Appendix 2

Response to CLG on Self –Financing Determination

The Housing Revenue Account Self-financing Determinations
Consultation Response from Northampton Borough Council

1 General

1.1 Northampton Borough Council welcomes the opportunities and the real ability to properly forward plan that the self financing determinations afford.

2 The Settlement Payments Determination 2012

2.1 The recent self financing valuation increased the payment that this Council will have to make to £194.2m from the £179m in the original proposals; this is equivalent to a level of debt per property of £17,269, compared to £15,880, an increase of nearly 9%.

2.2 This will lead to additional pressures on our HRA business plan which will last for the 30 years of the plan. The primary reason for the increase in the buy-out payment is the use of the same methodology that that rent has been calculated in the subsidy system historically for the buy-out calculation. Whereas it can be understood that the Government wishes to protect its own financial position, *this Council believes that the impact is unequitable*. One of the primary reasons that the HRA subsidy system is being dismantled is because it was removing funds from the national housing stock. Implementing a rise like this exacerbates that situation and impacts on HRAs into the long term.

2.3 In the Government document "Laying the Foundations: A Housing Strategy for England", Chapter 3 paragraph 55, it says "Once self-financing is in place, voluntary transfer of the stock remains an option. The Government will actively encourage voluntary transfers that offer good value for money and can leverage additional investment. We will bring forward proposals for a programme of transfers, clarifying the level of financial support (through writing off housing debt) and the criteria to be applied in prioritising such support. The Government is particularly interested in exploring the scope for transfers that deliver a robust, long-term sustainable future for estates and neighbourhoods." In order to make stock transfer viable for authorities that have taken on substantial debt, the Council would urge the Government to also make provision for writing off any debt redemption premia.

2.4 The national rent rise is calculated using RPI + 1/2 %, based on RPI in September of 5.6%. This indicates a national rent rise of 6.1%. The likely impact after applying the Government's rent restructuring policy is that rents will rise in the region of 7% on average. Initial views of tenants at a recent Tenant's Forum in Northampton indicated strong dissatisfaction with this.

2.5 Any future changes to legislation or regulations deviating from those assumed to apply within the settlement calculation assumptions will not have been reflected in the calculation and so this remains a risk for the Council.

2.6 An example of this is the proposed changes to the Right to Buy regulations. HRA business plans are reliant on the rental stream created by renting out property. Reductions in the number of properties held has an adverse impact on these business plans and any sale proceeds from these properties that are retained by the authority must be used to repay the debt related to that property in order to maintain viability into the long term. As stated above, the base level of debt relating to each property will be £17,269. The Council understands that changes to the Right to Buy regulations will be the subject of a future consultation and that Government have indicated that impacts on Councils will be mitigated, however this still remains a concern to the Council in the context of a self financing HRA.

3 Limits on Indebtedness Determination

3.1 This determination relates to the so-called debt cap. This is a limit on the amount of housing debt that each local housing authority can hold. This determination defines the formula by which this will be calculated.

3.2 The Limit on Indebtedness for Northampton Borough Council is £209.7m. This therefore gives the Council debt headroom of £15.5m at 1st April 2012.

3.3 The proposals within the consultation do not include any increase in the Limit on Indebtedness for inflation. It would therefore be fixed at this level for the 30 years of business plan unless other regulations are passed. In order to achieve an increased supply of social housing, a stated aim of the self-financing regime, and continue to maintain council houses and estates, the Council believes that if there is to be a limit on indebtedness, an inflationary factor should be applied to it.

3.4 Councils have demonstrated, through the successful operation of the prudential system, that debt can be successfully managed by ensuring that future resources are available to repay the debt and that debt is not taken out without the means to repay. The Council believes that there should not be a limit on indebtedness and that removing this requirement would be true to the spirit of the localism agenda.

4 Housing Revenue Account Subsidy (Amendment) Determination 2011-2012

4.1 This determination is amended to allow for a payment of interest, within the subsidy calculations for 2011/12, for the period 28th March 2012 and 31st March 2012. This is because the settlement payment is due to be paid to CLG on 28th March but self financing only starts on 1st April 2012.

4.2 This payment of additional subsidy is welcomed in principle.

4.3 However one issue with this arrangement is that PWLB are only making special rates for the purpose of taking out debt to make the self financing payments available on 26th March 2012. If the money were to be paid to the Council from PWLB on that date, it would therefore mean that the General Fund could be charged with up to two days interest on the loan. At a 4% interest rate, this could cost this Council's General Fund in the region of £40k. If this is the case, w*e would urge consideration to be given to ensuring that* *the whole period of 26th March to 31st March is covered by the Amendment Determination.*

4.4 At a Sector briefing on 16th December, a CLG official stated that the date of 26th March was only to reserve the funds from PWLB and that they would be paid over on the 28th March. This therefore would avoid the issue described in 4.3, however it causes another problem which is described below.

4.5 The Settlement Payments Determination states at paragraph 3.2 that the settlement payment "must be made as cleared funds via electronic banking transfers on or before 28 March 2012".

4.6 The timing of these two events means that the Council cannot guarantee payment on the due date previously announced by CLG. This is because of the electronic banking process:

- The Council cannot make the CHAPS/priority payment to CLG until it has received the monies into its account.
- There are cut off points for same-day CHAPS transfers (3.30pm for our HSBC bank account).
- Electronic banking cannot guarantee the timing of the receipt into the recipients bank account for such transfers and as such the Council may not have the funds available for transfer to CLG on the due date through no fault of its own.

4.7 The only way to be sure that funds are received and paid in time will be for either:

a) The Council to receive the funds from PWLB on 27th March, and make payment to CLG on 28th March, or

b) PWLB to make a direct payment to CLG on 28th March.

4.8 Additionally, *the Council would like assurances that the PWLB will be able to manage the number of transactions that they will potentially have to process on one day.*

5 Item 8 Credit and Debit (General) Determination 2011-2012 Amending Determination [2012]

5.1 This determination is amended to allow for interest to be charged to the Housing Revenue account for the period between the payment being made to the CLG (nominally 28th March 2012) and 31st March 2012. These date restrictions, combined with the restrictions in the Housing Revenue Account Subsidy (Amendment) Determination 2011-2012 above, lead to the potential for costs being borne by the General Fund as indicated.

5.2 In addition to this, *the Council believes that local authorities should be given the freedom to take out debt to make the debt payment at a time that they consider to be most financially beneficial. Therefore this determination should be amended to allow the HRA to be charged with the costs of taking out debt early to gain advantageous interest rates.*

6 Item 8 Credit and Item 8 Debit (General) Determination from April 2012

6.1 This determination leaves the basis of the capital charges to the HRA largely unchanged for the first four years of the self financing regime. Thereafter it will mean that the HRA will be charged with "real depreciation", calculated using a component approach, and impairment.

6.2 Depreciation

A component approach to asset accounting means that each asset is broken down into a number of components. This approach currently applies to local authorities since the adoption of International Financial Reporting Standards, although local authorities only have to identify "significant" components. Northampton, along with many other authorities, has limited the identification of components; in the case of the housing stock this is limited to two components – land and buildings. The reason for this is that there is no added value to componentisation; it increases the work of finance substantially to add more components and if many components were added to the housing stock this could cause significant resource issues at a time when the Council is seeking to reduce costs and increase efficiency.

The implication in the draft determination is that there would be expected to be more components relating to housing stock – resulting in the staffing resource issues indicated above – which would be likely to mean higher charges being made to the Housing Revenue Account. If this is combined with "real depreciation" i.e. not reversing out the charge, this could result in higher charges to the HRA where they are not needed to support the capital programme. This therefore limits the flexibility to manage the finances of the HRA.

6.3 The Council understands that componentisation would tend to ensure that funding for replacements would be available, however because of the freedoms to use MRA on items other than those components specifically, this will not necessarily be the case without good financial management.

6.4 The effect of componentisation is that each component would need to be revalued. At a time when authorities are seeking efficiencies, this leads to additional work and burden on authorities. Whereas it is accepted that componentisation would increase the depreciation levels because of the age of different elements, Councils would have to fund replacements anyway and the contribution from revenue would vary. This will limit flexibility of the HRA to deal with short-term revenue pressures in one year and then funding capital in a subsequent year.

6.5 The required end result could be achieved through ensuring robust asset management strategies are in place, backed up by sound business plans. A requirement to keep and maintain these could be included as an audit requirement for HRAs.

6.6 Impairment

A more critical situation could occur in the case of impairment. Impairment is where the value of assets are reduced from the value of the assets held in the balance sheet and, in this context, includes reductions in house prices because of the overall market position. The potential impact of this is as follows:

- When house prices rise, the increase in valuation is held in the revaluation reserve
- The revaluation reserve balance currently is negligible following the reductions in house prices over the past few years
- Where house prices reduce (known as impairment), this must be charged to the revaluation reserve up to the value of revaluation balances
- Any impairment over the amount held in the revaluation reserve must be charged to revenue

6.7 For the initial transition period, this charge to revenue can be reversed, however after that point it becomes a real cost to the HRA. This could easily have the effect that a HRA goes into deficit for this reason alone, and not through any financial mis-management.

6.8 There appears to be an assumption of upward valuations before any impairment is made. Economic forecasts do not indicate that this will be the case and indeed the Chancellor in his autumn statement indicated a 1 in 3 chance of recession in 2012. Currently there are only very small balances on the revaluation reserve. Significant house price inflation would be necessary to gain a financial buffer against the risks posed by real impairment and there is currently no indication that this will occur before the transition period is over. Part of the issue is the starting point for the balances in the revaluation reserve; the reserve was set up in 2007/08 at a nil balance because of the general lack of historic records to identify the true level of revaluations. There has therefore been little opportunity to build up proper levels of revaluation reserve balances.

6.9 To put this in context for Northampton, impairment charged to revenue for 2008/09 was £57m and in 2010/11 it was £151.5m

6.10 The implementation of “Real Impairment” and “Real Depreciation” therefore pose significant financial risk to the self financing HRA depending on what happens to house prices in the market.