

London Borough of Sutton**The Executive - 6 July 2010****Report of the Executive Head of Community Living****SUTTON'S HOUSING REVENUE ACCOUNT BUSINESS PLAN 2010/11 - 2039/40
PROPOSED REFORM OF THE HOUSING REVENUE ACCOUNT****Ward Location:** Not applicable**Author(s) and Contact Phone Number(s):**Trevor Hart, Housing Strategy &
Performance Manager (x5844)**Area Served:** Borough-wide**Executive Member:** Cllr Jayne McCoy**Report for Key Decision****Summary**

This report seeks The Executive's approval of a newly updated Housing Revenue Account (HRA) Business Plan. The new Business Plan, appended to this report, sets out the Council's plans for managing and maintaining its housing stock in the medium to long term, covering a period of 30 years. It also discusses the proposed reform of the HRA subsidy system and provides for approval a draft Sutton response to the latest Government consultation proposals.

Recommendations

I recommend that:

- (i) subject to any amendments The Executive wishes to make and any further updating or minor amendments that officers consider necessary, after consultation with the Executive Member for Housing, the draft HRA business plan, as set out in Appendix 1, be approved for publication;
- (ii) in light of the projected capital investment funding gap and the overall revenue position should the current subsidy system remain unchanged, and given the uncertain and shifting national economic and policy context, officers keep under review the alternative strategic options for the future of the Council's landlord function in order to advise Members of the appropriate timing of a further strategic option appraisal should this prove necessary; and
- (iii) the proposals for the reform of the Housing Revenue Account and the potential implications of these locally be noted and the draft Sutton response to the consultation, set out in Appendix 2, be approved.

1. Background

- 1.1 The Council last published its Housing Revenue Account (HRA) Business Plan in April 2009. The HRA Business Plan addresses the Council's role as landlord and looks at investment in the housing stock and the future of its management in the medium to long term. In light of subsequent changes to the resource position, particularly regarding the £112.5m of ALMO funding awarded in 2008, and also the proposed reform of the HRA subsidy system (see section 3) the opportunity has

been taken to produce a new and up-to-date Plan. This has been produced in partnership with the Council's arms-length management organisation or 'ALMO' - Sutton Housing Partnership (SHP).

- 1.2 The proposed updated HRA Business Plan is included at Appendix 1, while key elements of the Plan and issues arising are summarised briefly in the next section. It should be noted that there are a number of instances, referred to in highlighted italicised bold type, where factual updates will be provided in the final published version, as these were not available at the time of despatch. Members are also advised that an earlier version of the Plan was the subject of consultation with the Sutton Federation of Tenant and Resident Associations and the Sutton Leaseholders Association.

2. HRA Business Plan -content and issues

- 2.1 The Business Plan begins in chapter 1 by outlining the policy context within which the Council's landlord function operates, at the national, regional and local levels. In relation to the latter, the chapter goes on to describe how the HRA Business Plan contributes to meeting the Council's strategic housing aims and its wider aims and objectives as reflected in the Sutton Plan and other key strategic documents.
- 2.2 Chapter 1 concludes by setting out the overall aim of the Council's landlord role, which is:

"To deliver excellent, cost effective housing management services that improve the quality of life of Sutton's tenants and leaseholders and provide a decent home for all."

- 2.3 This aim is supported by a number of more specific objectives, as follows:

- 1. To bring all homes up to the decency standard and continue to improve and maintain them as an asset for the future*
- 2. To invest in and improve estate grounds and the communal areas of flatted blocks*
- 3. To provide high quality responsive repairs and cyclical maintenance services*
- 4. To provide excellent tenancy management and leaseholder services and create neighbourhoods where people feel safe and want to live*
- 5. To ensure all customers have access to services and that the diverse needs of tenants and leaseholders are fully met*
- 6. To promote and maximise the opportunities for customer involvement with service delivery*

- 2.4 Chapter 2 describes the make up and characteristics of the local authority housing stock, which comprised 6,463 rented units at 1 April 2010, providing a detailed breakdown by type, size and age. It goes on to describe the condition of the stock, beginning with the process that has been gone through to assess dwellings in terms of their future sustainability. The overall investment needs of the stock over the next 30 years is then set out (totalling £422m) and an analysis provided of the current level of non-decency (40%).
- 2.5 Following on from this, the chapter offers a brief description of our tenant and leaseholder customer base, providing demographic information on the two groups derived from recent surveys and SHP's management processes. The chapter concludes with a short assessment of the supply and demand for social housing in

the borough, confirming that the stock is likely to remain in high demand at least into the medium and probably into the longer term.

- 2.6 Chapter 3 briefly describes the structures and mechanisms in place for consulting and involving residents in service delivery. It also sets out the tenant and leaseholder priorities for both major works and day-to-day services that were identified as part of the option appraisal process that led to the setting up of SHP.
- 2.7 The next chapter explains the performance reporting arrangements that were put in place when SHP was established in order to ensure that the Council could properly monitor the service being provided to its tenants and leaseholders. Reference is made to the management agreement between the parties and, as part of this, SHP's annual delivery plans.
- 2.8 Chapter 4 goes on to describe current levels of performance, comparing SHP with previous direct Council management and also with neighbouring boroughs and other London ALMO authorities on certain key indicators. It also considers SHP's service improvement plans, specific performance in other areas such as repairs and maintenance, customer satisfaction and recent reviews of service. Finally, this chapter looks briefly at future performance and targets.
- 2.9 Chapter 5 describes the resources, both capital and revenue, that are available to fund the Council's landlord function. The former include the Major Repairs Allowance, paid annually as part of the HRA subsidy settlement, and assumed levels of supported borrowing and our ALMO funding award. The current revenue position is also described, with the approved HRA estimates for 2010/11 included in an appendix to the Plan.
- 2.10 This chapter goes on to describe the resourcing position in the longer term and introduces the 30 year HRA Business Plan model. The model shows the relationship between income and expenditure over the 30 year life of the Plan, and separate capital and revenue summary sheets for this are produced as appendices. A brief description of the key results of the modelling is then set out, including the resultant funding gap when capital resources are set against the investment requirement. This chapter also looks at the alternative resourcing position in the event that the proposed national reform of the HRA goes ahead.
- 2.11 Chapter 6 begins with a brief summary of the current HRA capital programme before considering the issue of future investment. The analysis brings together the resources anticipated to be available (including our full ALMO funding award) and the overall required levels of investment, both in terms of meeting the decent homes standard in the medium term (by 2014/15) and over the 30 year period of the Business Plan. From this we have identified a capital funding gap amounting to £25.2m over the next five years, with this rising to £111.3m over the 30 year life of the Plan.
- 2.12 Given this position, the chapter goes on to put forward an outline investment programme of major works covering the five year period from 2010/11 to 2014/15, based on anticipated levels of funding. As described in the commentary, this falls some way short of the full investment requirement, and although it may be technically possible for all homes to be brought up to the decent homes standard at the end of the five year period, it would not be possible to undertake all decency-related works to all dwellings, which was the basis for the Council's bid for ALMO funding. Many other works would also not be carried out, in particular those related to the communal parts of blocks and estate environmental improvements.

- 2.13 This chapter also looks at the alternative investment position in the event that the proposed reform of the HRA goes ahead. It is clear from the analysis that, should 'self-financing' be introduced on the basis of the current assumptions, then the HRA financial position changes completely. Not only are there sufficient capital resources to meet all the investment required, but over time a very significant positive balance arises on the revenue account. It should be remembered, however, that the proposed basis of the debt settlement is predicated on authorities using the additional revenue generated by the "generous" proposed discount rate of 7% to support the provision of council new build (see section 3).
- 2.14 The chapter concludes by looking at regeneration in terms of previous and current projects and the potential for further redevelopment of elements of the stock in the future.
- 2.15 Chapter 7 covers the planning and delivery of day-to-day landlord services, and sets out in some detail efficiencies that have been and will be made through our ongoing work with SHP. The chapter concludes with a discussion on HRA revenue estimate projections in the medium term and considers the implications of these for service delivery, also looking at the alternative scenario in the event that the proposed reform of the HRA goes ahead.
- 2.16 Chapter 8, as by way of a conclusion, assesses the overall HRA position, in both capital and revenue terms, and looks briefly at the strategic options available for addressing the problems we face. It is clear that, without the HRA reforms going ahead, there will continue to be considerable pressures on the HRA as far as our ability to deliver day-to-day (revenue) services are concerned. Despite the proposals to reform the HRA subsidy system, the outcome of this is by no means certain, and the Council could well continue long into the future paying substantial sums back to central Government by way of negative subsidy.
- 2.17 As mentioned above, should the proposed reform of the HRA not go ahead, the projected funding gap in terms of capital investment is considerable, even with the full ALMO funding award coming on stream. Moreover it calls into question the ability of the Authority to properly maintain its housing assets in the longer term. In light of this, and given the uncertain and shifting national economic and policy context, officers feel there may be a need to keep the alternative strategic options for the future of the Council's landlord function under review.

3. Proposed Reform of the Housing Revenue Account

- 3.1 For a number of years there has been considerable criticism, both within the housing profession and amongst tenant groups, of the Housing Revenue Account (HRA) system of funding council housing management and maintenance. This has resulted in a national tenant-led campaign to change the system, and in particular address the perceived unfairness whereby the large majority of housing authorities now pay significant sums of rental income in the form of 'negative subsidy' into a national redistributive pool.
- 3.2 Under the HRA subsidy system, which effectively operates as a single national account, the Government is able to re-direct what it calculates to be excess resources in certain areas of the country to help subsidise the lack of resources in others. In short, authorities may either receive subsidy, where their costs are deemed to exceed their income, or they may be required to make a payment to the Exchequer ('negative subsidy') where their income is deemed to exceed their costs. Sutton has been in negative subsidy for a number of years, with its anticipated

payment to Government in 2010/11 amounting to £9.2m, this set against an estimated total rental income of £27.6m.

- 3.3 The previous government had recognised the issue, and in 2008 announced its intention to reform the system. It conducted an initial consultation exercise in 2009 in which one option proposed was to completely dismantle the current system and allow each individual authority to become 'self-financing' (i.e. where they would keep all their income and not receive or pay any further subsidy amounts). However, the price to be paid for this would be that collectively councils would need to take on the national HRA debt, presently estimated to amount to £25.1bn. The proportion of this debt to be allocated to each authority would depend on its ability to service it.
- 3.4 Having considered the many responses to this initial exercise, the Government issued a further consultation document (referred to as a "prospectus") in March 2010 - *Council housing: a real future* - which, together with an accompanying financial analysis, set out the option of self-financing in more detail including the likely level of debt that each authority would be expected to take on.
- 3.5 With the subsequent change of government in May, there was some initial uncertainty about whether the reforms would continue to be pursued. However, the Housing Minister has recently announced that he does intend to continue with the reform proposals and will be proceeding with the current consultation exercise. The closing date for submissions is 6th July, and so there will be the opportunity to take into account the views of Members at the meeting of The Executive before our proposed response (see below) is finalised and dispatched.
- 3.6 The key proposals of the latest consultation paper can be summarised as follows:
 - The replacement of the current HRA subsidy system with a system of self-financing where authorities would keep all their income and not receive or pay any further subsidy amounts
 - Housing authorities collectively to take on the national HRA debt, the proportion of this allocated to each negative subsidy authority depending on its ability to service it; authorities receiving subsidy would receive a one-off payment to compensate them for loss of subsidy
 - The calculation of the debt to be based on the tenanted market value or 'TMV' methodology using a 7% discount rate rather than the usual rate of 6.5% used for stock transfer valuations. This is in order to reduce the debt amounts to be applied and thus allow "headroom" for authorities to fund council new build (the paper suggests that this reduction in discount rate should allow authorities to produce 10,000 new homes p.a. from the end of this parliament)
 - The settlement calculation to also take into account significant uplifts to the management, maintenance and major repairs allowances, which form part of the current subsidy system, these uplifts having the effect of reducing the level of apportioned debt.
 - For each individual authority, their future HRA borrowing to be limited to the level of their initial debt settlement
 - The HRA ring fence to be maintained, with greater clarity around what costs can be charged to it
 - Rents to continue to be subject to the current restructuring arrangements, with subsequent national policy on rent levels directed by the Tenant Services Authority (TSA)

- Tenant service charges to be excluded from the self-financing valuation, with levels continuing to be set in accordance with national policy
- A recognition that around £3.2bn is still needed to meet the decent homes target and confirmation that funding will be provided to authorities for them to fulfill their decent homes programmes
- Authorities to be allowed to keep 100% of Right-to-Buy receipts, with 75% to be applied to housing and discretion on the use of the remaining 25%
- Stock transfer valuations in future to be based on the self-financing debt settlement and no further government support to assist with the clearance of debt or gap funding
- An intention to work towards voluntary implementation of self-financing from 2011/12 or, should this not prove possible, implementation from 2012/13 through primary legislation

3.7 In order to help formulate our response to the proposals, Tribal Consulting have been commissioned by the Council to carry out an assessment of the implications of the self-financing proposals locally. This follows on from a previous report on the initial consultation paper that they produced in September of last year. Tribal's latest report is available from the Executive Head of Community Living. Their paper was also the subject of a seminar given by the consultants for officers and Members in early June.

3.8 The key points arising from the Tribal analysis are as follows:

- Under the self-financing proposals Sutton would be required to take on £141m of additional debt, which when added to its notional debt within the subsidy system of £18m would bring its total assumed debt to £159m. Our HRA borrowing would be limited to this ceiling. However, the Council's actual HRA debt is only £1m and so with the additional £141m its actual level of HRA debt under self-financing would be £142m, leaving headroom for borrowing up to a further £17m (£159m - £142m).
- The consultation's proposed uplifts in management and maintenance allowances and the major repairs allowance, when combined, amount to an increase of 14%, one of the highest of any authority nationally.
- A 6.5% discount rate would have resulted in an assumed debt level of £167m as opposed to the level of £159m with a 7% rate. The difference (£8m) is the amount that the Government expects the Authority would have as headroom to fund council new build. However, as borrowing would be limited at the £159m ceiling, all things being equal the Council would need to deploy the revenue benefits of the lower debt settlement. Tribal calculate that these would be sufficient to provide for a new build programme of some 150 - 180 units over the next 30 years (5 - 6 p.a.). They also comment that the presumption in the consultation paper that self-financing at the 7% discount rate would in due course allow local authorities to build some 10,000 new homes per annum is very optimistic.
- As the national level of debt proposed to be allocated (£25.1bn) exceeds the actual level of debt known to be within the system (£21.5bn) by £3.6bn, and given the statements within the consultation paper on the Government's commitment to complete the decent homes programme, there is an

implication that the £3.2bn required to fund this would be made available via capital grants (paid outside of the debt settlement).

- On the basis of self-financing being introduced next year and the debt settlement calculated at the 7% discount rate, and assuming that our ALMO funding award is met in full, then the modelling undertaken by Tribal suggests that there would be sufficient resources to meet all capital investment needs, while at the same time a very significant balance would accrue on the revenue account, reaching £275.6m by year 30. An initial funding gap does arise in year 1, but this can be overcome by year 6 with the use of revenue balances as these accrue.
- Tribal have also looked at a number of other scenarios by applying certain sensitivity tests to their modelling (e.g. making different assumptions about inflation, interest rates etc). In all cases a significant balance accrues on the revenue account by year 30 and, assuming our ALMO funding award is met in full, there are sufficient resources to meet all capital investment needs between now and then. These are explained in detail in their report and also considered within the draft HRA Business Plan.
- Certain of the Tribal sensitivities consider lower amounts of ALMO funding coming forward (75%, 30% and 0% of the outstanding award). These inevitably lead to corresponding investment funding gaps, which over the 30 year period can be compensated for to varying degrees by the use of revenue balances but in the short to medium term will have serious consequences in terms of stock investment, both in relation to the decent homes standard and other required works. It should also be noted that a reduction in the amount of our ALMO funding award coming on stream could happen regardless of whether self-financing is introduced.
- Finally, the analysis considers the position regarding stock transfer. The paper is clear that after introduction of the reforms valuations would be based on the self-financing settlement value, and there would be no further government support for over-hanging debt or gap funding (where the valuation is negative). The Tribal analysis re-presents the previous Sutton transfer valuation calculation from last year although this was based on previous business plan data. It also considers the actual stock transfer receipt that the Council might expect depending on whether or not the Government were to seek to protect the overall self-financing financial position - showing how such an approach could reduce what could be a net receipt of £17m to a cost to the Council of £136m. They further anticipate that the position post self-financing would be much the same.

3.9 It is clear from the consultation paper and Tribal's analysis of its implications that self-financing would be a much better option for Sutton than the continuation of the current system. Accordingly, our draft response, set out in Appendix 2, makes it clear from the outset that the Council supports the proposals in principle. However, there are also a number of concerns that we have raised. These include how the proposed LB Sutton opening debt figure is calculated, the amount of uplift in the allowances, the limitations on future HRA borrowing and some accounting issues around debt management.

3.10 We also raise some concerns around the future funding of specific activities such as adaptations and fire safety works and how self-financing effectively transfers risk from central to local government on a 'once-and-for-all' basis without any proposed

'safety nets' should new spending pressures come along. Above all, our response stresses the importance of our ALMO funding award being met in full.

4. Financial Implications

- 4.1 The financial implications in relation to the HRA Business Plan are set out in paragraphs 2.9 to 2.16 above and also in the Business Plan itself, in particular Chapters 5, 6, 7 and 8. Essentially, under the current HRA financial regime, the revenue position will become increasingly tight and the level of cost reductions required to maintain the HRA in balance will put even minimum standards of service at risk. Similarly on the capital side the Council's ability to maintain its housing assets will be threatened, with a capital funding deficit of over £111m over the period of the plan. The proposed reform of the HRA may result in a more sustainable position, but in the absence of this, alternative strategic options will need to be considered.
- 4.2 In relation to the HRA reform proposals, Tribal Consulting have undertaken a detailed analysis of the proposals and what they would mean for Sutton. This report also examines the effects on Sutton if the assumptions made change - for example, a change in the predicted rate of inflation.
- 4.3 The proposals have been compared with the Council's current 30-year business plan for the HRA, and a separate model has been produced to cover the same period under self-financing.
- 4.4 Under the proposals Sutton would be expected to take on redistributed debt of £141m, in return for this debt Sutton would no longer have to pay negative subsidy into the national pool.
- 4.5 The analysis shows that if we carry on with the existing subsidy system there would need to be significant savings made within the HRA in order to sustain the minimum working balance on the account (£824k in 2010/11 rising to £1.6m in 2039/40). Under self-financing, a revenue surplus of £23.9m is estimated at the end of the first 5 years and £275.6m by the end of the 30-year period.
- 4.6 We currently pay £9.4m of negative housing subsidy; this is estimated to increase to £28m by the end of the 30-year business plan. Under self-financing we would pay an estimated £7.3m in interest charges on the redistributed debt, this interest charge would remain consistent over the 30 years, the difference in not paying negative subsidy against the increased interest being paid would increase over the period allowing large surpluses to build up within the HRA.
- 4.7 The Council has not received the full allocation of decent homes funding; an amount of £107.5m is still outstanding. The self-financing proposals imply that any outstanding allocations will be paid by capital grant. There is a risk that this funding will not be received but there is also a risk that it will not be received under the current subsidy system due to the current national financial position.
- 4.8 The intention of the reform proposals is that they will have no impact on the general fund, but there are a number of risks to the general fund in the proposals. In particular, under the present rules for calculating the interest charge to the HRA ("Item 8"), the first year charge (ie for 2011/12 if implementation was on 1 April 2011) would be only half of the estimated £7.3m cost. The balance of £3.65m would be a charge to the General Fund in that year. The response to the consultation document seeks clarification on how this would be managed.
- 4.9 Furthermore the proposals do not make clear whether capital grants for adaptations and safety works will continue as separate funding streams. In the absence of these we would have to divert funds from other HRA priorities and, in respect of works to

private sector and Housing Association stock there would be an additional pressure on Council capital resources and programmes would have to be scaled back or withdrawn. Our response also seeks clarity on this point, although these grants must be vulnerable whether or not the self-financing proposals go ahead.

5. Influence of the Council's Core Values

- 5.1 The direction, strategic aims and supporting objectives of the new HRA business plan reflect the Council's vision and core values in terms of working in partnership, making services open and accessible, seeking innovative approaches to delivering better, more cost-effective services and promoting diversity.

6. Council's Priorities –The Sutton Plan 2009/10 to 2011/12

- 6.1 Sutton's new HRA business plan reflects and addresses action required to implement specifically priority 9 of the Sutton Plan but it also more indirectly supports a number other priorities.

7. Equality Impact Assessment

- 7.1 An equalities impact assessment of the new HRA business plan is set out in Appendix 3.

8. Background Papers

Council housing: a real future, CLG (March 2010)

Self Financing Update, Tribal (10 June 2010)

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