RESOURCES, REMUNERATION AND REGENERATION COMMITTEE
6 JANUARY 2011

ITEM B3

CONSULTATION ON HOUSING REVENUE ACCOUNT 2011/12

Report of the Director and Company Secretary

1. SUMMARY

The Council is consulting on its proposals for the Housing Revenue Account for 2011/12. The Committee is invited to make comments should it wish to do so.

2. RECOMMENDATION

That the Committee considers a response to the consultation and agrees to recommend to the Board

- support the overall proposals
- the reduction in the management fee by £1m in real terms over the next four years
- request that the cleaning and caretaking services also be brought into being funded directly by service charge income rather than the fee to make the position reflective of the actual situation (on the same basis as for tenancy sustainment and grounds maintenance services)
- to make representations about the value of the Family Intervention Project (FIP) to the Council and suggests that Supporting People funding for this service be maintained and other funding from Children and Young Persons Services be considered
- raise concerns about the potential rise in rent arrears and debts for tenants in future years and the need for the money advice service and Derby Homes to work closely together in the future.

3. MATTER FOR CONSIDERATION

3.1 The Council has set these out in its consultation paper which is attached at Appendix 1.

3.2 The key points are that while rents are increasing by 7.4%, allowances will go up by only 1%. In addition, the Council will no longer benefit from the current Round 1 ALMO bonus of getting 8% interest on its borrowing of £97.1m but will have to claim actual costs of servicing that debt. As this is currently around 4% this means a loss of around £3.9m in subsidy, massively increasing the amount that has to be paid to government from around £1m to around £5m next year. As a consequence of that and the increased capital spending of the last few years, we are likely to face a reduction in reserves from £16.9m at the start of 2010/11 to a balance of under £4m by the end of 2011/12 – ie an ‘overspend’ of £13m over two years. Clearly that is not sustainable but there will in effect have to be a reduction in spending largely on capital in 2012/13 and thereafter, unless other things change. Reserves should be maintained at least at 5% of rents or £2.3m.

3.3 As a result, the next couple of years will be tighter than have been experienced recently, and it is in this context that the Council is requiring a £1m reduction in our fee over the next four years. This is substantial but much less than is being required of other services. The HRA ring fence prevents reductions being applied to the general fund, but their difficulties will have wider implications.

3.4 After 2012/13 the plan as drafted would allow limited additional investment – essentially the £1m saved over the next few years – to be reapplied to service provision as required, or saved up to contribute to future stock needs.

3.5 The funding of some services – Tenancy Sustainment and now Grounds Maintenance – is entirely through service charge income rather than the management fee. One response to the consultation could be to suggest that this principle is correct and should be rolled out to the other service funded by a specific service charge – that is caretaking and cleaning. This would transfer the existing level of service charge out of the management fee and into direct funding by service charges, in line with the definition of management used by CIPFA. The service charge income for this service is about £56,000.

3.6 This plan is drawn up under the HRA subsidy system, and should the reform result in additional resources there will have to be further reports following consideration of the right balance between immediate and long term investments. If reform goes ahead, it will be crucial that we focus more on the long term needs of the stock as there will be no further investment by the Government and we would be expected to live within the rents we receive – in other words act in a manner similar to an RSL – at least in planning terms - albeit within the Council.

3.7 The loss of FIP funding is partially addressed by the suggested funding of this service through Estates Pride, but this funding is starting to run out and cannot sustain the service other than temporarily and on a reduced scale.

3.8 All the above modelling in the consultation is done on the basis of living within the major repairs allowance which we know is inadequate in the longer term by around £3m a year. Overall therefore, there remains a huge shortfall if the current system continues and that has to be addressed through HRA reform in 2012.

3.9 We can expect that an average 7.4% increase in rents, combined with changes in benefit systems is likely to add to rent arrears and debts owed by tenants who pay rent. There will be a need for close working with the Council Money Advice Team and other agencies to publicise debt and welfare benefit advice. This work has already begun.

4. CONSULTATION IMPLICATIONS

The Council is consulting with tenants through the DACP, Derby Homes Board, and the Adults, Health and Housing Commission.

5. FINANCIAL AND BUSINESS PLAN IMPLICATIONS

The immediate reduction in fee of £250,000 next year has already been delivered through the proposed budget plan with some resources going into business transformation to support that process which will need additional investment over the next few years beyond the current level. The second year savings should also be delivered within existing plans, but further work will be necessary to deliver further savings to get to the £1m target in the third and fourth years. In the meantime, the proposals for repairs allow for slightly more than we have currently budgeted, and there may be some scope to support the transformation agenda there in terms of systems support and implementation or fleet restructuring.

6. EQUALITIES IMPACT ASSESSMENT

The outcome of the consultation means that current levels of service can continue for the final year of the subsidy system.

7. RISK IMPLICATIONS

The impact of the budget is fundamental to many risks we face – resources are fundamentally linked to the resources received by the HRA.

8. PERSONNEL IMPLICATIONS

The loss of £1m of fee income will mean that the current target of 40 FTE posts to be lost will have to be fully delivered over the next four years, along with lost staff where other income is lost. The FIP funding loss will mean that temporary employees cannot be re-employed at the end of their contracts, and there are further posts that will need to be lost eventually as funding runs out. In addition, some employees are currently at risk and will need to be redeployed as rapidly as possible to fully funded posts.

The areas listed below have no implications directly arising from this report

- Legal and Confidentiality
- Personnel
- Environmental
- Policy Review

If Board members or others would like to discuss this report ahead of the meeting please contact the author, or the Chief Executive, phil.davies@derbyhomes.org - Tel 01332 888520

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Background Information: None.

Supporting Information: Derby City Council Consultation Document (Appendix 1)

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Consultation Document

Housing Revenue Account Business Plan 2011/12

KEY ISSUES SUMMARY

- Reform of the Housing Revenue Account Subsidy System (HRASS) is due from April 2012. This is expected to be the last year of the current system.

- The details of the new system have not been released at this point (December 2010) and it is therefore difficult to plan for its implementation. It also makes it difficult to commit further capital resources in the short term without understanding if there will be sufficient ability to sustain them in the new system.

- Details of the new system are due early in the new year and the strategy will need to be reconsidered once the implications are assessed.

- The plan here is based on the current system continuing.

- Rents will increase by an average 7.4% next year, but resources will fall in real terms, with only a 1% increase in spending allowances given in the subsidy system.

- Service charges will rise by 5.1% - RPI plus 0.5%. No new service charges are proposed this year.

- It is intended that the balance of management and repairs be changed so that a greater proportion of spending within that limited resource be deployed on repairs.

- As a consequence, there is a need to reduce the Derby Homes management fee by £1m over the next four years in order to redeploy a similar amount on either repairs or capital spending.

- Under the current system, the additional resources for repairs or capital will not be available until 2013/14, and then would need to be reduced after 10 years.

- This level of funding would be inadequate in the medium term and in the longer term the 30 year plan would be around £350m short of the resources required to provide an adequate service to tenants.

- Additional funding from the reform of HRASS might still be possible, but is anticipated to be considerably less than it might have been – until details are released it is difficult to draw firm conclusions however.

- The additional funding within the subsidy system – around £4m a year – that we have been used to since 2002 will cease next year and the Council will need to pay significant sums in negative subsidy as a result. The relative restraint in spending and building up of reserves over the last few years means that this has not had the dramatic affect on services that it might have done otherwise. The Estates Pride programme has in effect been funded by this additional funding and this will now come to an end, although an element of it has still to be committed or delivered.

- Additional funding on a transitional basis is proposed to fund the continuation – albeit on a smaller scale – of the Family Intervention Project for 18 months and to enter a partnership with CYP for youth works in areas of the City not covered by the current Enthusiasm project. If approved this would be available for 2 years.

Consultation Document

Review of HRA financial position 2010/11

1 The aim of the Housing Revenue Account, HRA's, financial strategy for the last six years has been to generate sufficient funding in the short term to allow a relatively smooth transition after the ending of substantial additional funding of over £4m a year. In addition, the strategy involved the maintenance of an Estates Pride fund of £15m for improvements to estates and facilities available for the benefit of tenants.

2 In the last couple of years, considerable effort has gone into attempting to reform or abolish the HRASS. The hope was that such a reform would not only free the Council from the unnecessary complexity of the system, but also enable longer term plans to be more meaningful as control of the critical elements would all be delegated to Councils. The government have announced that the HRASS will now be abolished from 2012/13 following legislation to require all Councils to accept the arrangements. The missing element at the moment is the detail of the proposals which will have to be dealt with fully in next year's report. The details have not been published at the time of writing this report. A verbal update will be given at Cabinet relating to the key points should these be revealed in time. It is expected though that the structure of the settlement will be broadly as indicated previously in the prospectus issued in March 2010, but that the financial elements within that deal will be considerably less generous than that prospectus, enabling much less additional work to be done than might have been anticipated at that point.

3 Over the last couple of years, in addition to the Estates Pride programme, the Council has been able to invest significantly in additional capital spending using a considerable portion of the reserves built up in previous years. In 2009/10, additional spending of £7.3m was approved to be spent on aids and adaptations (£1.5m), additional heating and thermal insulation projects (£5.05m), the refurbishment of Rebecca House (£550k) and other smaller projects. In 2010/11, additional investment of £1.65m was approved for investment in new Council homes, and a further £3m was approved for investment in solar panels, funded in the short term by borrowing with this being paid off over the longer term by the returns from the Feed In Tariff provided by energy companies. Despite some slippage in some of these capital spending plans into next year, the current year's HRA is showing a considerable excess of expenditure over income, expected to be around £6m.

4 The reserves are now anticipated to fall sharply to around £4m by the end of 2011/12. Reserves should be maintained above 5% of rents which would be around £2.3m for 11/12, so there remains only a little scope for further additional investment under the current system. At this stage, however, the terms of the HRA reform remain to be fully clarified, but will require that the Council remains within a debt cap equivalent to the starting level of debt imposed on the Council. This will probably mean that there will be very little scope in the first few years following reform for additional investment, but that after a few years – as rents near the overall target level, the position should improve and become sustainable. The detail of the HRA reform and in particular the debt settlement is essential to understanding this. The details are expected to be released in the early part of 2011.

5 The longer-term position is hugely dependent on the detail of the terms of the HRASS reform. Should the terms be similar to that put forward in the prospectus earlier this year, there would clearly have been some additional resources in time. If the terms worsen significantly as might now be expected, the benefit of the reform would be eroded, but hopefully not entirely eliminated. In addition, reforms to Housing benefit over the next few years may mean that tenants face a more difficult financial position, which may result in greater pressure to restrain rents and potentially higher bad debts in future. For the moment, such concerns are not reflected in these plans.

6 Should the reform detail be as hoped for, the intention is that the Council should be able to increase its projected planned spending on Council homes considerably. The hope is that we would be able to finance the core of the stock condition survey needs over the next thirty years and to enable further investments in estates improvements and ideally some limited rebuilding. There may even be scope to invest further in regeneration projects and other priorities of the Council. The reform rules will need to be set out and the financial impact understood before further investment can be sustained, but it is hoped that – even with a tighter settlement – some of this may still be possible.

7 This year's financial position for the HRA includes the following projected key (under) and over spends:

Rent	(£400k)
Lower Interest rates	(£500k)
Impact of lower interest rates on subsidy	£425k
One off costs relating to repairs	£350k
Overall	(£125k)

£125,000 is about 0.3% of HRA income. In addition, there may be an 'underspend' created by slippage in capital spending – which will need to be earmarked for that planned spending in next year.

Future planning

8 The HRA budget has to be balanced each financial year, and the Council plans for the HRA over a period of thirty years.

9 The proposed HRABP for the next thirty years is set out at Appendix 1. The basis on which these have been produced is on a continuation of the HRASS. The costs indicated for major repairs are based on the current allocation from the government of around £600 a property, which is inadequate in the longer term.

10 If a more realistic investment level of around £1000 a property was to be used, the position becomes unsustainable. The deficit would be of the order of £350m over the plan, and a substantial reworking of the current plan will be necessary. If HRASS reform does not enable a significant level of additional resources over time, the plans will involve reductions in current levels of investment and service.

11 The plan sets out additional spending of around £1m a year after 2013/14, reducing to around half of this after 10 years – which would be all that could be afforded under the current system should it continue. This is of course well below an adequate level.

Previous plan

12 In the previous plan, key assumptions were made about rent levels, capital costs and funding, and housing subsidy levels.

- **Rents**: it was assumed that the government would manage to complete restructuring of rents by 2012/13 as suggested by them last year. This is extremely unlikely, with actual rents remaining on average 10% below target. To achieve 2012/13 for convergence would therefore require 5% a year real terms increases in rents.

- **Capital:** it was assumed that the Estates Pride programme would be contained within the £15m set aside for the programme, and that thereafter costs could be contained within funding levels made available by the government through the Major Repairs Allowance, MRA, albeit supplemented until 2010/11 by £750,000 a year from HRA balances. In addition, further funds were made available for a programme of further additional investment as detailed above.

- **Housing Subsidy:** it was assumed that Management and Maintenance Allowances would continue to increase in real terms by 0.5% a year during rent restructuring.

Review of key assumptions

Rents

13 This year's subsidy determination has set out that nationally guideline rents will increase by 6.8% in 2011/12. Derby's average actual rents are likely to increase by around 7.4%, although there remains an individual tenant limit on rent increases of RPI (4.6%) + 0.5% + £2 a week. A separate consultation is taking place on a proposed increase in rents for 2011/12. The date of convergence has been changed yet again and is now anticipated to be 2015/16, consistent with the proposals for reform. Under the reform it is anticipated that this new date will remain fixed and the major variable in future rent increases will be the level of inflation.

14 The government's proposals for the HRASS have again been drafted for one year only, as the government plans to abolish the system next year.

15 The government's plans effectively require Councils to increase rents to target by 2015/16 – a period of 5 years. As we are currently about 11% below the target rent, the implied rent increase in real terms above inflation is around 2.2% a year. The gap between the current rent and the prospective rent convergence point is going to be difficult to fully close as a result of the limit to individual tenants' rents of RPI + 0.5% + £2 a week. Individual tenants will be at different points on the path to convergence – we have a few that are already at formula rent while many others are a long distance from the target – and will all move at an individual pace to the overall formula rent target. Some will take longer than the target date to reach convergence as a result of the limit to rent increases, which restrain the additional income that can

be raised in any one financial year. Some tenants will not reach the target rent level for 10 years, although a majority should do so by 2015/16. These issues are discussed in the separate paper on rents and service charges.

16 In view of the substantial increase in rents expected this year, it is not proposed to raise significant extra funding from service charges next year, other than the normal increase at RPI plus 0.5%. No new service charges are proposed this year. Additional funding can be raised however, should the Council determine to move new tenants straight to target rent for their property rather than base the tenant's rent on the previous tenant's rent as is currently the practice. This is discussed further in the rent consultation.

Capital

17 The biggest risk in the budget remains the ability to maintain the existing stock within the anticipated funding from the Major Repairs Allowance, MRA, and the existing repairs account in the longer term.

18 In the longer term, maintenance of the decent homes standard will become difficult in some homes without increased funding. It is anticipated that around an additional £350m over the period of the plan would be needed to maintain homes on a long term basis above the level of funding currently provided for in the plan. Reform of the HRASS is hoped to address much of that deficit over time. The majority of the financial difficulty is in the medium to long term rather than immediate, as a result of the huge investments made possible in the last few years.

19 Over the last two years, a total of £12m has been invested from HRA reserves into additional capital. Some limited addition to this level of investment might be possible under the current system, but it is critical that the future system's requirements relating to a debt cap are understood before final decisions can be made. It is therefore proposed that no further investment be made at this point, but that this is reviewed once the implications of the HRA reforms are fully understood and a longer term strategy can be agreed. The HRA business plan strategy that emerges will need to balance immediate investment with the debt cap proposals and the longer term need to reduce debt in order to invest in the medium to longer term when the stock requires much greater maintenance and improvement. It is hoped that when the reform is clearer that some limited additional spending might be possible.

Subsidy

20 The settlement this year is – as might be expected – tough. Allowances have been increased by only 1% at the same time as rental increases at a national level of 7% have been assumed. There is no 'rebasing' of the allowances assumed this year as has previously been the case.

Repairs Account

21 The repairs account has been massively reformed this year with the direct management of repairs being taken on by Derby Homes. Significant structural changes are continuing in the operation of the service and are likely to continue to

improve the overall financial position over time. In the short term, there have been some one off costs incurred to restructure the service amounting to around £350,000 – around £100,000 by the Council and £250,000 by Derby Homes. If these are discounted, however, the repairs account appears to be coming back under control as a result of the changed management arrangements and increased funding put in place this year. It is proposed that specific costs of restructuring the service where these have delivered real savings to be reinvested in the service should be funded by a one off contribution from HRA reserves.

Estates Pride

22 The Estates Pride programme is revenue funded by the HRA and can therefore be used on either revenue or capital. It can be used in a completely flexible manner, with no time limits, revenue or capital constraints.

23 2010/11 is the last full year of the original programme which is now almost fully committed. There are a few programmes which will last a little longer than this, funded by brought forward funding within the original total of £15m. From 2011/12 a series of funding streams will end, including a contribution towards funding for neighbourhood management.

24 There are new proposals from Derby Homes to commit £200,000 in 2011/12 and a further £100,000 in 2012/13 to allow for a gradual reduction in the Family Intervention Project run by Derby Homes rather than a sudden cessation. This will allow around 18 months to seek alternative sources of funding, albeit for a service around half the current size. In addition it is proposed to support a partnership with the Council to support youth projects – funding of £100,000 a year for 2011/12 and 2012/13 is proposed. The balance of funding in the Estates Pride fund will reduce by £0.5m as a result if these proposals are accepted. The balance of the £15m left uncommitted has reduced to just over £1m. Once these funds have been exhausted there will be no further funds remaining.

Pressures on the current plan not covered at present

25 To summarise, the business plan remains stable in the short term, but is not viable in the longer term under the HRASS if the full cost of maintaining the condition of the stock were to be factored in to longer term plans. If not addressed, this deficit will begin to build up a backlog of major repairs and maintenance issues. This is the key reason why it is hoped that the imminent reform of the HRASS will provide additional resources over the expected track of HRA subsidy. Taking on additional debt as part of that reform will have a cost, but there remains hope at this point that at least some additional funding will be possible through the offer towards reducing this funding gap.

26 It remains the expectation that there could in fact be a tightening of resources in the short term as a result of the reform, drawing down HRA reserves quite sharply as a result of the imposition of the debt cap and the effect of depreciation rules requiring additional resources to be set aside for future use. It is therefore critical at this point to maintain HRA reserves at around the current planned level – which are currently set to fall to around £4m, and certainly above the minimum 5% level of £2.3m - in

order to be able to manage in the next few years, at least until the impact of the reforms can be fully assessed.

Housing Subsidy

27 This year's housing subsidy should be the last subsidy determination received with the imminent abolition of the subsidy system. The figures themselves are likely to be consistent with HRASS reform, but this cannot be guaranteed as that announcement is being made later than the determination. The government has continued with previous policies of increasing spending at a much slower rate than rent increases, enabling a greater proportion of the rent to effectively be clawed back to central government.

28 The update this year is likely to result in a higher debt being imposed on Councils under the HRASS reform. The longer the reform takes to implement, the higher the cost is likely to be to Councils. The removal of an 'early opt out' option from 2011/12 is therefore disappointing as this would potentially have resulted in a better financial settlement than is now likely. However, the plans should remain viable as long as the increased rent proposed can continue to be collected, and the final reform is not much worse than that previously proposed.

Derby Homes' management fee

29 The basic principles of setting Derby Homes' management fee remain the same as previously agreed. Inflation has been calculated based on a split between pay – at nil – and non pay at RPI – giving an overall inflation rate of 1.1% for 2011/12, 0.6% for 2012/13 and an estimate of 2.5% thereafter. These are in line with the Council's policy relating to pay.

30 Given the outlook for the HRA, along with the need to reinvest into repairs, it is proposed that significant reductions be made to the management fee of Derby Homes, to be reinvested into the repairs fee. The expectation is that the management fee will reduce by £250,000 a year in real terms for the next four years - a total of £1m a year by 2014/15. Derby Homes have also committed to make savings of up to £1m a year within the repairs account with a view to further reinvestment into repairs. Alongside this, the management of repairs is being moved from management to repairs – a transfer of £855,000 of costs, and funding for grounds maintenance will from the current year come from service charges rather than a management fee. The business plan has been updated to show this major shift in resources from management to repairs. Derby Homes has already commenced a programme of restructuring its costs to meet these targets. The shift in resources from management to repairs will substantially address the current imbalance between these two areas. It is expected that spending on repairs will continue to increase as spending on management falls and that by the end of four years, repairs spending will be higher than management spending.

31 Appendix 2 sets out the fee proposed for Derby Homes for the next four years.

Conclusions

32 The longer term financial position for the HRA remains very difficult under the current system, but the short term financial position of the HRA remains acceptable thanks to the additional ALMO funding which has supported the Estates Pride programme for the last few years. While that funding has now come to an end, the prudent approach over the last few years means that the Council should be able to maintain the majority of core services at around their current level. Had reserves not been built up, the Council would now be attempting to reduce spending by around £4m a year. The ability to invest heavily in real improvements over the last couple of years cannot be sustained at the previous levels unless considerable additional resources are available as a result of HRASS reform.

33 The reliance on current capital funding is likely to prove to be inadequate in the future. It is hoped that the HRASS reform detail will enable the Council to address the longer term capital shortfalls, but until the detail of this is understood, there is very little scope for further investment in capital over and above the £12m committed in the last two years. Reserves are set to fall from around £16.9m to around £4m as a result of current plans. While this is an adequate level of reserves, it is likely that HRASS reform is likely to require a further drawing on reserves in the next few years, before the position subsequently improves. It is therefore proposed that the full consequences of the reform are absorbed before making longer term decisions on the strategy relating to investment.

Consultation

34 This consultation paper on these issues will be widely circulated, including Derby Homes' Board and its senior management, the City Housing Consultative Group, Derby Association of Community Partners, and the Adults, Health and Housing Commission.

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Background papers:	Housing Revenue Account Subsidy Determinations 2011/12