.e. compensating councils for the average difference between constrained and unconstrained rents."

3.13 Councils that have raised this issue will therefore be disappointed.

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3.14 The policy document confirms that with self-financing, councils will continue to be able to apply for an exclusion from pooling the receipt from a right to buy sale of a new build home. Communities & Local Government is taking powers in the Localism Bill to do this after the subsidy system ends.

4. Limit on Indebtedness

4.1 This section sets out how the limit on indebtedness will be calculated. More details are included in the accompanying draft determination.

4.2 The policy document confirms the government's position on debt and borrowing as follows:

"Self-financing must not jeopardise the Government's first priority, which is to bring borrowing under control. Self-financing will give council landlords direct control over a very large rental income stream. Borrowing financed from this income must be affordable within national fiscal policies as well as locally. We will therefore limit the debt that can be supported from the Housing Revenue Account in each local authority."

4.3 However, there is some comfort for those who feared that the government might use the mechanism of reducing borrowing caps as a way of achieving further savings in the housing revenue account in that the policy document states that:

"Ministers have stated during the passage of the Localism Bill that we will not subsequently reduce the aggregate borrowing cap, or the borrowing caps for individual councils, which are set out in the original self-financing determinations. Councils will therefore be able to plan ahead on the basis of those caps."

4.4 The policy document states that the maximum amount of housing debt that each local authority can hold under self financing will be the higher of:

- The self-financing valuation for the local authority plus any capital financing provided by the local authority before 1st April, 2012 to support a new build scheme under a contract with the Homes and Communities Agency.
- Where the local authority is making a self-financing settlement payment to the Secretary of State, the end-year Housing Capital Financing Requirement for 2011/12 plus the value of the payment
- Where the local authority is receiving a settlement payment from the Secretary of State, the end-year Housing Capital Financing Requirement for 2011/12 less the value of the payment.

4.5 A local authority will be in breach of the limit if its housing debt exceeds its debt limit on the final day of any financial year. It will not be in breach where housing debt exceeds the limit at any other time during the year.

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4.6 A working draft of the limits on indebtedness determination is attached as part of the draft self-financing determinations. Communities & Local Government intend to consult formally on the determinations in November 2011 but would welcome views from the sector on the current version.

4.7 The policy document warns against 'creative accounting' as follows:

"If it becomes apparent that councils are developing financing models which undermine the purpose of the debt cap in controlling public borrowing for housing, we will consider using a different measure of housing debt in order to prevent this."

5. The Payment Arrangements

5.1 This section sets out the payment arrangements and what local authorities need to do to achieve a successful transition.

5.2 Key points include:

- The payment date of 28th March 2012.
- Adjustments that the government will make to subsidy payments for 2011/12 as a consequence of this early payment.
- Why it is important to have an overall picture of sources of funding.
- Arrangements for local authorities wishing to borrow funds.
- The Public Works Loan Board's variable rate loan for self-financing
- Arrangements for local authorities having debt paid off.

5.3 So – after all the discussion it has now been decided that 'settlement day' will be 28th March 2012 in accordance with the wishes of the Treasury and contrary to the wishes of local authorities. The reason for this is given as follows:

"The date of 28th March, 2012 enables all the money to be raised and paid within the same financial year, and before the start of self-financing on 1st April 2012. Completing all the payments in the same financial year helps aggregate accounting by the Treasury – a key advantage given the significance of these payments to the national fiscal position."

5.4 As Councils will be borrowing significant sums of money on 28th March 2012 they will be incurring significant capital financing costs over the four days 28th to 31st March 2012. Interest on £13.2billion of borrowing at an average of 5% (for example) would be over £7million for the four days.

5.5 The government will therefore amend the Housing Revenue Account Subsidy determination 2011/12 so that subsidy entitlement for this year is adjusted to take account of four days' interest on the settlement payment. The interest rate used for local authorities receiving a settlement payment will be their consolidated rate of interest. This reflects the fact that the settlement payment will be used to pay down existing debt. The interest rate used for local authorities due to make a payment will be the Public Works Loan Board 30 year maturity borrowing rate, as councils will generally have to take on new borrowing to fund the payment.

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5.6 The government will also amend the 2011/12 Item eight determination so that interest due (or received) on settlement payments before 1st April 2012 can be charged (or credited) to the Housing Revenue Account.

5.7 The government will require local authorities to notify them of the amount that they intend to borrow and whether this will be from the Public Works Loans Board or private sources.

5.8 The Public Works Loans Board will make short-term variable rate loans available to local authorities. This will enable them to defer taking a decision on the long-term financing of the additional debt until after 28th March 2012.

5.9 Where an authority is having its debt reduced the Public Works Loans Board will apportion or top-slice the repayment across the authority's portfolio.

5.10 The policy document makes an offer to local authorities as follows. It will be interesting to see how many take this up!

"Local authorities who wish to pay in advance of 28th March are welcome to do so although it would be helpful if they would notify the Department prior to payment."

6. Closing down the Subsidy System

6.1 This section provides information on the arrangements for closing down the subsidy system and the treatment of decent homes and private finance initiative payments.

6.2 The government had previously said they were minded to adjust the debt settlement figure to reflect Decent Homes Backlog funding allocations for 2012/13. However, they no longer intend to make payments this way. The self-financing settlement payments will not take account of these sums in the interests of simplicity and transparency. Decent Homes backlog funding for 2012/13 will be paid as grant early in April 2012. In London, grant will be paid by the Greater London Authority, elsewhere in England it will be paid by the Homes and Communities Agency.

6.3 The government will ensure that these grants are used for the purposes intended. They intend to make a direction under Item 97 that requires this sum to be credited to the Housing Revenue Account and a direction under Item 88 to require this sum to be subsequently debited from the Housing Revenue Account and paid into the Major Repairs Reserve.

6.4 The government announced in 'Implementing self-financing for council housing' that they would continue to pay Private Finance Initiative payments separately as a revenue subsidy. From the start of self-financing the Department intends to pay this subsidy as a grant using powers in section 31 of the Local Government Act 2003. They will also amend the item eight credit determinations to provide for this payment to be credited to the Housing Revenue Account.

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6.5 Councils with Housing Revenue Account Housing Private Finance Initiative schemes that reach contract signature after 31st March 2012 will not have had their Major Repairs Allowance reduced to reflect the properties included in the Private Finance Initiative contract. The subsidy that is paid will be adjusted to take account of Major Repairs Allowance included in the self-financing valuation for properties that are subsequently included in a Private Finance Initiative contract.

7. Accounting and Regulatory Framework

7.1 This section describes the accounting and regulatory framework for self-financing. It covers:

- Depreciation and Impairment
- Separating Housing and General Fund debt
- The operation of the housing ring-fence and the revised item eight credit and debit determinations
- Minimum Revenue Provision

7.2 The government intends to retain the principles of the major repairs reserve. They consider that with self-financing it will be even more important for Councils to set aside an appropriate provision for capital works and that money needed for the capital programme is not spent on other things. The policy document states that:

“There will not be a major repairs allowance with self financing. The amount to be paid into the major repairs reserve must therefore be drawn from a local assessment of capital spending needs.

“This assessment should be based on the amount which needs setting aside for depreciation, namely the cost of replacing or renewing all the time-limited components of the stock plus an amount for the fabric of the building. If the components are replaced at the end of their lifespan then it is expected that the fabric of the building will have a long life. As the self-financing valuation is based on an updated Major Repairs Allowance which is built up using the same method in respect of components, we expect that the need to spend in local plans will be broadly similar to the figure funded in the self-financing valuation.”

“Under the subsidy system, councils have been required to put a figure equivalent to their depreciation into the Major Repairs Reserve, but have then been allowed to ‘reverse out’ any difference between that and the Major Repairs Allowance. In future, councils will need to develop a component-based approach to depreciation in order to comply with accountancy standards. There should be no difference between this and the need to spend on major repairs identified in the business plan, which is itself based on the cost of replacing and renewing components. We therefore see no need longer term to have a mechanism which prevents the full depreciation charge from hitting the Major Repairs Reserve.

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7.3 These are interesting statements. Communities & Local Government has previously maintained that with self-financing the amount transferred into the major repairs reserve should be equal to depreciation and it is confirmed that with self financing this will be the case. However, this policy document refers to three different approaches: depreciation, the up-rated major repairs allowance (that will not be recalculated each year) and a local assessment of capital spending needs. It implies that all three methods should result in a similar conclusion. In practice this may not be the case as depreciation is usually a higher figure than the up-rated major repairs allowance or councils' assessments of capital spending needs. Consequently, the use of depreciation to calculate the transfer to the major repairs reserve could be unaffordable. This matter has been raised by 'AWICS' and others in the consultation on major repairs and depreciation that was carried out by the Chartered Institute of Public Finance & Accountancy in February 2011. The policy document continues:

"However we recognise that councils will need time to implement component-based depreciation. There are also issues to be resolved, including the link between depreciation and stock valuations (and revaluations) and how impairments are dealt with. The Chartered Institute of Public Finance and Accountancy consulted on proposals in February and will issue a further consultation on this shortly. We expect this to propose a five-year transitional period during which councils may choose to use the uplifted Major Repairs Allowance in the self-financing valuation as the figure which must be funded in the Major Repairs Reserve. They will also be able to reverse out the effect of impairments as a below the line adjustment in the Statement of Movements on the Housing Revenue Account balance sheet. Authorities will still be able to transfer amounts in excess of depreciation to their Major Repairs Reserves."

7.4 This paragraph suggests a five year transitional period during which councils will be able to use the uplifted major repairs allowance to calculate the transfer to the major repairs reserve. It also suggests that impairment should continue to be 'reversed out' as it is now. It is said that details will be provided in a consultation paper that will be issued by the Chartered Institute of Public Finance & Accountancy. Communities & Local Government appear to recognise in this final paragraph the difficulties that would be likely to arise if depreciation was used to calculate the transfer to the major repairs reserve.

7.5 The policy document confirms that there will be a separation of housing and general fund debt and states that:

"The Government and the Chartered Institute want councils to have the flexibility to develop an approach to treasury management that meets local needs, subject to the principle that there should be a fair apportionment of costs and risks between the General Fund and the Housing Revenue Account.

"The Chartered Institute of Public Finance and Accountancy will be seeking further views this summer on options for managing debt under self-financing."

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7.6 The Item 8 determination will continue to specify the items that can be debited or credited to the Housing Revenue Account, but in most cases it will require councils to follow proper practice in calculating the appropriate amounts to credit or debit, rather than setting out a detailed set of rules and formulae. Guidance from the Chartered Institute of Public Finance and Accountancy will strengthen the definition of proper practice in this area.

7.7 The government will amend the guidance on Minimum Revenue Provision to ensure that self-financing does not create a new need to make a Minimum Revenue Provision in the general fund.

8. Improving Accountability and Transparency to Tenants and maintaining the Decent Homes Standard

8.1 This section provides information on the wider context for self-financing including empowering tenants and the continuing importance of accommodation meeting the Decent Homes Standard. It covers:

- Proposed changes to standards expected by the regulator designed to increase tenant empowerment
- Proposed changes to the quality of accommodation standard (the 'Decent Homes Standard')
- Transparency around service charges

8.2 The Government is currently consulting on draft directions from the Secretary of State to the Social Housing Regulator (Implementing social housing reform: directions to the Social Housing Regulator – published 7th July 2011). This includes a proposed direction on tenant involvement. This would support effective scrutiny by tenants by setting the expectation that local authorities (and other registered providers) should provide timely, useful information about their performance. There is also an expectation that providers issue an annual report to tenants, in a form which providers should agree with their tenants in advance. The presentation of financial information in a form which is useful to tenants will be a key element of this.

8.3 The Department is also consulting on a draft direction for the Regulator on the 'quality of accommodation' standard. The new standard will specify that social landlords will be expected to maintain their stock at a decent level, investing capital and using their asset management strategy to ensure pre-emptive improvements are delivered so that their homes do not fall into a non-decent state. Only in exceptional circumstances will temporary exemptions to the standard for specific homes be given.

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8.4 The Landlord and Tenant Act 1985 sets out information that tenants (other than secure tenants) can expect to receive from their landlord. Local authorities are not required to provide this information to their secure tenants although long leaseholders are entitled to such information. In the interests of greater transparency and accountability, local authorities are asked to consider how they can comply in so far as practicable with requirements of Act in respect of secure tenants. This would mean that secure tenants receive similar information about their service charges to other social housing tenants.

9. Related Policy Developments

9.1 This section sets out the wider policy context for the implementation of self-financing. The key points include:

- A more detailed description of government policy on stock transfers
- Proposed changes to the consents and disposals regime

9.2 The self-financing proposals appear to place a barrier in the way of future stock transfers. This is because of the suggestion that a transfer housing association would be obliged to take on all the housing debt of the local authority. This would prevent them from being able to afford to borrow for capital investment and would be a particular problem in the case of a local authority that had yet to attain the decent homes standard.

9.3 The Policy document states that:

"The Government considers that self-financing gives all stock owning councils a viable long-term future and it is the assumed solution for maintaining their stock in good repair.

"Under self financing, whole and partial stock transfers remain an option for councils and their tenants. However, the Government's policy on the extent of financial support for transfers has changed to better align it with funding for self financing.

"Although value for money has been a consideration in transfers prior to the development of self financing, more generous settlements had often been funded to meet tenant aspirations.

"Given the current fiscal climate, a more rigorous approach is required. The Government's starting point for consenting to transfers, set out in a number of recent publications, is that the transfer business plan in aggregate should be justifiable in comparison with the financial settlement for self financing.

"In considering transfer proposals the Department will take the self-financing valuation as the norm, taking account of any Decent Homes backlog and any additional factors such as different tax treatment which would affect a valuation."

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9.4 The final paragraph suggests that the valuation for a stock transfer could be different to the self-financing valuation and in particular that the valuation could be reduced to reflect the cost of value added tax to the housing association and the cost of investment needed to attain the decent homes standard. However, if this occurred there would be a viable housing association but the Council would be left with overhanging debt. The policy document does not comment on how this would be financed but it is understood that Communities & Local Government has no budget for clearing overhanging debt.

9.5 The policy document also refers to altering the valuation in situations where there is stock that requires regeneration rather than repair but comments that:

"The Department may agree that the transfer valuation can take account such factors, but this will be the exception rather than the rule."

9.6 In the case of partial transfers the government will expect councils to use any receipt to pay down housing debt.

9.7 The government is proposing to remove the requirement to seek the specific consent of the Secretary of State to any disposal at market value except where such a disposal would result in a secure tenant becoming the tenant of a private landlord or a disposal would be to a subsidiary of the local authority. The government also proposes to give greater freedom for local authorities to dispose at less than market value where they consider it appropriate to achieve wider objectives.

9.8 Receipts from non-Right to Buy (or similar) sales will continue to be retained by local authorities provided they are spent on affordable housing, for regeneration purposes, or for paying off Housing Revenue Account debt. However, the government will seek views on amending the regulations to make clear their policy objective that the requirement to surrender 75% central government shall apply only to receipts arising from Right to Buy sales or sales that are Right to Buy in all but name. Sales at market value to other purchasers could be retained provided it is spent on affordable housing, regeneration projects or paying off housing debt.

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10. Conclusions

10.1 The main issues arising from this policy document for local authorities appear to be:

- The likely increase in the self-financing valuation at the time of the draft determination in November 2011 and the consequent need to carry out a sensitivity analysis surrounding the level of the valuation and other risks in business plans
- The practical arrangements for making and receiving payments and taking out loans
- The mechanism for depreciation and calculating the transfer to the major repairs reserve on which a consultation paper is expected from the Chartered Institute of Public Finance & Accountancy.
- How the two loans pools will operate. A consultation paper on this is expected from the Chartered Institute of Public Finance & Accountancy.
- How local authorities will be able to address the achievement of the Decent Homes Standard (where this has not already been achieved) in the absence of sufficient capital grants, the presence of the debt cap and the government's new approach to the financing of stock transfers.

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About 'AWICS'

'AWICS' provides a full range of management consultancy and training services, principally to those who are involved in social housing.

Our mission statement is 'Independence, Integrity, Value'. We therefore provide support to clients from an independent standpoint that is designed to help the client to achieve their objectives. We are passionate about working with the utmost integrity. We believe that we offer the best value for money that is available today!

We are currently assisting local authorities with the implementation of self-financing.

We also offer training in local authority housing finance through:

- Our series of regional seminars on 'All You Want to Know about Local Authority Housing Finance 2011'
- Our seminar on 'Developments in Local Authority Housing Finance 2011'
- Tailored in-house training

Each year we update our guides to local authority housing finance: 'All You Want to Know about Local Authority Housing Finance' and 'Developments in Local Authority Housing Finance'. The 2011 editions are now available.

And we publish the popular free e-newsletter for housing services – the 'AWICS Housing News'. We are big enough to make a difference – but are small enough to care!

For more information about us and our services please visit our website at www.awics.co.uk or contact Adrian Waite at Adrian.waite@awics.co.uk .

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