Department for Communities and Local Government

The draft Item 8 Credit and Item 8 Debit (General) Determination from 1 April 2017

May 2016
Department for Communities and Local Government

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Introduction

The introduction of self-financing to the Housing Revenue Account (HRA) in April 2012, fundamentally changed the way that local authority housing is funded. The former system of redistributive subsidy, with all its associated complexity, was replaced with a system where rental income is kept locally in return for authorities taking on a level of debt representative of the value of the stock. Local Authorities took on the responsibility for investment in the housing assets based on a 30 year Business Plan.

As part of the self-financing settlement, substantial changes were made to the accounting treatment of capital assets. A five year transitional period was put in place to help local authorities manage the impact of these changes by allowing them to “reverse out” impairment charges and to use the former Major Repairs Allowance (MRA) as a proxy for calculating depreciation, whilst preparing for fully componentised depreciation in line with proper accounting practices.

The transitional period ends on 31 March 2017. This consultation paper outlines the Department’s proposals for dealing with the end of that transitional period.

Proposals

The Department proposes to amend the Item 8 Credit and Item 8 Debit (General) Determination to:

- Continue to allow impairment charges on dwelling assets to be reversed out of the HRA following the end of the transitional period.
- Extend the principle to non-dwelling assets in the HRA from 2017-18.
- To confirm that from 2017-18 depreciation should be charged to the HRA in accordance with proper practices.

The Department proposes that the above arrangements will be delivered through an amended Determination that will come into force on 1 April 2017.

Impairments

Impairments are the reduction in the book value of a capital asset compared with market values and are often a consequence of natural changes in the market. However, impairment charges will also arise as a result of the need to reflect the difference between a property's value on the open market and its value as social housing (i.e. rented at a sub-market rent to someone with security of tenure).

A property's value as social housing will be very different to the market value, for example, in the South East it might be only around a third of market value. This could mean a local authority in the South East that built or acquired on the open market a home with a market value of £240,000 could face an impairment charge of £160,000.[1]

Impairments on dwellings

As part of the transitional arrangements put in place at self-financing in 2012, local authorities have been able to "reverse out" impairments on dwellings until March 2017. Reversing out a receipt or a cost is an accounting technique to move credits and debits between accounts. The HRA accounts for useable resources, whereas the capital adjustment account (which records capital value gains and losses) is an unusable account that records accumulated capital debits and credits, which would only be realised at the point that an asset is sold.

The end of the transitional period is a significant concern for many local housing authorities as impairments would then count as an actual cost to the HRA and reduce future funds available; the impairment charge would fall to the HRA and have to be balanced against actual resources, impacting on the bottom line and reducing the resource available to support social housing.

As well as affecting existing stock, impairments could impact on those local authorities looking to use Right to Buy or High Value Assets receipts to build, or acquire new housing stock, or with other regeneration plans. By extending "reversing out" local housing authorities would be allowed to continue to transfer the charge from a useable to an unusable account ensuring that real resources are not lost because of what is essentially a technical accounting requirement, more properly aimed at private companies.

Impairments on non-dwellings

There are similar issues with regard to the impairment of non-dwelling assets in the HRA. Under the current arrangements, however, such impairments cannot be reversed out in the same way.

The different treatment was driven by a desire for these assets to be used more efficiently and provide an incentive for local housing authorities to transfer such items to the General

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[1] From 1 April 2016 the Valuation Office Agency (VOA) discount methodology will no longer be prescribed, though it will remain available for use by authorities.

Fund. The Department recognises however, that in some cases such transfer is difficult where non-dwelling assets are also integral to housing assets, for example, shops under flats on an estate. Again this falls as a direct cost to the HRA's bottom line.

On that basis, we propose that from 2017-18 impairments on non-dwellings should be reversed out of the HRA.

We do not propose that local housing authorities will be allowed to revisit or otherwise retrospectively restate their HRA to reverse out prior year impairments on non-dwellings. To do so would distort the account for the 2017-18 financial year.

Depreciation

Depreciation is the decline in the value of an asset over time due to wear and tear. Before the introduction of self-financing, depreciation was not charged to the HRA; subsidy provided as the Major Repairs Allowance (MRA) was used as a proxy. To allow local authorities time to properly prepare for accounting for the fully "componentised" (costs broken down to reflect the individual items depreciating: boilers, roofs etc.) costs of depreciation we provided a transitional period until March 2017 in which local housing authorities could continue to use the MRA figure as a proxy in the HRA.

We believe by 2017-18 all local housing authorities should be in a position to properly account for depreciation in the HRA. Our proposal is that depreciation should be accounted for as a transfer to the Major Repairs Reserve which can be used to fund capital expenditure, or to pay off debt.

The Department proposes, therefore, that the transitional period allowing use of the MRA ends in March 2017 as planned.

Status of the new Determination

The Department proposes to issue a new Item 8 Determination to deliver the changes proposed, which will come into force on 1 April 2017. The draft Determination is attached as an Annex to this document.

Responses

Comments are welcomed on this consultation and on the draft Item 8 Determination. Responses should be emailed to bryan.lea@communities.gsi.gov.uk by 8 July 2016

Annex A

The draft Item 8 Credit and Item 8 Debit (General) Determination from 1 April 2017

The Secretary of State as respects all local housing authorities in England, in exercise of the powers conferred by section 87 of, and item 8 of Part I and item 8 of Part II of Schedule 4 to, the Local Government and Housing Act 1989 after consulting such representatives of local government and relevant professional bodies as appear to be appropriate, hereby makes the following determination:

Citation and commencement

1.1 This determination may be cited as the Item 8 Credit and Item 8 Debit (General) Determination. It has effect from 1 April 2017 for the year 2017-2018 and subsequent years.

1.2 Subject to paragraph 1.3 the Item 8 Credit and Item 8 Debit (General) Determination from 1 April 2013 is hereby revoked.

1.3 The following Determinations will continue to have effect for the purpose of the determination of Housing Revenue Account self financing for the year beginning 1 April 2012:

- The Settlement Payments Determination
- The Limits on Indebtedness Determination
- The Housing Revenue Account Subsidy (Amendment) Determination 2011-2012
- Item 8 Credit and Item 8 Debit (General) Debit Determination 2011-2012 Amending Determination

and in so far as may be necessary for the purposes of any calculation to be made under this or any other determination relating to the calculation of Housing Revenue Account self financing.

Interpretation

2.1 In this determination, unless the context otherwise requires:

"1989 Act" means the Local Government and Housing Act 1989;

"authority" means a local housing authority in England;

"cluster" means a group of rooms in a house in multiple occupation serving as separate accommodation for 2 or more persons but sharing a common kitchen, bathroom and

lavatory; where such a house accommodates 6 or less than 6 persons, this shall count as one cluster;
where such a house accommodates more than 6 persons the number of clusters shall be calculated by dividing the number of persons by 6, with any balance counting as one cluster;

subject to sub-paragraphs (2) and (3) of this definition, a **"dwelling"** means:

(1) (a) a building or part of a building which is provided for occupation by a single family unit (that is to say an individual or a family, in either case together with any lodger), or

(b) a group of 3 bed spaces in a hostel (for this purpose the number of groups of bed spaces shall be calculated by dividing the total number of bed spaces by 3, with any balance counting as one dwelling),

to which section 74(1) of the 1989 Act for the time being applies, together with any yard, garden, outhouses and appurtenances belonging to or usually enjoyed with that building or part, and irrespective of whether or not the dwelling is occupied on 1 April;

(2) a dwelling which is put to another use which is not a permanent change of use shall continue to be treated as a dwelling for the purposes of this determination; however

(3) a dwelling falling within the description in paragraph (1)(a) or (b) of this definition shall not be treated as a dwelling for the purposes of this determination if it is either:

(a) an unoccupied dwelling which the authority has formally resolved should be demolished or disposed of and which is no longer available for letting; or
(b) a dwelling of which a lease has been granted under the rent to mortgage scheme.

"financial year" means the period of 12 months beginning on 1 April

"HRA" means the Housing Revenue Account of the authority whose settlement payments and limit on indebtedness is under consideration

"local housing authority" has the same meaning as in the Housing Act 1985

“non-dwelling” means a building or part of a building that does not fall into the definition of dwelling above

"proper accounting practices" in relation to the accounts of a local authority are defined in accordance with section 21 of the Local Government Act 2003

"self-financing" is the system for financing council housing that replaced the Housing Revenue Account subsidy system

"shared ownership lease" has the meaning given in section 622 of the Housing Act 1985

2.2 In this determination, unless the contrary intention appears, reference to an Act or Statutory Instrument is a reference to the Act or Statutory Instrument as amended.

Item 8 of Part I – Credit to the Account

3.1 The sum to be credited to the Housing Revenue Account under item 8 of Part I of Schedule 4 to the 1989 Act shall be calculated as follows for the 2017- 2018 financial year and subsequent financial years:

> Item 8 Credit = interest on HRA Capital Financing Requirement + interest on notional cash balance + interest on loans for purchase of HRA properties + discounts for early repayment of debt + PFI subsidy payments + impairments adjustment for dwellings + impairments adjustment for non dwellings.

where:

Interest on the HRA Capital Financing Requirement is credited to the Housing Revenue Account on investments by the Housing Revenue Account where there is a negative Housing Revenue Account Capital Financing Requirement.

Interest on notional cash balance means the interest credited to the Housing Revenue Account on notional credit balances attributed to the Housing Revenue Account, the Housing Revenue Account Repairs Account and the Major Repairs Reserve.

Interest on loans for purchase of HRA properties is the interest receivable by the authority during the year in respect of any loan (including a part of the purchase price left outstanding) made to enable the borrower to acquire a dwelling within the Housing Revenue Account.

PFI subsidy payments are payments made to an authority by the Department for Communities and Local Government for Housing Revenue Account Private Finance Initiative (PFI) schemes approved by the Secretary of State which are service concession arrangements as defined within the Code of Practice on Local Authority Accounting in the United Kingdom.

Impairments Adjustment allows local authorities to reverse revaluation and impairment decreases on dwellings and non-dwellings out of the Housing Revenue Account. Revaluation and impairment decreases are calculated in accordance with proper accounting practices.

Discounts for early repayment of debt are calculated in accordance with proper accounting practices.

Item 8 of Part II – Debit to the Account

The sum to be debited to the Housing Revenue Account under item 8 of Part II of Schedule 4 to the 1989 Act shall be calculated as follows:

> Item 8 debit = interest on loans + depreciation of dwellings + depreciation of non dwellings + debt repayments + charges under credit arrangements + interest on notional cash balance + debt management expenses + premiums for early repayment of debt + revenue charged to capital under statute + transfer to Major Repairs Reserve + impairment charges for dwellings + impairment charges for non dwellings

where:

Interest on loans means the interest on loans, both external and internal, in relation to the Housing Revenue Account Capital Financing Requirement.

Depreciation on both council dwellings and other assets within the Housing Revenue Account should be calculated in accordance with proper accounting practices.

Debt repayments are where authorities choose to repay debt from the Housing Revenue Account.

Charges under credit arrangements mean charges related to the financing of capital expenditure on any interest in housing land where authorities make payments in accordance with sections 7 and 8 of the Local Government Act 2003. PFI scheme payments which are "on balance sheet" are included here. However where such payments are "off balance sheet" they are properly debited under item 1 or item 3 of Part II of Schedule 4 to the 1989 Act. PFI scheme payments made to contractors under a Housing Revenue Account PFI scheme in respect of housing land which is no longer in the authority's Housing Revenue Account are not PFI scheme payments for the purposes of this determination.

Interest on notional cash balance means the interest charged to the Housing Revenue Account where it has notional debits and liabilities.

Debt management expenses are a proportion of the authority's debt management expenses for the financial year calculated in accordance with proper accounting practices to reflect the proportion which the Housing Revenue Account should bear.

Premium charges for early repayment of debt are calculated in accordance with proper accounting practices.

Revenue charged to capital under statute is any charge attributable to the Housing Revenue Account that is calculated in accordance with proper accounting practices in respect of Revenue Expenditure Funded From Capital Under Statute.

Transfer to Major Repairs Reserve. Where decent homes backlog funding has been credited to the Housing Revenue Account in accordance with a direction made by the Secretary of State under item 9 of Part I of Schedule 4 to the 1989 Act, then a debit equal to this amount must be made to the Housing Revenue Account under item 8 and transferred to the credit of the Major Repairs Reserve. In addition an authority may wish to transfer an amount in excess of any charge for depreciation to its Major Repairs Reserve.

Impairment charges means any revaluation and impairment decreases in respect of land, houses or other property within the authority's Housing Revenue Account calculated in accordance with proper accounting practices.