CABINET

21st September 2011

REPORT OF THE PORTFOLIO HOLDER QUALITY OF LIFE

COUNCIL HOUSING FINANCE REFORM

EXEMPT INFORMATION
None

PURPOSE

- To update Cabinet regarding the implementation of Council Housing Finance Reform (CHFR)
- To agree a waiver to financial guidance in the retention of the services of Sector Group to provide advice and support in the development of the Council's Treasury Management Strategy
- To agree key principles in relation to the development of the Council's 30 year business plan as set out in this report
- To approve the implementation plan shown at **Appendix Four**

RECOMMENDATIONS

- That Cabinet agree a waiver to financial guidance in the retention of the services of Sector Group to provide advice and support in the development of the Council's Treasury Management Strategy
- That Cabinet agree the key principals which will guide the development of the Council's 30 year business plan as set out in this report
- That Cabinet agree the implementation plan shown at **Appendix Four**

RESOURCE IMPLICATIONS
The proposal received by Sector Group to support the development of Treasury Management Strategy has a cost of £6k. This can be met from within existing HRA resources.

The implementation of HRA reform will involve the Council's borrowing liability relating to the HRA rising to a minimum of £66.6m with the potential for this figure to increase to £78.4m. The current settlement figure payable to the Government by 28th March 2012 is £43.7m for which additional borrowing will need to be sourced. It is essential that the Council receives detailed and expert advice in developing its Treasury Management strategy for the HRA. Relatively small benefits in relation to interest on borrowing will have significant financial impact whilst the advantages of improved interest rates must be set against any associated risks. The cost of employing Sector Group to provide advice and reassurance therefore represents Value for Money. This decision represents a waiver to Financial Guidance.

Council Housing Finance Reform is a major project and the commitment of human resources to achieve a successful implication cannot not be underestimated.

The proposal to commence a stock condition survey making use of temporary staffing resources will result in expenditure during the current financial year 2011/2012. A total of £41K (£20.5 reserve and £20.5K budget) is already allocated for the purpose of completing a stock condition survey. Expenditure will be met from within this budget.

An updated longer term business plan for the HRA will be developed (as well as one for the usual medium term planning period) and reported to Members as part of the budget process for 2012/13

LEGAL/RISK IMPLICATIONS BACKGROUND
Please see risk assessment attached.

SUSTAINABILITY IMPLICATIONS
CHFR has the potential to provide substantial investment in the Council's Housing asset and local neighbourhoods. An effective, balanced business plan will provide the framework for good maintenance and improvement of Council homes, finance for environmental works to improve neighbourhoods, improvements in energy efficiency and the potential for renewal of poor housing.

The implementation of a self financing system provides the Council with greater ability to plan and predict future resources and to make informed investment decisions over the long term.

CONCLUSIONS
CHFR represents a major undertaking for the Council and has significant risks.

The Council, Council tenants and Tamworth residents stand to benefit from the implementation of CHFR through increased investment the housing stock and environment, potential for renewal in neighbourhoods and improved services. In addition the Council will benefit from increased certainty in relation to future funding. This certainty must be balanced against the fact that the Council has no external safety net in relation to HRA funding.

BACKGROUND INFORMATION

Background

On 30 June 2010 members received a report outlining the basis of Government proposals to reform the current system of financing for Council housing. An outline 'offer' was issued in April 2011 providing Councils with an opportunity to consider the impact of reform on their own financial plans. The financial settlement remains in draft until a final determination is issued to Council's in February 2012.

Guidance has been issued by CLG on the 30th July 2011 detailing further the issues for consideration by Local Authorities in implementing CHFR and setting out the timetable for implementation. This guidance is attached at **Appendix One**. In light of this guidance Local Authorities are now fully informed as to the timetable for implementation and the requirements of Government in relation to these plans.

In preparation for the implementation of reform the Council has engaged financial consultants to support the development of an HRA Business Plan which will be supported by a long term financial plan. Initial financial modelling has been undertaken and key issues for the Council have been identified. A briefing provided by the Council's financial consultant is attached at **Appendix Two**.

The Government intends to legislate for the implementation of CHFR via the Localism Bill. Government clearly view the reforms as closely linked to the principals of localism and as such has been clear that it expects Council's to ensure that tenants are directly involved in developing the business plans and investment decisions made as a result of CHFR. Reform is not optional and is set to take place in accordance with the timescale set out by Government.

Outcome of the initial Financial Modelling

A briefing by the Council's financial consultants is shown at **Appendix Two**. This provides an outcome of the initial financial modelling based on the draft settlement figures provided by

Government.

The principal details of the current offer are that:

- The Council's debt ceiling is £78.4m
- The Council currently has a HRA debt liability of £22.9m
- The amount which the Council will be required to pay to Government under the settlement is £43.7m (equating to a £66.6m total HRA debt liability)
- The Council will therefore effectively be taking on an additional 43.7m of debt
- The difference between the amount which the Council will pay to the Government (the opening debt) and the debt ceiling of £78.4m is £11.8m. This figure is therefore potentially available as additional borrowing (ie- borrowing headroom).

Based on the current figures and assumptions made within the modelling the Council has a fully funded HRA for 30 years with the possibility of significant surpluses accumulating over this period. The Council has the opportunity to borrow an extra £11.8m over and above what will be required to be paid to central government. This provides an opportunity for the Council to borrow against future income in order to deliver its housing priorities.

Under the current subsidy system the Council had identified a funding shortfall of £1.3m occurring by 2016/17 (with an £8.1m shortfall over 10 years). The implementation of CHFR will therefore have a positive impact in relation to the Council's housing financial position. However it should be noted that the forecasts are based on the current draft settlement figures. As identified in **Appendix 2** these figures are likely to be subject to change. It is therefore possible that the position could worsen once a final settlement is reached.

In addition the initial modelling has been based on a number of assumptions and work will now be required to develop and refine the data. Key strategic decisions remain which will also impact on the shape of the Council's Business Plan and will inform the financial modelling going forward. These issues are considered below:

Key Issues

In implementing Council Housing Finance Reform there are a several linked work streams which must be delivered. These issues are itemised and considered separately below.

1. **Developing a long term financial plan for the HRA and supporting business plan**

   Following the implementation of Council Housing Finance Reform the Council will have greater autonomy for and certainty over its finances. However, the Council will also be entirely responsible for the management of its resources over the long term. Decisions relating to use of resources will therefore be supported by a 30 year financial forecast and HRA Business Plan.

   The Business Plan will detail the Council's vision and plans for the Council housing stock including setting out how it will invest in the stock, how services will be developed and improved and how tenants will be actively involved in decisions relating to the management and maintenance of their homes. The business plan will set the priorities which will drive the allocation of the available funding and set the parameters which the treasury management strategy will follow.

   Broadly the business plan must balance the relative priority of the following areas:

   - **Investment in the housing stock**

     The Council has a responsibility to ensure that the housing stock is maintained and that components are renewed or replaced when required. The basic requirement for investment in the stock is driven by the Government Decent Homes Standard. However this is a basic and limited standard which does not match the expectations or the needs of tenants and does not address wider stock maintenance and investment issues. The Council will need to consult with tenants to establish the investment priorities for the stock and to develop a standard for investment which meets the needs and expectations of tenants.

Currently the outline financial modelling has been based on the investment requirements identified with in the last stock condition survey undertaken by the Council. Since this time the Council has made significant value for money savings and has also been forced to reduce its investment in the housing stock due to financial constraints. In particular the Council has been unable to make any meaningful investment into the environment surrounding Council homes. The Council will need to review these investment decisions in the light of CHFR.

In addition, to support ongoing stock investment decisions, the Council will need to update stock condition information and, over time develop a detailed asset management strategy for the housing stock. In the past the Council has undertaken stock condition surveys on the basis of a 10% sample of properties by archetype. This sample data is then cloned through the stock to provide an indication of investment needs. Whilst this supports broad investment planning decisions this approach has some drawbacks. Firstly, the use of cloned data means that there is a margin of error in relation to individual property investment needs. Secondly CLG have indicated that in the future it will expect Council's to allow for depreciation based on individual property components. It will be beneficial for the Council to gain a more complete record of properties than can be achieved through a small sample of properties.

It is suggested that to ensure that the Council is able to gain a more complete picture of the condition of the stock an increased proportion of the housing stock is subject to survey. It is therefore intended to achieve a survey of a minimum of 80% of the housing stock over the next 12 months. This data will be used to inform a comprehensive asset management strategy.

- **Delivering and Improving services**

  The Business Plan will set out the Council's priorities and plans for the delivery and continuous improvement of services to tenants. A comprehensive Landlord Services Improvement plan already exists and this will be reviewed and revised with tenants to form the basis of the Business Plan.

  The Business Plan will show how services will be delivered to reflect the priorities and needs of tenants and how delivery of these services helps in meeting corporate priorities.

- **Investing in housing renewal**

  In June 2011 Cabinet approved the Local Investment Plan which set out ambitions for new affordable housing development and housing renewal within the borough.

  To support the delivery of the ambitions laid out in the plan Cabinet requested that feasibility studies be undertaken to review the potential for housing renewal to be undertaken. If these ambitions were achieved this would achieve a number of key objectives including dealing with stock investment issues and making a major contribution to the Council's wider aims and priorities.

  The potential for housing renewal to deliver new Council Housing is currently being explored. However, for this ambition to be realised it will be necessary for the Council to make provision in its financial plan to support these aims. If the Council's ambitions for redevelopment of some stock are realised then this will lead to a loss in Council housing numbers overall. This will impact on the future viability of the HRA Business Plan. It will therefore be important if these ambitions are to be realised for the Council to make allowance within its Business Plan and financial strategy for investment to re-provide Council owned housing.

The HRA Business Plan must therefore balance these priorities and allocate available resources accordingly. This will in turn drive the treasury management strategy and guide key financial decisions. It is therefore proposed that the HRA Business Plan is developed in accordance with the following aims:

- To meet and build on the Decent Homes Standard in relation to investment in the Housing Stock
- To invest in the environment surrounding Council homes
- To develop and improve services in accordance with the needs and expectations of tenants
- To provide the opportunity for renewal of neighbourhoods as identified in the Local Investment Plan and the re-provision of Council homes where this supports corporate priorities and the requirements of the HRA business plan

Taking these into account, an updated longer term business plan for the HRA will be developed (as well as one for the usual medium term planning period) and reported to Members as part of the budget process for 2012/13.

2. Developing a Treasury Management Strategy for the HRA

While the Council already approve a Combined Annual Treasury Management Strategy for General Fund & HRA alongside the Budget Setting report in February, to support the aims of the Business Plan the Council will require a Treasury Management Strategy for the HRA. In essence this Strategy will show how the Council will manage its borrowing over the life of the forecast period and involves two entirely different issues.

Firstly on the debt settlement date, the Council will be required to make a payment to CLG which will increase the HCFR. Secondly, during the course of 2012/13, the Council (as it will have a positive HRA CFR on 1st April 2012) will need to consider whether its borrowing (or alternative form of finance) should either:

a) be disaggregated in order to create separate HRA and Non-HRA borrowing pools; or

b) otherwise determine how the HRA should in future be recharged in respect of its share of debt financing costs.

The implementation of CHFR leads to an unprecedented level of borrowing for the Council and it is considered essential that the Council receives expert advice and guidance in relation to these issues. A proposal has been sought from Sector Group who currently provide the Council with advice regarding a number of financial issues. It is proposed that the Council appoint Sector Group at this time to advise on the development of a Treasury Management Strategy and to support decisions regarding borrowing. This represents a waiver to financial guidance as competitive quotes have not been sought for this work. However, this is justified given the expertise of Sector Group in this field, their knowledge of the Council's finances and the need for advice to be provided in a short timescale to enable timely implementation of CHFR. The cost of this appointment can be met from within existing budgets.

Debt Settlement

On the debt settlement date Tamworth Borough Council will, as an authority with an existing borrowing/debt liability, be required to make a payment to CLG (in respect of the allocation of additional HRA debt liability and new borrowing - which we have discretion to decide as to the means of funding).

There will be full access to PWLB, where required. However, LAs are required to notify CLG regarding their likely requirements before 31st January 2012. The other options to raise the funds include market loans (from banks) or bonds – which could potentially offer more competitive rates of interest. An outline of the Bond route is shown at **Appendix Five** to this report.

In view of anticipated changes in interest rate levels by the debt settlement date, the use of advance borrowing may be considered appropriate/prudent. However, under present HRA Determination rules this is likely to cause an increase in the proportion of debt financing costs borne by the General Fund (the cost of carry).

There have been no indications from CLG to facilitate forward borrowing in a manner which allows for this to be accompanied by HRA Item 8 charge increases coupled with associated subsidy cover (all that is perhaps required is for the estimated future amount of debt settlement liability to be treated as part of the adjusted CFR used for CRI purposes). There should be sufficient surplus monies available within the present subsidy process for the government to be able to facilitate this.

For borrowing in advance, the Council would need to ensure the necessary powers to borrow were in place, although this is not envisaged to represent a problem. The Authorised Limit, associated Prudential Indicators and borrowing in advance of need policy would require revision by Council.

Disaggregating
Disaggregating of HRA proportion of existing borrowing and separation of all new borrowing.

It is intended that external borrowing in existence on the debt settlement date should be either separated or otherwise accounted for in a manner which enables the HRA to be responsible for the cost of that borrowing thereafter, and to control how it should be managed. Similarly, all new borrowing after the settlement date should be related to either GF or HRA.

This is considered by CLG to be necessary in order to overcome shortcomings within the present CRI arrangements, which are felt to act as a disincentive to new capital investment in view of adverse financial implications.

CIPFA were requested to provide guidance as to how the process might be applied. It is evident that CLG are prepared to accept that discretion should be given regarding the manner in which this is achieved.

CIPFA Guidance
Provided that this is an accepted approach, it is likely to be possible to arrive at a process which removes the main anomalies or incorrect procedures or assumptions which exist within the present recharge arrangements.

The fundamental principles outlined for disaggregating are that there should be no detriment to General Fund, and that there should be broad equity between HRA and GF. All future new or replacement borrowing should be allocated specifically between GF and HRA, together with any under-funded proportion of debt liability, or internal borrowing, properly identified between GF and the HRA.

CIPFA has identified three different approaches that might be adopted as follows:

(i) Two Pool Option - Long term borrowing within the existing loan portfolio should be physically split between HRA and GF in the case of PWLB loans.

Such splitting would need to take place after the PWLB loans have been top-sliced on the debt settlement date. It is considered that such a physical split would facilitate, for example, rescheduling of the HRA proportion of an existing loan independently of any corresponding decision being considered appropriate in respect of the GF proportion. Although importantly there is no express new facility to charge or credit the HRA with interest arising from penalties or discounts from its pool. This may be implicit to the reforms. In addition the current rescheduling regulations only apply to the General Fund as the Item 8 determinations covered the HRA.

For any short term borrowing or under-funded debt (internal borrowing), they suggest a recharge to the HRA based upon their assessed share of this, and relying on an assumption that this has been facilitated by the availability of largely GF balances and reserves etc. The HRA recharge would be carried out as part of the interest on balances calculation that is made at present.

(ii) Three Pool Option - An alternative would be a three pool approach, under which only new borrowing carried out on or after the debt settlement date would be separated between HRA and GF pools. Existing loans would only form part of these two separate pools once they fall due for repayment, or are prematurely repaid. Separate consideration would be given to the method by which the HRA share is arrived at, and also whether an ongoing recharge should be made on a fixed or variable basis.

(iii) One Pool Option - A third option would be the one pool approach, which would continue to reflect the present type of recharge arrangements, possibly using a continued form of CRI calculation. CIPFA has provided their view on the pros and cons of each of these approaches, and favour option (i), but ***the Council will need to review each option to ensure the most appropriate one is used. A number of modelled approaches will be needed.***

Future Demolition of properties

The settlement from Government will be based on the base data provided by the Council in an audited form by October 2011. A key factor in assessing the Council's settlement figure will be the rental income it can expect to receive from its stock of properties. Government have recognised that this could change over time if Council stock reduces as a result of demolition or disposal. An opportunity has therefore been provided for Council's to exclude properties from the base data where there are well advanced plans in place which will result in overall stock reduction.

In order to make such exclusions the guidance requires that consultation must have been undertaken with the individual tenant and a firm decision to demolish must have been made by the Council. As previously discussed the Council has outlined its ambitions in its Local Investment Plan to test the feasibility of undertaking housing regeneration. However no plans are in place to demolish any property and it is therefore not considered that the Council will be in a position to exclude any property from the base data. Should any future plans result in the demolition of properties and net reduction in the stock then the financial implications of this would form part of the feasibility study and business case informing the decision.

3. **Developing Governance Structures**

Within the attached consultants report the Council is advised that it should establish appropriate governance structures to manage the financial decisions which will affect the HRA in the future. This is for two reasons:

- To establish an auditable process that demonstrates that there is a focus on the needs of the HRA in making decisions

- To ensure that HRA 'ring fencing' is preserved

These structures must be linked to tenant co-regulatory structures and decisions linked to the requirements of tenants. The Council has well developed tenant co-regulatory structures in place and a strong record of involving tenants in decision making. Consultation with tenants regarding CHFR has already begun and tenants views will influence investment and service delivery issues.

Programme for Implementation

The Council has made good progress in its preparation for the transition to the new system and recent Government guidance confirm the approach taken to date. The latest guidance from CLG provides a clear roadmap for Council's in achieving the implementation by 28th March 2012.

A considerable amount of work remains to be completed and an indicative implementation plan is attached at **Appendix Four**. This implementation plan is dependent upon the timely issuing of notifications from CLG.

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LIST OF BACKGROUND PAPERS

APPENDICES
Appendix One: CLG Guidance
Appendix Two: Report of financial consultant
Appendix Three: Risk Assessment
Appendix Four: Implementation Plan
Appendix Five: Bond Example