Response to the 21 November 2011 consultation on the self-financing determinations

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Department for Communities and Local Government

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Department for Communities and Local Government response to the 21 November 2011 consultation on the self-financing determinations

1. In total the Department received 57 responses to the consultation on the self-financing determinations. 52 were from stock-owning councils or their Arms Length Management Organisations, four were from other organisations and one was from an individual tenant. A full list of respondents is at the end of this response. The first section of this document is structured around responses to the five individual determinations; the second section covers broader issues raised by respondents.
2. The overwhelming majority of local authorities did not challenge the principles of self-financing or the broad methodology for calculating valuations and settlement payments. Instead they focused on detailed elements of the methodology.
3. The one tenant that responded directly did however fundamentally object to the principles of self-financing, the level of debt councils would take on and the rents assumptions, arguing that the reforms would continue a pattern of unfair treatment for council landlords in comparison with housing associations.
4. Many of the responses raised narrow issues related to the data for particular councils used in the self-financing valuation model. A number of other councils submitted revised data directly to the team responsible for managing the valuation model. This summary does not include updates to the data for individual councils, which have been made in accordance with the policy and process set out in the consultation documents.

The settlement payments determination

Rent assumptions

5. A majority of respondents objected to the rent increases for 2012/13 implied by continuation of national social rent policy and which are used as assumptions in the self-financing valuations. Many respondents noted the impact of the high September RPI figure in the rent formula.
6. A small number of councils said that they would not follow the formula, but most said that it would be necessary in order to deliver the funding needed in their business plan. Many councils said Government should diverge from national rent policy, as had been done previously, in order to allow councils to afford to set lower rent rises in 2012, in particular to help tenants who are not eligible for housing benefit.

Government response

7. The rent assumptions used in self-financing apply a policy established in 2001 by the last Government. This links rent rises to the September RPI figure, along with an extra element to gradually move council rents in line

with rents charged by housing associations. Under this policy, the rents we assume councils will charge next year will remain below those charged locally by housing associations for similar properties. In most cases they will also remain well below market rents. Housing Benefit will continue to meet the costs for those who cannot afford to pay.

8. A change to rent policy would either leave councils with less to spend on their housing, or would need to be funded by Government from other programmes. Rents are an integral part of reforms which will deliver a long term, securely funded, future for council housing. We do not therefore propose to change rent policy.

The impact of the higher rent assumption on the valuation

9. A number of councils said that use of the September RPI figure unreasonably increased their valuation as inflation was unusually high at this point. A few argued that this gave them a higher level of debt than was supportable in their local business plan.

Government response

10. The increase in the valuation reflects an actual increase in income for councils that follow social rent policy. Once the rent policy is established, it is right that the valuation should be based on this.

Type of debt to be paid off by Government

11. A small number of councils questioned the approach to paying off debt in councils by means of a pro-rata reduction in all Public Works Loan Board loans. One council said that councils with high average interest rates should have more expensive loans paid off in order to bring the average interest rate down.

Government response

12. We propose to take the same approach used in a large scale voluntary transfer. Top-slicing all Public Works Loans Board loans ensures that the average interest rate on all council debt held with the Board does not change. As Government is meeting the premium costs, a decision to pay off more expensive debt would give local authorities a financial benefit which would be paid for by Government through higher premiums. Councils will have a range of loans of different lengths which will affect their average interest rates over time. The average rate of interest at the date of the transaction does not provide a robust indication of longer term borrowing costs.

Assumptions about housing debt held by councils for purposes of calculating the settlement payments

13. A small number of councils argued that the actual housing debt figure for a council should be used in calculating the settlement payment, in cases

where this was higher than the notional figure used in calculating entitlement to subsidy. It was argued that prudential borrowing for investment in works such as Decent Homes should be reflected in the deal, as other councils had this funding provided through nationally funded programmes. It was also argued that borrowing for new build outside the two grant funded local authority new build schemes should be taken into account in calculating the settlement payments, as the operating surpluses from these homes were reflected in the valuations.

Government response

14. Use of the notional level of debt in calculating settlement payments ensures that councils who elected to pay off debt are not penalised for this decision. It also ensures Government does not bear the costs of councils borrowing prudentially in the past. Councils that prudentially borrowed for capital works or new supply within the Housing Revenue Account would have not expected any debt support and would have reached a view that they could afford the costs of the increased borrowing. The self-financing valuations and settlement payments do not change those expectations.

The impact of regional costs adjustments on settlement figures

15. The impact of updating the regional cost adjustments on the overall settlements for some councils was raised by a number of councils particularly in London and the north east. A few expressed the view that the methodology effectively locks in one year's movement in allowance factors and projects this forward over 30 years. Some argued that the costs built into the model were artificially low due to the current economic downturn or that this year's relative movements between areas were unusual.

Government response

16. The self-financing methodology requires us to establish a starting point for each council and to project that forward. We do not have evidence to suggest that a different pattern of relative costs would be more likely to reflect the movement over the next 30 years. In addition, some of the costs, including the regional cost adjustments, are 3 year averages, which should reduce the impact of short term volatility and better reflect longer term trends. We therefore do not propose to change the methodology.

17. There was a change to the methodology for calculating the area cost adjustment factor in the 2011-12 local government finance report. The assumed proportion of costs in providing adult personal social care services was changed from 80% to 65%. Such a change would have been reflected in a continuing HRA subsidy system and it is right that the self financing settlement includes the most up to date assumptions.

Transitional protection

18. One council said that it was unfair not to apply the cost uplifts to the levels of allowances after transitional protection, rather than to the formula allowances.

Government response

19. The methodology gives each council the costs that were identified in independent research. Applying the uplifts to transitionally protected allowances would give councils with transitional protection funding above those cost levels for 30 years. We therefore do not propose to change the methodology.

Market value of stock

20. One council was concerned that the valuation takes no account of the market value of its stock and that this places it at a disadvantage when compared with other authorities.

Government response

21. The self-financing valuation takes account of a number of factors including rental income and the costs of managing and maintaining the different types of council houses. These factors are relevant in testing the viability of the business. We believe that this produces a settlement that is sustainable for all councils and we do not propose to change the methodology so that it takes account of the market value of a council's stock.

Right to Buy sales in the model

22. A small number of councils said that Right to Buy sales in 2011/12 should be in the model. A number of local authorities also questioned the Right to Buy forecasts built into the model on the basis that the regional basis by which they had been derived did not reflect local trends.

Government response

23. We agree that a forecast of Right to Buy sales in 2011-12 should be added to the valuation model consistent with what was published in February 2011. This has been added to the final model.
24. A pragmatic approach was required for forecasting right to buy sales given the many factors that might influence take-up and the difficulties associated with developing a personalized forecast for each authority. The current approach forecasts Right to Buy sales at the national level and disaggregates the total between regions based on recent sales activity, and between individual authorities pro rata to their stock holding. The recent consultation on reinvigorating the right to buy indicated that if sales

exceed these forecasts the HRA would retain sufficient funds from the receipt to maintain viability.

Caps and limits compensation

25. A few councils questioned the approach taken to the compensation provided to councils for observing the caps and limits constraints on rent rises in national rent policy, saying that it under-estimated the real income they would lose in applying the policy.

Government response

26. Caps and limits compensation has been paid annually to councils to reflect the income foregone by councils who apply the guidance on annual rent increases for individual tenants. Unlike most elements of subsidy, it is paid in arrears and the formula takes into account the actual rental decisions of authorities.

27. In order to take into account the costs of following the limit policy in future years within the valuation model a forecast must be used and the link to actual rent levels will be lost. The model therefore calculates an estimate of compensation, assuming councils follow the formula, on the basis of average rents. Additional complex calculations, data collection and audit requirements would be required in order to analyse caps and limits compensation on a per property basis for each council. In addition over time as properties are re-let, there will be opportunities for councils to move rents on properties to the formula level. This is not captured in the caps and limits compensation in the model. We believe the approach we proposed is proportionate and reasonable.

Measures used to inflate future income and costs

28. One council expressed concerns that the methodology applied different indices to different aspects of the settlement, i.e. the Retail Prices Index (RPI) in relation to calculating income and the Gross Domestic Product (GDP) deflator in relation to costs.

Government response

29. Government has a policy of setting social rents with reference to the Retail Prices Index (RPI). It does not propose to change this policy, which was established in 2001 by the previous Government. The income assumptions in the model reflect the actual income adherence to this policy would generate.

30. The Gross Domestic Product (GDP) deflator has been used as an indicator of cost inflation in the council housing sector in the subsidy system. We have not identified a better indicator. The GDP deflator is a broader measure of inflation than the Retail Prices Index (which is based on a basket of consumer goods) and thus more suitable for deflating public expenditure series.

31. However, the discounted cash flow methodology used in the model is based on real values. The model assumes no difference between the RPI inflator and GDP deflator over the 30 years of the valuation.

Funding for disabled adaptations

32. A small number of councils disputed the approach taken to allocating additional funding for disabled adaptations. One council said that the proposed new per dwelling funding for disabled adaptations should be distributed on the basis of houses, rather than all dwellings, as more disabled tenants would tend to live in houses. It argued this would produce a fairer proxy for allocating the resources, given that there were no other local factors applied to the formula. Another noted that it consistently spent more than the new funding.

Government response

33. This funding was additional to the original proposal and was secured, to the benefit of LA landlords, as part of the Spending Review negotiations. The funding included in the valuation is intended to provide for newly arising need. The Department does not have the information to make forecasts of future demand for disabled facilities adaptations for each local authority; this demand could be influenced by a number of factors including demographics and the current level of provision across the council's stock. Effective management of properties with adaptations will be important to make the best of the stock. Our view is that flats as well as houses may require adaptations for tenants and funding should not be differentiated on this basis.

Disagreement with overall approach to valuation

34. One council challenged the whole methodology for valuing the self-financing business and adjusting housing debt

Government response

35. The overwhelming majority of local authorities accepted the principles and broad methodology, which were initially proposed by the sector. We have not identified any reason why the approach would be unreasonable to apply to any particular local authorities.

Reopening the settlement

36. One LA asked for further clarification as to the circumstances in which the settlement would be re-opened

Government response

37. Ministers have been clear, during the passage of the Localism Bill, that this would only be done in exceptional circumstances in order to protect

either local authorities or the Exchequer. The legislation restricts the circumstances in which the settlement can be reopened. This can only be done if there is a change in a matter which was taken into account in making the previous determinations.

38. During passage of the Localism Bill, the Parliamentary Under-Secretary of State set out the circumstances in which the power might be used. He said: *The purpose of the clause is to protect both parties to the agreement – both central Government and local authorities – from being locked into a deal that, because of changes in policy affecting either a landlord's income or cost, no longer reflected a fair valuation and might have a material impact on viability.* Public Bill Committee on 8 March 2011.

The limit on indebtedness determination

The limit on indebtedness

39. A significant number of councils disputed the need for the cap on housing borrowing, arguing that it was unnecessary given the prudential borrowing rules, artificially constrained borrowing that would be sensible and affordable within a local business plan, and that it would restrict new building to meet housing demand.

40. A number of councils argued that if a debt cap is required it should be index-linked, whilst several others accepted its appropriateness in the current economic context but said the cap should be repealed or increased in the longer term.

Government response

41. The Government has been clear that the self-financing reforms must support the Government's priority of bringing public debt under control. The cap on housing debt is necessary to ensure that the extra income and flexibilities under self-financing are not used to support an increase in public borrowing. This borrowing might be affordable locally but would undermine national fiscal policy. We therefore do not propose to change the policy on capping housing debt in each local authority.

42. The debt cap is necessary to prevent increases in public borrowing. It would not be consistent with this aim to commit to increase the cap annually.

Meaning of housing land in the definition of the HRA Capital Financing Requirement

43. One respondent asked whether the reference to expenditure on housing land is intended to cover all capital expenditure within the HRA.

Government response

44. The reference to expenditure on housing land in the definitions of the HRA Capital Financing Requirement is intended to include all capital

expenditure within the HRA that is funded by borrowing or credit arrangements. This applies in both the limits on indebtedness and Item 8 amending determinations.

HRA Housing Private Finance Initiative Schemes

45. A number of councils questioned the inclusion of capital spend on Housing Revenue Account Public Finance Initiative (PFI) schemes in the HRA Capital Financing Requirement, which includes credit agreements from April 2011. There were concerns about how it applied to new and existing PFI schemes, the possibility that it could lead to breaches of the borrowing cap or use up borrowing headroom.

Government response

46. The inclusion of credit arrangements in the calculation of the HRA Capital Financing Requirement (HCFR) is consistent with the Government's aim of bringing public debt under control. The HCFR includes capital expenditure that is financed by credit arrangements. This includes capital expenditure on on-balance sheet PFI schemes from the date on which the asset on which the expenditure is incurred becomes available for use. The end-year HCFR for 2011-12, which is used in the calculation of the initial limit, will include capital expenditure on these schemes where the asset has become available for use during the year.
47. It is not our intention that HRA Housing PFI schemes that are supported by this Department should place authorities at risk of breaching the debt limit. The Department will therefore be writing to each of the authorities with signed schemes for information on the capital expenditure on them and will make adjustments to their debt caps where necessary. For schemes that are still in procurement the Department will consider the impact of the scheme on the debt cap when the scheme reaches contract signature.

Appropriations between the General Fund and the Housing Revenue Account

48. A small number of councils queried why appropriations form part of the Housing Capital Financing Requirement calculation as an appropriation does not increase or reduce the level of debt that the council holds, but will be taken into account when measuring compliance with the debt cap. Others questioned the way appropriations in 2011/12 are treated in the calculation of the Subsidy Capital Financing Requirement used in setting the settlement payments, with one council asking whether it should apply to the appropriation of just dwellings or dwellings and land.

Government response

49. The proposed treatment of appropriations in the calculation of the HCFR is the most appropriate way of maintaining the ringfence in the self-financing environment. The ringfence exists to protect the interests of both council

taxpayers and tenants and it is important that it should apply to all interactions between the HRA and the General Fund.

The subsidy amendment and the Item 8 Credit and Debit amendment determinations for 2011-12

50. A small number of councils sought clarification as to which interest rates would be used when calculating the compensation for the four day period. One said this should be the actual interest rate on the loan. Councils also asked whether this adjustment would be achieved via the final subsidy claim or a special determination.

Government response

51. Full details of the calculation of the interest adjustment will be provided in the Special Determinations that the Department will be sending to the affected councils in the next few days. The Government will be making payments to the councils that are receiving compensation for increased interest payments through LogasNet on 15 March. Payments from councils that are required to make a payment to the Department will be collected through LogasNet on 22 March.

The Item 8 Credit and Debit Determinations for 2012 onwards

References to 'proper accounting practices'

52. A number of treasury management advisors together with a small number of councils queried the reference to the use of 'proper practices', on the grounds that there are a number of different legislative provisions and sources of guidance as to 'proper practices'. A small number of respondents highlighted inconsistencies in drafting with some references to 'proper accounting practices' and some to 'proper practices'.

Government response

53. We agree that the determinations could provide more clarity on this point. The item 8 determination now refers to proper accounting practices and this term is defined in the interpretations section. In addition, the term has been removed in four places – *Interest on the HRA Capital Financing Requirement* and *Interest on notional cash balance* in the item 8 credit and *Interest on loans and Interest on notional cash balance* in the item 8 debit – where guidance from the Chartered Institute for Public Finance and Accountancy exists but is not established as proper accounting practices. Where this is the case we would expect councils to apply a fair and evidenced approach to their calculations.

Premiums and discounts for the early repayment of loans

54. A number of treasury management advisors together with a significant minority of councils questioned our proposals on premiums and discounts.

Some suggested the proposals as currently set out would have a negative impact on their General Fund. Some respondents suggested we should continue the approach taken by the current Item 8 determination.

Government response

55. We believe that Regulation 30C of the Capital Finance Regulations will apply to the treatment of premiums and discounts as these should be calculated 'in accordance with proper accounting practice'. Regulation 30C should apply to premiums and discounts that are outstanding at 1 April 2012 and to premiums and discounts where early repayment of loans takes place after this date.

Depreciation, Impairment and Revaluation

56. There was general acceptance of the approach to these and a welcoming of the five-year transitional period though councils are waiting for the final guidance from the Chartered Institute for Public Finance and Accountancy. There were questions about whether the transitional period applies to revaluation losses and to non-dwellings.

Government response

57. The impairments adjustment also includes revaluation losses. The Government can also confirm that the transitional provisions only apply to dwellings. Depreciation, impairment and revaluation losses on non-dwellings should hit the bottom line from 1 April this year. The text of the Item 8 determination has been amended to provide clarity on these issues. .

Data issues

58. Several councils referred to or included requests for data changes in the valuation model. Many councils provided further information on this outside their formal response to the consultation. We have responded directly to councils seeking changes to their data, for example as a result of new audited data becoming available.

Broader issues raised in the consultation

Reforms to the welfare and benefit systems

59. A significant minority of local authorities said forthcoming changes to the benefits system and the introduction of Universal Credit increased risks to self-financing. In particular, some said that paying benefits directly to tenants would increase both arrears and collection costs and that these risks had not been taken into account in valuing each council's housing business. One council said that rental income in the first five years should have been assumed to be less in the model to reflect these risks during the period that welfare reforms bed in.

Government response

60. The June 2010 emergency Budget implemented a number of reforms to the housing benefit system such as the under occupation measure and benefit cap. DCLG negotiated the terms of the HRA reform settlement based on these additional costs. It was agreed that using a 6.5% discount rate to value the business would reflect the additional costs associated with the reforms announced as part of the Emergency Budget.
61. The introduction of Universal Credit will see an increase in direct payment of housing support to the tenant rather than landlords. The Welfare Reform white paper set out the Government's intention to work to protect landlord income:
62. *"There are advantages in paying the housing component to individuals, rather than the current system of payments direct to landlords. This would encourage people to manage their own budget in the same way as other households. However, we also recognise the importance of stable rental income for social landlords to support the delivery of new homes and will develop Universal Credit in a way that protects their financial position. Options for achieving this could include some ongoing use of direct payments to landlords, use of direct debits, and a protection mechanism which safeguards landlords' income. We will work closely with the devolved administrations, providers and lenders in developing the new system."*
63. To this end DCLG has been working closely with DWP on the design of direct payment to tenant and will be launching housing demonstration projects in June. These will involve paying housing benefit directly to tenants and testing support, exemptions, financial products and rules for switchback to landlord payment to help inform Universal Credit design in a way that minimises costs to landlords and increases the likelihood of success when UC is introduced.
64. The Government has also commissioned a review of the projects led by Professor Paul Hickman from the Centre for Regional Economic and Social Research at Sheffield Hallam University. The review will evaluate the impact of direct payments on claimants and vulnerable groups, as well as local authorities and social rented sector landlords.
65. It is through our close work with DWP and the careful design that we aim to protect landlord's financial position as much as possible and maintain the viability of their businesses.

Right to Buy reform

66. A significant minority of councils raised the possible impact on the viability of their housing business from Right to Buy reform. Some said that significant sales would jeopardise viability of their self-financing business as maintenance and repair costs would not reduce in proportion with the size of the stock. A number also said that the debt cap under self-financing would make it harder to replace locally each unit sold and that it

should be raised to cover any borrowing for replacement units. Many responses also covered wider issues related to the Right to Buy reforms.

Government response

67. The self-financing valuations already include a forecast of Right to Buy sales based on current Right to Buy policy. The housing debt councils will take on under self-financing is reduced to reflect the value to the landlord business of those properties.

68. In announcing its intention to reform Right to Buy, Government said that first call on receipts from additional sales arising from the change to Right to Buy policy would be to pay off an amount of housing debt which reflects the value of those extra properties to the Housing Revenue Account. This commitment will ensure the viability of council landlords' businesses under a revitalised Right to Buy.

69. Right to Buy policy is the subject of a separate consultation. Wider policy issues related to Right to Buy will be considered and addressed in that consultation process.

Decent homes funding and costs of addressing other backlogs

70. A number of local authorities noted that self-financing did not fund Decent Homes works and said it would be important to receive full funding in the future to meet their Decent Homes backlog. A similar number also stressed the importance of receiving their indicative Decent Homes allocation in 2013/14 and 2014/15. Some said that uncertainty about future funding inhibited their planning and potential efficiencies. One council noted that it had other maintenance backlogs which it wanted funded either through the self-financing deal or outside it.

Government response

71. The Government has provided £1.6bn for decent homes funding through the spending review. Decisions regarding future funding provisions will be taken at future spending reviews.

Restricting borrowing from the Public Works Loan Board at the reduced rate to applications made on 26 March

72. A significant minority of councils objected to the announcement by the Public Works Loan Board that the lower borrowing rate would only be available for applications made on 26 March. Councils and others argued that this posed an unnecessary financial risk to councils, related to the interest rates that applied on that one day. A small number wanted assurances that the Public Works Loan Board would have the operational capacity to deal with this volume of requests on one day. A small number of councils said that the reduced borrowing rate should be available to those councils having debt paid off, in part to help deal with funding pressures in the early years and to help reduce average borrowing costs.

Government response

73. The Public Works Loan Board is making fixed and variable rate loans available at a special reduced rate for borrowing to meet self-financing payments. This lower rate will save local authorities up to £100 million per year that can be reinvested in housing. The rates were reduced in response to local authority concerns that this borrowing was for a unique and non-discretionary transaction to deliver the reform, and as such it is available only to local authorities who are making payments to Government. The rate that PWLB offers for general borrowing by local authorities will be kept under review.
74. On 21 November it was announced that the reduction would only apply to loans arranged on 26 March. The purpose of this announcement was to achieve greater fiscal certainty for central Government in terms of the timing of significant gross borrowing, which is important in times of market uncertainty. It reduces the risks associated with local authorities holding large sums in advance of the transaction. It also takes into account local authorities' expressed preference for the timing of borrowing, and ensures that all participating local authorities have access to the same lower rates.
75. The Public Works Loan Board self-financing website is in the final stages of development and has a range of appropriate safeguards. It is designed to process a substantial volume of loans, far above the number anticipated on the day. Local authorities will be able to input the loans they require during March and finalise their applications on 26 March. In the unlikely event of the website being unavailable on 26 March, the Board is developing contingency arrangements. Please see www.dmo.gov.uk/selffinancing for further details, including training arrangements.

Public Works Loan Board arrangement fees

76. A few councils noted that they would be charged arrangement fees to borrow to meet their settlement payment and said that these fees should be met by Government as a cost in the self-financing deal.

Government response

77. Although it is for local authorities to decide where to source their borrowing, the Public Works Loan Board offers a very modest and transparent fee structure and is making a lower interest rate available for self-financing borrowing. There is no recent precedent to altering the fee structure, which reflects costs involved in making funds available, and the Government does not see a case for doing so. The valuation methodology includes an annualised element which reflects the ongoing costs of treasury management.
78. Local authorities will need to be aware that Public Works Loan Board loans are paid net of their arrangement fee (£0.35 per £1,000 advanced for fixed rate loans, £0.45 per £1,000 advanced for variable rate loans).

Authorities will need to be ready to make up this amount when making settlement payments to the Department.

Table of respondents to the consultation

Local authority / organisation
Arlingclose Ltd
Ashford Borough Council
Babergh District Council
Barking and Dagenham Council
Barnsley Metropolitan Borough Council
Basildon Borough Council
Birmingham City Council
Brent Council
Cambridge City Council
Camden Council
Canterbury City Council
Chartered Institute of Public Finance & Accountancy
Cheshire West and Cheshire UA
City of London Corporation
Croydon Council
Doncaster Metropolitan Borough Council
Durham County Council
East Riding of Yorkshire Council
Enfield Council
Fareham Borough Council
Gateshead Council
Hackney Council and Hackney Homes
Haringey Council
Haringey tenant
Harlow District Council
Harrow Council
High Peak Borough Council
Hinckley & Bosworth Borough Council
Hull City Council
Kingston upon Thames Council
Kirklees Council
Leeds City Council
Lewisham Council
Manchester City Council
Mid Suffolk District Council
Newcastle City Council and Your Homes Newcastle
Newham Council
Northampton Borough Council
North Tyneside Council
Nottingham City Council

Reading Borough Council
Redbridge Council
Rotherham Metropolitan Borough Council
Sector Group
Sheffield City Council
Solihull MBC and Solihull Community Housing
Southampton City Council
Southwark Council
Sterling Consultancy Services
Stockport Council and Stockport Homes Ltd
Stoke-on-Trent Council
Swindon Borough Council
Tower Hamlets Council
Wandsworth Council
Westminster City Council
Wigan Council and Wigan & Leigh Housing
Woking Borough Council