Chief Financial Officers / Chief Accountants,
Local Housing Authorities,
Treasury advisers

21 November 2011

COMMENTS ARE REQUIRED BY NO LATER THAN 5pm on 6 JANUARY 2012

Dear Chief Finance Officer/ Chief Accountant / Head of Housing

Consultation on the draft determinations to implement self-financing for council housing

Introduction

Under section 173 of the Localism Act 2011, the Secretary of State is required to consult representatives of local government and each affected local authority before making determinations to implement self-financing for council housing.

Consultation on amendments to the 2011-12 Housing Revenue Account Subsidy Determination, amendments to the 2011-12 Item 8 Determinations, and the Item 8 Determinations which will apply from April 2012, take place under powers conferred by sections 80 and 87 of the Local Government and Housing Act 1989.

The purpose of this letter is to notify you of the consultation on these determinations, which will deliver a major change in the way council housing is financed. The **consultation closes at 5pm on 6 January 2012.**

We are consulting on five draft determinations:

- The **Settlement Payments Determination**. This sets out the amount each local authority will either pay the Government or receive from the Government on 28 March 2012 in order to exit the current subsidy system, and the way in which the payments will be made.
- The **Limit on Indebtedness Determination**. This places a cap on the amount of housing debt each council may hold.
- The **Housing Revenue Account Subsidy Amendment Determination** for the year 2011-12. This adjusts the subsidy entitlement for this financial year in order to take account of the interest costs or savings arising from the settlement payments. These payments will be made before the end of the financial year.

- The **Item 8 Credit and Debit Amendment Determination** for the year 2011-12. This enables the appropriate charges to be made between the Housing Revenue Account and a council's General Fund to reflect the borrowing costs or savings in this financial year arising from the settlement payments.
- The **Item 8 Credit and Debit Determinations** for 2012 onwards. This provides a framework for the Housing Revenue Account ring-fence to continue to operate under a devolved system of funding.

Alongside the draft determinations, we are publishing the spreadsheet models which have been used to calculate the self-financing valuations, settlement payments and debt limits set out in the determinations. As part of the consultation we ask you to consider whether the data and calculation for your authority are correct. We are also publishing for information commentaries on these models. These documents comprise:

- The *Baseline Model*. This calculates the year one rents and non-uprated allowances as a basis for the self-financing calculations. It uses the latest data provided by councils. It is very similar to the spreadsheets used in previous subsidy determinations.
- A *Commentary on the Baseline Model*. This provides a technical explanation of the calculations in the Baseline Model.
- The *Self-financing Model*. This uses the data in the Baseline Model to produce a self-financing valuation for each local authority. It applies the self-financing methodology, including uprating of allowances and rent policy, to calculate the value of the landlord business over 30 years.
- A *Commentary on the Self-financing Model*. This provides a technical explanation of the calculations in the Self-financing Model.

You may also wish to look at two documents which we previously published and which may help you to review the above material:

- A *Report on the model inputs, assumptions and outputs*. This was produced by PwC to explain the self-financing methodology in less technical language. It was written for the model published earlier this year but, except for very limited changes which we have set out, is relevant for the model on which we are now consulting.
- *Model user guide*. This is a simple guide to using the self-financing model. This was written originally for the model published earlier this year but remains a useful guide for using the current model.

All these documents are available on the Department for Communities and Local Government website at:

http://www.communities.gov.uk/housing/socialhousing/councilhousingselffinance/

Background to implementing self-financing

On 5 October 2010 the Government announced in a Written Ministerial Statement its intention to replace the Housing Revenue Account subsidy system with a devolved system of council housing finance called self-financing. Prior to this decision there had been two public consultations on the proposed reforms. The first, in July 2009, established the principles of self-financing; the second, in March 2010, consulted on a detailed methodology for applying these principles. The overwhelming majority of councils welcomed the proposed reforms. A number of small changes to the methodology were made in response to views expressed in the consultation. For a summary of responses to the March 2010 consultation on the detailed methodology see: www.communities.gov.uk/publications/housing/realfuturesresponses.

Key elements of the self-financing model

The draft determinations and the models set out the self-financing policy and methodology. Key components in the self-financing valuation model are:

i. *Assumed rental income*: As described in both the February and July 2011 policy documents[1], national social rent policy is that rents in the council housing sector should converge with those charged by housing associations by 2015-16, followed by rent rises at RPI + 0.5% per year after this, in line with housing associations. In valuing each local authority's housing business we have assumed adherence to this rent policy.

   In keeping with previous years, we will base next year's rent rises on RPI inflation in the previous September, combined with a convergence factor to reflect the number of years to rental convergence with the housing association sector.

ii. *Assumed costs to manage and maintain the stock*: The costs in the models are based on the allowances in the subsidy system. These allowances have been uprated in line with the costs of maintaining and managing council housing stock as identified in independent research by BRE and HQN. This research was published as part of the 2009 consultation. On average, this assumes that local authorities will need to spend 14.5% more on managing and maintaining their stock under self-financing than the funding provided under the present system.

iii. *Stock numbers*: The valuation model excludes stock that councils have planned to demolish in the next five years, at the point it will become void. Government has not set any targets for demolitions. The New Homes Bonus financially rewards councils for getting empty homes back into use. The plans set out by councils for demolitions are substantially lower than the number demolished in the last five years of published data.

[1] *'Implementing self-financing for council housing'* and '*Self-financing: Planning the Transition'* , which can be found at http://www.communities.gov.uk/housing/socialhousing/councilhousingselffinance/.

Interaction with other housing policies

Right to Buy

On 2 October 2011 the Prime Minister announced his intention to raise Right to Buy discounts in order to make it attractive to tenants across England. This is expected to substantially increase sales. In making this announcement, Government said it would ensure that these changes did not have an impact on the viability of self-financing landlords.

The self-financing valuation model includes a forecast of Right to Buy sales based on current Right to Buy policy. This adjusts each council's debt to a level that can be supported from their income after an assumption is made about stock losses each year from Right to Buy sales. We are retaining this element in the self-financing deal.

Ministers have stated that the first call on the net receipts from the additional sales arising from a change in Right to Buy policy will be to pay off the housing debt associated with those properties. Our proposals for reforming Right to Buy policy will include proposals for calculating the amount of housing debt which needs to be paid off and for ensuring this is met out of the sales receipt. We will deal with any additional costs to self-financing landlords arising from a change in Right to Buy policy through changes to the rules that apply to capital receipts - the 'pooling' rules - rather than adjustments to the self-financing settlement.

We intend to link this policy to actual sales rather than forecasts. This will provide local authority landlords with comfort that unpredictable levels of sales do not pose a risk to business plans.

More detailed proposals are being set out in the Housing Strategy and the Right to Buy consultation which will be published shortly.

Large Scale Voluntary Transfers (Full and Partial)

The final self-financing model and the determinations will include the value of all stock owned by local authorities at the date the determinations are issued. Self-financing valuations, settlement payments or other elements of the determinations will not be adjusted to reflect the loss of stock from partial transfers after this date. We will instead deal with the financial impact of partial transfers through transfer agreements with individual councils.

Local authorities that transfer the whole of their stock between publication of the final determinations and 28 March 2012 (the date that self-financing settlement payments will be made) will not be required to make, or be eligible to receive, self-financing settlement payments. Local authorities that do not complete a transfer by this date will be treated the same as any other stock-owning local authority. They will become self-financing and will be required to make or receive the self-financing settlement payments as set out in the determinations.

We are separately contacting all the local authorities that are planning a full or partial transfer to set out our proposals.

Housing Revenue Account Private Finance Initiative schemes

There are seven Housing Revenue Account housing PFI schemes currently in procurement. Dwellings covered by PFI schemes do not get a Major Repairs Allowance in the subsidy system. The self-financing valuation likewise does not assume costs for Major Repairs for those properties covered by housing PFI schemes.

As with partial transfer, the self-financing model and the determinations will not anticipate PFI schemes which are planned but have not completed by the date we issue the final determinations. Major repairs costs for those properties intended to be covered by schemes that have not completed by that date will therefore remain in the self-financing model, the valuation and the determinations. Schemes which subsequently complete will receive grant which is adjusted to reflect the major repairs funding provided in the self-financing settlement.

The definition of the Housing Revenue Account Capital Financing Requirement that is included within the Limits of Indebtedness Determination includes credit arrangements. We will be writing to the authorities with Housing Revenue Account Private Finance Initiative schemes supported by this Department for information on the impact of this.

The scope and focus of the consultation

Set out below is a description of each of the determinations on which we are consulting, with some key issues which local authorities might wish to consider:

i. **The Settlement Payments Determination**: This sets out the amount of money each local authority will be required either to pay Government or receive from Government on 28 March 2012 in order to exit the current subsidy system, and the way in which the payments will be made. This should be reviewed alongside the Baseline Model and the Self-financing Model. The Baseline Model calculates the year one rents and non-uprated allowances, as a basis for the self-financing calculations, using the latest data provided by councils. It is very similar to the spreadsheets used in previous subsidy determinations. The Self-financing Model calculates the value of each local authority's housing business over 30 years. We are also publishing commentaries on each of the models which provide detailed technical explanations of the calculations in them. For background information and not for consultation, we have also republished a report on the inputs, outputs and assumptions that are applied in the self-financing model and a short user guide to the model. These two documents were first published as part of a previous consultation. ***Local authorities are asked to check carefully the figures used against the data they provided.***

ii. **The Limit on Indebtedness Determination**: This defines the Housing Revenue Account Capital Financing Requirement - the measure of housing debt which will be used in setting a limit on each council's housing debt. It sets out the principles by which the limit will be calculated for each local authority, and gives an estimate of the limit for each local authority, based on the latest data submitted to Government. The actual limits will be set out in the final determination issued in January 2012, following the same methodology, using the most recent data and forecasts available. We will issue a subsequent Limit on Indebtedness Determination for councils who demonstrate a difference between the forecast and final outturn audited data.

Local authorities are asked to note the methodology for calculating the debt limit and the current estimate of the limit.

iii. **The Housing Revenue Account Subsidy Amendment Determination for 2011-12**: This determination amends the Housing Revenue Account Subsidy determination for 2011-12 so that subsidy entitlement for that year can be adjusted to take account of borrowing costs or savings arising in that year from the date of the settlement payments (28 March 2012). We intend to consult in January 2012 on the special determination required to make the adjustments in subsidy entitlement to reflect these costs or savings. The payments will take place through LogasNet in March 2012. ***Local authorities are invited to comment on the details of the proposed amendments.***

iv. **The Item 8 Credit and Debit Amendment Determination for 2011-12**: This enables the appropriate charges to be made between the Housing Revenue Account and each local authority's General Fund to reflect the borrowing costs or savings in this financial year arising from the settlement payments and other consequential arrangements. It amends the calculation of the Consolidated Rate of Interest for 2011-12 so that it is not affected by the settlement payments. It also allows the interest costs on loans taken out for the settlement payment to be charged to the Housing Revenue Account from the date of Royal Assent (15 November 2011). ***Local authorities are invited to comment on the proposed amendments.***

v. **The draft Item 8 Credit and Debit Determination for April 2012 onwards:** This provides a framework for the Housing Revenue Account ring-fence to continue to operate under a devolved system of funding. We do not intend to issue new Item 8 determinations each year.

   a. The determination specifies the items that can be debited or credited to the Housing Revenue Account. Councils are generally required to follow proper accounting practice in calculating the appropriate amounts to credit or debit, rather than follow a detailed set of rules and formulae. Guidance from the Chartered Institute of Public Finance and Accountancy will provide more detailed guidance about how council's can meet proper practice in this area.

   b. The determination also includes a five-year transitional period before the depreciation figure must be funded in full in the Major Repairs Reserve. During this time, councils may choose to use the uplifted Major Repairs Allowance used in the self-financing valuation as the figure which must be funded in the Major Repairs Reserve – i.e. similar to the current rules. During this period, they will also be able to reverse out the effect of impairments as a below the line adjustment in the Statement of Movements on the Housing Revenue Account balance sheet. Authorities will still be able to transfer amounts in excess of depreciation to their Major Repairs Reserves.

   Local authorities are invited to comment on the proposed Item 8 determination.

Responses to the consultation on the draft Settlement Payment and Limit on Indebtedness determinations should focus on the accuracy of the calculations and the data used in them. The methodology has already been subject to two public consultations and scrutiny by Parliament through the provisions in the Localism Bill.

Notifying the Department of changes or corrections to the data

Please check carefully the figures used in the calculations for your local authority against the information provided by your local authority and certified by your auditors. If you wish to seek amendments to any of the data used in the calculations, please submit these through your auditor. All amendments to data must be submitted via LogasNet. The Department will not accept any amendments submitted by other means, including disk, email, fax or on paper copies of the form. A certificate from your auditor and a full explanation as to why changes to the data are required should accompany any amended data submitted. Auditor-certified amendments must be submitted as soon as possible and no later than 5 pm on 6 January 2012. Please note the treatment of audit qualifications, explained below.

However if you think there are any errors in the data or calculations please contact the Department as soon as possible to discuss these. In the first instance you may wish to telephone one of the contacts below.

Amendments or corrections made to an individual authority's data as a result of this consultation will not affect the figures for other local authorities. From the point of issuing these draft determinations we regard each local authority's valuation as independent and will not issue new valuations for other local authorities as a result of such adjustments to an individual council's data.

The treatment of audit qualifications

As under the existing subsidy system, the draft and final determinations are calculated using audited base data supplied by local authorities on the base data forms which were completed over the summer of 2011 and audited in October 2011. There are inevitably some circumstances each year which require the Department to make assumptions when making the draft and final determinations, in particular where reliable data have not been returned in time for inclusion in the calculations.

As usual, the Department has written to individual local authorities with audit qualifications on their base data forms. In most cases we have been able to reach agreement with authorities on how to resolve the qualifications that have been raised. In some cases authorities have made changes via Logasnet; for others, these changes have been hard-coded into the model by the Department. Authorities are reminded that, where agreement is not reached, the Department maintains the right to make assumptions at any stage to calculate the draft and final determinations. It will make such assumptions as it deems necessary to protect the Exchequer in accordance with section 168(4) of the Localism Act 2011.

The Department is maintaining a separate record of all assumptions made as a result of audit qualifications, which supersedes the data held in Logasnet. As such, making changes to Logasnet will have no effect where the Department has made assumptions on the basis of audit qualifications. **In these circumstances you may wish to provide additional evidence, such as surveys, to support the data that was originally submitted on the return. The Department will consider such additional evidence on its merits.**

Consultation process

Paper copies of the consultation documents, annexes and supporting material are not being issued. The documents referred to in this letter are available on the Department's website at the following address:

http://www.communities.gov.uk/housing/publications/consultations.

They can be freely downloaded from the website. In case of difficulty accessing the material on the website please contact:

councilhousingfinance@communities.gsi.gov.uk

Where to send your consultation responses

Please send responses to the consultation to:

councilhousingfinance@communities.gsi.gov.uk

Please give your email the subject heading of *Self-financing determinations consultation*. This will enable us to process them more easily. **Responses must be received by the Department by 5pm on 6 January 2012.**

If you are sending a response in hardcopy, please send it to:

HRA Reform Team, Department for Communities and Local Government, Zone 1/J10, Eland House, Bressenden Place, London, SW1E 5DU.

Please indicate whether you wish your comments to be treated as confidential. Otherwise the Department will assume that you are content for a copy to be made publicly available in the Department's libraries and the House of Commons Library.

Queries and advice

If you have any queries you wish to discuss regarding the data used or the modelling please contact:

Paul Crittenden (tel: 0303 444 4286; paul.crittenden@communities.gsi.gov.uk)

or **Chris Stennett** (tel: 0303 444 2406; chris.stennett@communities.gsi.gov.uk)

If you have any queries regarding the wording of the determinations please contact:

Jon Yates (tel: 0303 444 3720; jon.yates@communities.gsi.gov.uk)

If you have any queries regarding the wider consultation process please contact:

Ann Hinds (tel: 0303 444 3722; ann.hinds@communities.gsi.gov.uk)

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