CITY OF CARDIFF COUNCIL
CYNGOR DINAS CAERDYDD

AUDIT COMMITTEE: 8 DECEMBER 2014

TREASURY PERFORMANCE REPORT AS AT 31 OCTOBER 2014

REPORT OF CORPORATE DIRECTOR RESOURCES

AGENDA ITEM: 9.1

Appendix 1 and Annexes A & B of Appendix 2 of this report are not for publication as they contain exempt information of the description in paragraphs 14 and 21 of Schedule 12A of the Local Government Act 1972

PORTFOLIO: CORPORATE AFFAIRS

Reason for this Report

1. To provide Audit Committee Members with performance information and a position statement on Treasury Management as at 31 October 2014 and highlight key changes from the previous report received as at 31 July 2014.

Background

2. The report attached at Appendix 1 provides the Committee with a snapshot of treasury performance, position statements on investments and borrowing.

Performance

3. The report updates for the latest forecast for interest income on investments and external interest payable at Month 6 budget monitoring. Whilst uncertain, assumptions around external interest payable reflect an underspend due to deferral of the timing of borrowing in the current financial year. Since the last performance report, the projected level of internal borrowing is forecast to be lower, primarily as a result of schools organisational plan schemes and requirement of WG to utilise grant as match funding in 2014/15 instead of Local Government Borrowing Initiative approval. Based on the forecast level of external borrowing, without any further borrowing, the level of internal borrowing at 31 March 2015 is projected to be £26 million.

Investments

4. Pages 2 and 3 of the Performance Report consider the position on investments. The charts on the Performance Report show the position at a point in time and investments continue to be closely monitored.

5. The current investments list details each investment, the interest rate, the start date and maturity date. It also links this back to the credit criteria by a colour coding which indicates the perceived strength of the organisation.

6. The balance of investments is at a point in time and will fluctuate depending on the timing of income and expenditure e.g. payments to suppliers, receipt of grants, capital receipts etc.

7. The charts that surround this table provide additional information and the key areas to highlight are shown below.

   - **Counterparty Exposure** displays actual investment against the maximum permitted directly with an organisation – This demonstrates that we are not exceeding any exposure limits.
   - **Remaining Maturity Profile of Investments**. Maturities of investments have been spread to achieve a balanced profile.
   - **Investments by Institution.** This expresses the investments held with different institutions as a percentage of the total. It can be seen that investments remain diversified over a number of organisations.
   - **Geographic Spread of Investments** as determined by the country of origin of relevant organisations. All countries are rated AA and above as per our approved criteria.
   - **Investments by Financial Sector.** The majority of investments are with banks.

8. The probability of default of the investments held (excluding LAMS) at 31 October 2014 was 0.019%. This equates to £12,540.

Borrowing

9. The last performance report to Committee indicated that up to £15m of external borrowing could be taken by 31 March 2015 to ensure the internal borrowing position is manageable. This was subject to a number of variables including progress on delivering capital schemes.

10. Borrowing of £5 million was taken during October at the rate and period set out in the report. Accordingly, at 31 October 2014, the total level of borrowing is £476 million. With loans to the value of circa £6 million to be repaid in the last quarter of the year, without any further borrowing, the forecast level of external borrowing at 31 March 2015 is £470 million. The timing and quantum of further borrowing will continue to be reviewed in conjunction with the Council's treasury advisors.

Other

11. Due to the timing of Audit Committee and Cabinet dates and lead in times for submission of reports, the Mid Year Treasury Management Report for 2014/15 was circulated electronically for comment to Committee. These reports, which provide an update on the Treasury Management position as well as on the latest position in respect of the 'buy out' from the Housing Revenue Account subsidy system have been the subject of both Cabinet and Council meetings in November 2014. The Mid Year Treasury Management Report for 2014/15 is attached at Appendix 2 for information.

Reason for Report

12. To provide Audit Committee Members with an update on the treasury management position as at 31 October 2014.

Legal Implications

13. No direct legal implications arise from this report.

The Committee is reminded of its statutory functions, which are to:

(a) review and scrutinise the authority's financial affairs,
(b) make reports and recommendations in relation to the authority's financial affairs,
(c) review and assess the risk management, internal control and corporate governance arrangements of the authority,
(d) make reports and recommendations to the authority on the adequacy and effectiveness of those arrangements,
(e) oversee the authority's internal and external audit arrangements, and
(f) review the financial statements prepared by the authority.
(g) to seek assurances that the Council has complied with the Treasury Management Strategy and Practices by demonstrating effective control of the associated risks and pursing optimum performance consistent with those risks.

Financial Implications

14. Treasury management activities undertaken by the Council are governed by a range of policies, codes of practice and legislation. This report indicates the treasury management position at one point in time and makes a number of assumptions in forecasts which will be updated in future reports. The report provides a tool for indicating to Members the treasury position. Future reports will highlight main changes since this report.

RECOMMENDATIONS

15. That the Treasury Performance Report for 31 October 2014 be noted.

CHRISTINE SALTER
CORPORATE DIRECTOR RESOURCES
25 November 2014

The following appendix is attached
Appendix 1 – Cardiff Council Treasury Management Performance Report
Appendix 2 – Mid-Year Treasury Management Report for 2014/15

CITY OF CARDIFF COUNCIL
CYNGOR DINAS CAERDYDD

CARDIFF
CAERDYDD

CABINET: 20 NOVEMBER 2014

TREASURY MANAGEMENT MID-YEAR REPORT 2014-15

REPORT OF CORPOPRATE DIRECTOR RESOURCES

AGENDA ITEM: 7

PORTFOLIO: CORPORATE SERVICES AND PERFROMANCE (COUNCILLOR GRAHAM HINCHEY)

Annexes A&B to Appendix 1 to this report are not for publication as they contain exempt information of the description in Paragraphs 14 and 21 of Schedule 12A of the Local Government Act 1972.

Reason for this Report

1. To inform Members of the Council's treasury management activities since 1 April 2014 and the position as at 30 September 2014.

2. The Report also recommends that the Council enters into a voluntary agreement to exit the current Finance Housing Subsidy system and recommends the approval of a delegation to the Director of Communities, Housing and Customer Services in consultation with the Corporate Director Resources and the Cabinet Member for Health, Housing and Social Care and the Cabinet Member for Corporate Services and Performance to conclude the appropriate detail within the voluntary agreement and sign on behalf of the Council.

Background

3. The Council's treasury management activities are governed by legislation and a Code of Practice developed by the Chartered Institute of Public Finance and Accountancy (CIPFA) updated in 2011.

Issues

4. In the budget report of February 2010, Council adopted CIPFA's revised Treasury Management Code by formal acceptance of the Four Clauses of Treasury Management and Treasury Management Policy Statement as Council policy. In accordance with these policies, this report provides members with a mid year update of Treasury Management activities as at 30 September 2014. Council requires the scrutiny of the accounting,

audit and commercial issues of its Treasury Management Strategy and Practices to be undertaken by the Council's Audit Committee. The mid-year monitoring report is attached as Appendix 1 and is to be referred to Council on the 27 November 2014 after consideration by the Cabinet.

5. The report also provides an update to members on Housing Finance Reform and a move to self financing taken forward by the 11 stock retaining Welsh Local authorities, Welsh Government and Welsh Local Government Association (WLGA). A draft introductory guide to this reform is attached at Annexe D to Appendix 1 and explains the requirement to undertake additional borrowing to ensure we can exit the current subsidy system.

6. The recommendations to this report is that Council approve a delegation to the Director of Communities, Housing and Customer Services in consultation with the Corporate Director Resources and the Cabinet Member for Health, Housing and Social Care and the Cabinet Member for Corporate Services and Performance to enter into the voluntary agreement to exit the current Finance Housing Subsidy system . Attached for information is the Cabinet report of July 2014 which provides further detail in respect of the background, financial benefits and technical detail in respect of the new Local Housing Authority Self Financing Scheme and the voluntary agreement that all housing councils will need to enter into.

Reasons for Recommendations

7. Council policy requires the Treasury Management Mid Year Report 2014-15 update to be submitted to Council.

8. A delegation is required to enable the Council enter into the voluntary agreement to exit the subsidy system.

Legal Implications

9. No direct legal implications arise from this report.

Financial Implications

10. The Council's treasury management activities are undertaken in accordance with the policies adopted by Council and under professional codes of conduct established by CIPFA, the Welsh Government and the Interim Section 151 Officer as part of treasury management practices. This report is part of a suite of reports that members receive on the Council's treasury management activities during the course of a year. Whilst there are no direct financial implications arising from this report, the risks involved with treasury management are continuously reviewed in conjunction with the Council's treasury management advisors.

11. The Report also provides an update in respect of the current position on Housing Finance reform and recommends a delegation to allow the Council as a stock retaining authorities to exit the subsidy system. It

should be noted that the value of loans entered into to enable the Council to exit the subsidy system will be dependent upon the interest rates in being at the 31 March 2015.

RECOMMENDATION

Cabinet is recommend to agree that Council be recommended to

1. note the Treasury Management Mid Year Report 2014-15 (Appendix 1)

2. note the current position on Housing Finance reform to allow all 11 stock retaining authorities to exit the Subsidy system following acceptance of a voluntary agreement

3. enter into a voluntary agreement to exit the subsidy system and delegate authority to the Director of Communities, Housing and Customer Services in consultation with the Director Corporate Resources and the Cabinet Members for Health, Housing and Wellbeing and for Corporate Services and Performance to conclude the appropriate detail within the voluntary agreement and sign on behalf of the City of Cardiff Council.

CHRISTINE SALTER
Corporate Director
14 November 2014

The following Appendices are attached:-

Appendix 1: Treasury Management Mid Year Report 2014-15:
Annexe A – Investments at 30 September 2014
Annexe B – Investment Charts at 30 September 2014
Annexe C – Maturity Analysis of borrowing as at 30 September 2014
Annexe D – Glossary of Treasury Management terms
Annexe E – Housing Revenue Account Reform – Self Financing in Wales – An Introductory Guide for Councillors

Appendix 2: 17 July 2014 Cabinet Housing Subsidy Reform Report

Appendix 1

Annexes A&B to this Appendix are not for publication as they contain exempt information of the description in Paragraphs 14 and 21 of Schedule 12A of the Local Government Act 1972.

Treasury Management Mid-Year Report 2014-15

The City of Cardiff Council

CARDIFF
CAERDYDD

Introduction

1.1. Treasury management activities are the management of an organisation's investments and cash flows, its banking, money market and capital market transactions; the effective control of the risks associated with those activities; and the pursuit of optimum performance consistent with those risks.

1.2. The Council carries out its treasury management activities in accordance with a code developed for public services in 2011 by the Chartered Institute of Public Finance and Accountancy (CIPFA) as well as Council approved policies and clauses adopted by Council in February 2010.

1.3. In accordance with these policies, this report provides members with a mid year update of Treasury Management activities as at 30 September 2014 and covers:-

- the economic background to treasury activities
- investments
- borrowing
- debt rescheduling
- compliance with treasury limits and prudential indicators
- other treasury management issues for 2014/15 primarily the additional borrowing to exit the Housing Subsidy System.

1.4 Annexe E includes a glossary which defines key terms used in this report. During 2014/15, Audit Committee has received a periodic update on the position and performance of Treasury Management. In addition Council received in September 2014 a report on the outturn position for Treasury Management for 2013/14.

Economic Background and Treasury Strategy Update

2.1 Economic forecasting remains difficult with so many external influences weighing on the UK. Growth is likely to continue through 2014 and into 2015 with forward surveys for the services and construction sectors encouraging and business investment also strongly recovering. However, for any recovery to become more balanced and sustainable in the longer term, the view is that there needs to be a move away from dependence on consumer expenditure and the housing market to exporting, and particularly of manufactured goods. Strong growth has resulted in unemployment falling much faster than expected and the Bank of England has therefore broadened its forward guidance by looking at a much wider range of economic indicators in determining interest rate decisions. Inflation has fallen sharply with the Consumer Prices Index (CPI) reaching 1.5% in May, the lowest rate since 2009. Forward indications are that inflation is likely to fall further in 2014 to possibly near to 1%. The return to strong growth has also helped lower forecasts for the increase in Government debt however, monthly public sector deficit figures so far in 2014/15 have been higher than expected.

2.2 The following table gives the Council's treasury management advisors, latest forecast of bank rate and Public Works Loan Board (PWLB) borrowing rates: Overall, markets are expecting that the Bank of England will be cautious in raising Bank Rate as it will want to protect heavily indebted consumers at a time when inflationary pressures are also weak. A first increase in Bank Rate is therefore expected in the first or second quarter of 2015 with increases after that to be at a slow pace to lower levels that prevailed before 2008.

	Sep-14	Mar-15	Mar-16	Mar-17
Bank Rate	0.50%	0.75%	1.25%	2.00%
5yr PWLB rate	2.70%	2.80%	3.10%	3.50%
10yr PWLB rate	3.40%	3.60%	4.00%	4.30%
25yr PWLB rate	4.00%	4.20%	4.60%	4.90%
50yr PWLB rate	4.00%	4.20%	4.60%	4.90%

2.3 It can be seen from the table that the cost of borrowing is significantly in excess of the rates that are available from investments. Since the Treasury Strategy was approved in February, PWLB rates have moved in a narrow band, but with rates recently affected by geo-political events. Whilst such issues can have short term impacts on rates, the long term trend is for PWLB rates to rise due to the high volume of debt issuance in the UK.

2.4 Increased confidence in UK growth and higher inflation expectations and reversal of quantitative easing measures could result in increases in borrowing rates. Conversely re-emergence of problems in heavily indebted European economies, geopolitical risks such as in the Middle East and Eastern Europe, could result in safe haven flows back to the UK, reducing borrowing rates.

Investment

3.1 The management of the Council's cash flows may involve temporary lending of surplus funds to low risk counterparties or temporary borrowing pending receipt of income.

3.2 The Council's investment priorities are the security and then liquidity of its investments. The Council also aims to achieve the optimum return on its investments appropriate to these priorities.

3.3 The Council invests with financial institutions in accordance with criteria approved in the Treasury Strategy. The categories, names, periods and size limits on this list can be extended, varied or restricted at any time by the Corporate Director Resources under delegated powers. Based primarily on Fitch credit criteria and a number of other factors which the Council takes into account, lending to these institutions is subject to time and size limits and credit worthiness continues to be carefully monitored.

3.4 Given that bank rates are historically low, and the damping effect on interest rates that the Government's Funding for Lending Scheme has had on availability of cash to banks, rates of investment return remain low.

3.5 At the 30 September 2014, investments stood at £70.1 million. These temporary funds fluctuate daily and arise for a number of reasons, including the timing differences between the receipt of grant and other income and the utilisation of these funds on salaries and other operating costs. It includes the level of reserves, provisions, and other balances. It is also affected by the timing of borrowing and capital expenditure transactions. **Annexe A** shows with whom these investments were held as at 30 September 2014. These were all deemed recoverable.

3.6 A selection of performance indicators and benchmarking charts, is included in **Annexe B** as follows:-

- **Counterparty Exposure** displays actual investment against the maximum permitted directly with an organisation – This demonstrates that we are not exceeding any exposure limits.
- **Remaining Maturity Profile of Investments**. This shows the duration of investments is spread and taking advantage of slightly higher rates for longer term investment up to one year where reasonable to do so.
- **Investments by Institution.** This expresses the investments held with different institutions as a percentage of the total and shows diversification is achieved where possible.
- **Geographic Spread of Investments** as determined by the country of origin of relevant organisations. All countries are rated AA and above as per our approved criteria, are licensed to take UK deposits and investments are in sterling only.
- **Investments by Financial Sector.** The majority of investments continue to be with banks.

3.7 Whilst a difficult figure to forecast due to the uncertainty of the markets, cash flows and the number of variables that impact on the figure, the forecast level of interest receivable from treasury investments for 2014/15 is £340,000 as included in our current projections for capital financing in the Month 6 Budget Monitoring Report. The return achieved since the start of the year is 0.57% compared to the benchmark 7 day London Interbank Bid Rate (LIBID) of 0.35%.

3.8 The Council currently uses the Debt Management and Deposit Facility (DMADF) as a last resort if no alternative investment opportunities are available. The maximum rates available from the facility are 0.25%

Borrowing

4.1. Long term borrowing is undertaken to finance the Council's Capital Programme and the main sources of borrowing currently are the PWLB and the Money Markets.

4.2. At 30 September 2014, the Council had £471 million of external borrowing predominantly made up of fixed interest rate borrowing from the PWLB payable on maturity.

31-Mar-14			30-Sept-14	
£m	**Rate (%)**		**£m**	**Rate (%)**
420.7		Debt from : PWLB	418.7	
52.0		Market	52.0	
0.6		Other	0.6	
473.3	**5.22**	**Total External Debt**	**471.3**	**5.23**

4.3 PWLB loans of £6 million are scheduled to be repaid by the end of the financial year, accordingly if no further borrowing is undertaken, the value of external loans at 31 March 2015 will be £465 million. At the 31 March 2015, the Council's need to borrow for capital expenditure purposes, its Capital Financing Requirement (CFR) is currently forecast to be circa £507 million. As the Council borrows for capital expenditure, its CFR rises and as it sets aside money for the eventual repayment of such expenditure (Minimum Revenue Provision), the CFR falls. The level of CFR is dependant on a range of factors including progress in implementing the Capital Programme. The Council last took external borrowing in March 2014 and without any further borrowing this financial year internal borrowing could be £42 million.

4.4 The borrowing strategy outlined in the February 2014 budget report indicated that:-

Whilst investment rates remain lower than long term borrowing rates internal borrowing will be used to minimise short-term costs where possible. The forecast level of internal borrowing at 31 March 2014 as a percentage of the CFR is deemed manageable. However, based on the forecasts of future capital expenditure plans and high level analysis of the Council's balance sheet position for future years, internal temporary cash balances will be insufficient to meet the totality of cash requirements, thus external borrowing will be required to be undertaken in 2014/15 or towards the end of 2013/14.

4.5 Long term borrowing rates are significantly higher than investment income rates, which means that the cost of undertaking any new borrowing would have a negative impact on the revenue budget, accordingly no new borrowing has been undertaken to date. External borrowing may be deferred in order to minimise short term costs by using temporary cash balances to pay for capital expenditure however deferring borrowing is only a short term measure and could expose the Council to higher borrowing rates and costs in the future.

4.6 Accordingly, it is proposed to take an element of the Council's borrowing requirement (up to £15 million) during the remainder of the financial year with timing of such determined by the Corporate Director Resources in conjunction with the Council's treasury advisors. This approach has been factored into the Month 6 revenue budget monitoring position, which shows a projected underspend due to deferring the timing of borrowing.

4.7 The Council sets aside money each year as a prudent provision for the repayment of historic capital expenditure incurred. This is in accordance with guidance issued by Welsh Government and the Policy approved by Council during the start of the year. An extract of the policy is shown below for information.

- *Historic expenditure prior to 1 April 2004 as well as subsequent supported borrowing approved by the WG is to be provided for at 4.5% on a reducing balance basis, rather than on a 25 year straight line basis. This is in excess of the WG requirement of 4%, but will continue to be reviewed for ongoing affordability.*
- *Additional borrowing for a general increase in investment to balance the Capital Programme in a year is to be provided for on a straight line basis over the estimated average life of the assets created.*
- *Any additional expenditure linked to specific schemes e.g. Invest to Save, SOP etc. is to be provided for on a straight line basis, or over the estimated useful life of assets being created or a shorter period as determined by the Section 151 Officer or suggested periods determined by WG as is the case with LGBI.*
- *Additional borrowing undertaken within the HRA will be provided for on a straight line basis over the estimated useful life of assets being created or a shorter period as determined by the Section 151 Officer. Historic expenditure prior to 1 April 2004 is provided for at 2% in line with current regulations.*

Any change in the level, timing and method of provision in year is delegated to the Section 151 Officer after consideration of affordability and prudence.

Debt Rescheduling

5.1 No debt rescheduling or early repayment of debt has been undertaken during the year to date.

5.2 Annexe C shows the maturity profile of the Council's borrowing as at 31 October 2014. None of the Council's Market Loans, which are Lender Option Borrower Option Loans (LOBO's) had to be repaid during the first half of the year. However £24 million of the LOBO's are subject to the lender potentially requesting a change in the rate of interest payable every six months, which could trigger early repayment. These are shown in the table below.

£m	Potential Repayment Date	Option Frequency	Full Term Maturity
6	01/03/2015	6 months	23/05/2067
6	21/11/2014	6 months	21/11/2041
6	21/11/2014	6 months	21/11/2041
6	21/11/2014	6 months	23/05/2067
22	21/11/2015	5 years	23/11/2065
5	05/01/2018	5 years	17/01/2078

5.4 Unless the Council's LOBO's are required to be repaid early, very little debt matures within the next 10 years. While the maturity structure of borrowing remains within the Council's limits, the maturity profile chart highlights a potentially substantial refinancing risk in 2056/2057.

5.5 While interest rates remain relatively low, and the PWLB continue to charge penalty rates for early repayment of loans, restructuring of this debt would incur large premiums. A review of options during the year identified that in order to remove the spike, it would result in an initial premium payment of circa £53 million and does not represent financial value based on current interest rates. Opportunities to review are likely to be limited in the short to medium term. The Council has also considered opportunities to repay LOBO's early to reduce financing risk, however, again the premiums payable do not make this a financially viable option.

Compliance with treasury limits and prudential indicators

6.1 During the financial year to date, the Council has operated within the treasury limits and prudential indicators set out in the annual Treasury Management Strategy in February 2014.

Treasury Management issues for the Remainder of 2014/15

7.1 Various issues continue to be monitored closely including the credit worthiness of counterparties and the timing of new borrowing. In conjunction with the 11 other Welsh Stock retaining Local Authorities, the Welsh Local Government Association and Welsh Government, the Council continues to develop the strategy to allow Wales to exit from the Subsidy system from 1 April 2015

7.2 The new self-financing arrangements which will be in place from April 2015 will increase revenue year on year within the HRA for the eleven landlord authorities. In Cardiff's case, this is because the annual negative subsidy payment of c£15 million to the UK Treasury will be replaced from April 2015 by a payment of c £8million of interest charges on circa £190 million of loans from the Public Works Loan Board (PWLB) on a basket of loans.

7.3 The move to self financing offers the opportunity for Authorities to retain all income from the HRA and use their role as a landlord to help achieve their wider priorities and ambitions. These could include economic regeneration, improving health and well being, improving community safety and helping vulnerable people to live independently in the community.

7.4 Attached at Annexe D is an Introductory Guide prepared by the WLGA for Councillors on Housing Finance Reform.

7.5 Cabinet received a report in July 2014, which provided delegated authority to enter into the voluntary Housing Revenue Account self-financing agreement for the City of Cardiff Council to the Director of Communities, Housing and Customer Services in consultation with the Director of Resources and the Cabinet Member for Heath, Housing and Social Care and the Cabinet Member for Corporate Services & Performance.

7.6 The treasury management implications of this will be factored into the Treasury Management Strategy for 2015/16 and Housing Business Plan to be reviewed by WG, however the paragraphs below update members on the proposals of Housing Finance reform and treasury management implications, by inclusion of a timeline.

July 2014

Report to Cabinet on response to WG consultation and financial implications. Delegated authority to enter into voluntary agreement

August 2014

WG Minister approves consultation outcome in line with approach recommended by all 11 authorities and WLGA

September 2014

Council to submit draft 30 year HRA business plan to WG confirming affordability of additional borrowing over a thirty year period and forming the basis of a bid for continuing receipt of Major Repair Allowance Grant

December 2014

WG to allocate share of £40 million interest payments to local authorities and a borrowing cap, based on their audited subsidy claims for 2013/14.

January 2015

To allow all authorities to exist from Subsidy system, City of Cardiff Council to sign Voluntary Agreement under delegated authority as outlined above and submit to WG

March 2015

Determine and take PWLB loans to meet settlement figure based on interest rates at 31 March 2015.

April 2015

Undertake all transactions to receive borrowed funds and transfer settlement funds to Welsh Government in accordance with the Voluntary Agreement.

Annexe A – Investments at 30 September 2014
Annexe B – Investment Charts at 30 September 2014
Annexe C – Maturity Analysis of borrowing as at 30 September 2014
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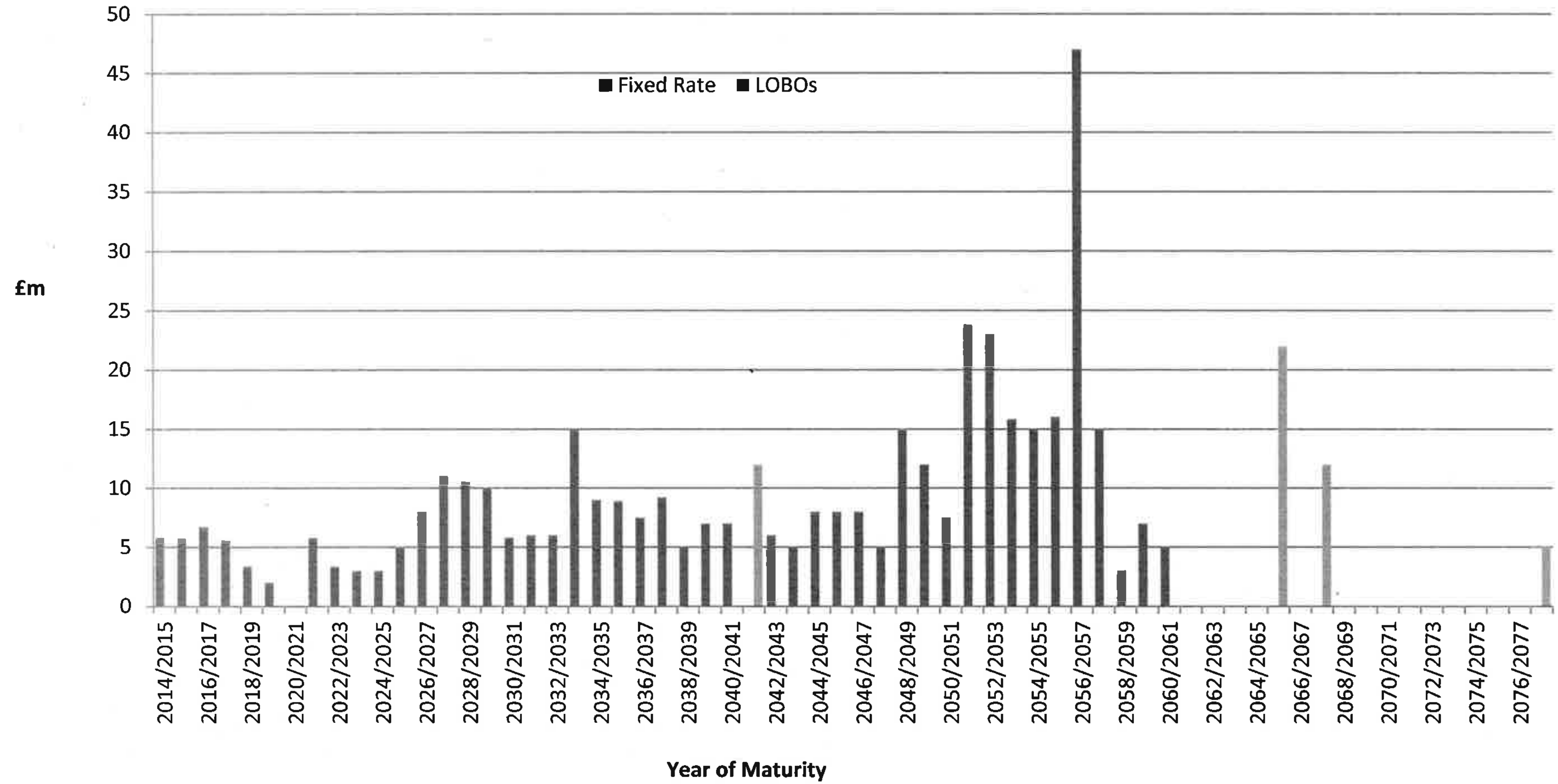
Maturity Profile of Debt at 30 September 2014



Glossary of Terms - Treasury

Bank Rate
The rate of interest set by the Bank of England as a benchmark rate for British banks.

Borrowing
Loans taken out by the authority to pay for capital expenditure or for the prudent management of the Council's financial affairs, which are repayable with interest.

Counterparty
One of the parties involved in a financial transaction.

Credit Criteria
The parameters used as a starting point in considering with whom the council may place investments, aimed at ensuring the security of the sums invested.

Credit Rating
A credit rating assesses the credit worthiness of an individual, corporation, or even a country. Credit ratings are calculated from financial history and current assets and liabilities. Typically, a credit rating tells a lender or investor the probability of the subject being able to pay back a loan. Ratings usually consist of a long term, short term, viability and support indicators. The Fitch credit rating of F1 used by the Council is designated as "Highest Credit quality" and indicates the strongest capacity for timely payment of financial commitments.

Debt Management Account Deposit Facility (DMADF)
The Debt Management Office provides this service as part of its cash management operations and of a wider series of measures designed to improve local and central government's investment framework and cash management. The key objective of the DMADF is to provide users with a flexible and secure facility to supplement their existing range of investment options while saving interest costs for central government.

Debt Restructuring
Debt restructuring is a process that allows an organisation to reduce, renegotiate and undertake replacement debt.

Diversification of Investments
The process of creating a portfolio of different types of financial instruments with regard to type, price, risk issuer, maturity, etc. in order to reduce the overall risk of the portfolio as a whole.

Duration (Maturity)
The length of time between the issue of a security and the date on which it becomes payable.

External Borrowing
Money borrowed from outside of the Council.

Fitch Credit Ratings
A commercial organisation providing an opinion on the relative ability of an entity to meet financial commitments, such as interest, preferred dividends, repayment of principal, insurance claims or counterparty obligations. The opinion is usually provided in the form of a credit rating.

Fixed Rate
An interest rate that does not change over the life of a loan or other form of credit.

Internal Borrowing
Money borrowed from within the Council, sourced from temporary internal cash balances.

Investments
The purchase of financial assets in order to receive income and/or make capital gain at a future time, however with the prime concern being security of the initial sum invested.

Lender Option Borrower Option Loans (LOBOs)
Loans to the Council where the lender can request a change in the rate of interest payable by the Council at pre-defined dates and intervals. The Council at this point has the option to repay the loan.

Liquidity
The ability of the Council to meet its financial obligations as they fall due.

Market Loans
Borrowing that is sourced from the market i.e. organisations other than the Public Works Loan Board or a Public Body.

Minimum Revenue Provision
This is the amount which must be charged to the authority's revenue account each year and set aside as provision for repaying external loans and meeting other credit liabilities. The prudent amount is determined in accordance with guidance issued by WG. This has the effect of reducing the Capital Financing Requirement (CFR).

Money Market Funds
An investment fund which pools the investments of numerous depositors, spreading those investments over a number of different products and counterparties.

Prudential Code for Capital Finance
The system introduced on 1 April 2004 by Part 1 of the Local Government Act 2003 which allows local authorities to borrow without Government consent, provided that they can afford to service the debt from their own resources and

that any such borrowing is prudent and sustainable. This requires the preparation and approval of various indicators.

Public Works Loans Board (PWLB)
The Public Works Loans Board is a statutory body operating within the United Kingdom Debt Management Office, an Executive Agency of HM Treasury. PWLB's function is to lend money from the National Loans Fund to local authorities and other prescribed bodies, and to collect the repayments.

Security
Protecting investments from the risk of significant loss, either from a fall in value or from default of a counterparty.

Sovereign Credit Ratings
The credit rating of a country. It indicates the risk level of the investing environment of a country, taking into account political risk and other factors.

Specified Investments
A term defined in WG investment regulations, referring to any investments for less than one year, in sterling, and where the principal sum to be repaid at maturity is the same as the principal sum invested. An investment not meeting the above criteria would be termed a Non-specified investment

Sterling
The monetary unit of the United Kingdom (the British pound).

Term Deposits
A term deposit is a money deposit at a banking institution that cannot be withdrawn for a certain "term" or period of time.

UK Government Gilts
Fixed-interest debt securities issued or secured by the British Government. Gilts are always denominated in sterling though the Government occasionally also issues instruments in other currencies in the Eurobond market or elsewhere.

Variable Rate
An interest rate that changes periodically in line with market rates.

Yield
The annual rate of return paid out on an investment in securities, expressed as a percentage of the current market price of the relevant securities.

Welsh Local Government Association

Annexe E

WLGA • CLILC

Llywodraeth Cymru
Welsh Government

Housing Revenue Account Reform: Self-Financing in Wales

Introductory Guide for Councillors

November 2014

Contact

Welsh Local Government Association

The WLGA's primary purposes are to promote a better local government, its reputation and to support authorities in the development of policies and priorities which will improve public service and democracy.

It represents the 22 local authorities in Wales with the 3 fire and rescue authorities and 3 national park authorities as associate members.

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Published: November 2014

ISBN: 978-1-78286-013-6

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Introduction

Bringing the HRA subsidy system to an end in Wales, particularly the annual payment from Wales to HM Treasury of over £70 million, has been a goal of the WLGA, the Welsh Government and landlord Local Authorities for many years, and something that the WLGA has consistently lobbied for.

After lengthy negotiations the Welsh Government and HM Treasury have reached an agreement that will allow the eleven Authorities in Wales with council housing stock to exit from the Housing Revenue Account (HRA) subsidy system and become self-financing from April 2015.

The agreement has two parts; firstly authorities will be required to buy their way out of the current HRA subsidy system with payment of a one off settlement figure to HM Treasury, and secondly Authorities will be subject to a cap on HRA borrowing.

The introduction of self financing from April 2015 will give authorities the resources, incentives and opportunity to provide good quality, well managed council homes and plan for the long term with certainty.

Authorities will be able to:

- accelerate Welsh Housing Quality Standard (WHQS) work, to ensure achievement by 2020, and sustain it into the future
- increase investment in existing homes and in regenerating neighbourhoods over the short, medium and longer term
- ensure tenants benefit from more efficient and effective housing services
- increase the supply of new affordable homes
- increase investment in a range of other local priorities which could include increasing the energy efficiency of council homes, estate regeneration, remodelling general needs or sheltered housing, and purchase of existing homes to increase supply

- take a much longer term and business - like view of the housing stock and associated assets such as garages, commercial properties and land

- create jobs and training opportunities, and increase investment in the local economy

The new self-financing arrangements which will be in place from April 2015 will increase revenue year on year for the eleven landlord authorities. This is because the annual negative subsidy payment of £73m from the eleven landlord Authorities in Wales to the HM UK Treasury will be replaced from April 2015 by an payment of £40million of interest charges on loans from the Public Works Loan Board (PWLB).

The move to self financing offers the opportunity for Authorities to use their role as a landlord to help achieve their wider priorities and ambitions within the context of the ring-fenced HRA. These could include economic regeneration, improving health and well being, improving community safety and helping vulnerable people to live independently in the community.

This short guide is intended to help councillors and others understand the main principles of the reform of the HRA Subsidy system, the opportunities that self financing offers and the preparations needed to ensure the Authority is ready for self financing in April 2015.

2. A Brief Outline of the Housing Revenue Account subsidy system

The Housing Revenue Account (HRA) subsidy system which will come to an end in Wales on 31st March 2015 2015 was originally designed as a national pooling system for council rents in England and Wales.

Allowances for management and maintenance to council homes were originally set by national Government and if rents exceeded allowances, authorities paid into the 'pool' (called negative subsidy), and vice versa where allowances were greater than rents.

The subsidy system has resulted in every Welsh landlord Authority paying 'negative subsidy' each year to the UK Treasury which totals £73m. This has diverted rental income away from investment in homes and has under funded council housing over many years. The subsidy system also offers no incentives to landlord Authorities to make services more efficient or to ensure that rents and service charges fully cover costs, as any increase in revenue merely increases the negative subsidy payments to the UK Treasury.

The annually determined allowances of the HRA subsidy system are also unpredictable and volatile and have prevented authorities from being able to plan for the long term with any certainty.

3. Overview of HRA Reform in Wales

In July 2013 the UK Government and the Welsh Government reached agreement on the terms under which Authorities with housing stock in Wales could exit from the HRA subsidy system and become self financing. The agreement requires authorities to buy their way out of the HRA Subsidy system through a one off payment that is referred to as the 'settlement figure'. The agreement also imposes a limit on HRA borrowing.

The move to self-financing in April 2015 will mean that Authorities for the first time be in a position where they can support their landlord activities from their own income. In addition Authorities can to continue to apply for Major Repairs Allowance (MRA). This is an annual capital grant from the Welsh Government to Authorities with housing stock. Only authorities that submit an 'acceptable' business plan to Welsh Government which demonstrates that WHQS will be achieved by 2020 can receive MRA. There are no current proposals to change the MRA arrangements.

Self-financing Authorities must continue to maintain a statutory, ring fenced Housing Revenue Account and to account for income and expenditure on council housing separately from Council Fund income and expenditure.

3.1 The Settlement figure

The eleven landlord Authorities currently make annual HRA negative subsidy payments to the HM Treasury. The settlement will effectively buy Authorities out of the requirement to make these payments from April 2015.

HM Treasury requires that the settlement is 'fiscally neutral over the long term'. This will require the eleven Authorities to take out loans from the Public Works Loans Board (PWLB) to fund their share of the settlement figure. Under the terms of the agreement with the Treasury the agreed £40million interest will be converted to a total settlement value using the PWLB 30 year maturity rate.

The settlement figure has been estimated to be £920 million, but the precise figure will depend on the interest rate for PWLB loans on 31 March 2015 when the loans are requested.

These new arrangements will increase HRA resources for every Authority as the annual negative subsidy payments which currently total £73 million for the eleven Authorities will be replaced with £40 million of interest payments on PWLB loans. After Minimum Revenue Provision (MRP) payments (estimated to be 2%) are taken into account, the eleven Authorities are expected to be better off each year.

3.2 Distribution of the settlement figure between Authorities

HM Treasury has agreed that the distribution of the aggregate settlement figure of approximately £920 million between the eleven authorities is a decision for Welsh Ministers. There is broad consensus that the distribution of the settlement should not result in any Authority being worse off and following consultation with the eleven authorities on distribution of the settlement figure the former Minister for Housing and Regeneration agreed that it will be distributed between the eleven authorities so all benefit by an equal percentage of their current negative subsidy payment. At a WLGA HRA Reform seminar and a subsequent meeting of the WLGA Co-ordinating Committee in May 2014, all eleven authorities supported this approach. A table of illustrative figures is included in Appendix 1.

3.3 Borrowing Cap

The HRA exit agreement with HM Treasury will impose an aggregate HRA borrowing cap of £1.85 billion on the eleven Authorities in Wales. This figure is based on the planned borrowing that Authorities included in the housing business plans submitted to Welsh Government with their applications for Major Repairs Allowance (MRA) in December 2012-13.

The HRA borrowing limit of £1.85 billion includes existing borrowing, investment to bring council owned homes up to WHQS by 2020 and the cost of the settlement figure. Some Authorities also included plans to build new homes.

The remaining borrowing headroom of approximately £112 million will be available to fund local investment priorities, for example new build, regeneration, remodelling of existing homes or improvement of housing services.

HM Treasury has agreed that the settlement value is a component part of the borrowing cap calculation. Therefore the £1.85 billion will change to reflect the final settlement value.

The illustrative figures below indicate the borrowing that, at the point in times of the consultation, would be included within the borrowing cap of £1.85 billion.

- Existing HRA borrowing by authorities **£460 m**
- Estimated borrowing required to bring all council owned homes up to WHQS by 2020 **£358 m**
- Estimated borrowing for the cost of the settlement with HM Treasury **£920 m**
- Borrowing capacity remaining for other HRA priorities for example New build, regeneration and re modelling **£112 m**

TOTAL **£1.85 Billion**

The figures above are illustrative and relate to the time of the consultation. These will be revised to reflect the PWLB interest on 31 March 2015 which is the day that the final settlement value will be known.

Appendix 5 provides the latest draft figures for the breakdown of the Limit on Indebtedness (usually referred to within this document as the "borrowing cap").

3.4 Distribution of the Borrowing Cap

HM Treasury has also agreed that Welsh Ministers can decide how the borrowing cap is distributed between Authorities in Wales. The UK Government is in the process of passing the necessary legislation to make this possible.

As the figures above illustrate, most of the borrowing capacity will be taken up by existing borrowing, borrowing required to bring all stock up to WHQS by 2020 and the settlement figure. This leaves approximately £112 million of borrowing headroom to be distributed to Authorities for other HRA investment priorities.

The WLGA and representatives from the eleven authorities have worked with the Welsh Government to identify credible distribution options for the borrowing capacity and three options were included in the Welsh Government consultation paper (Appendix 3).

The three distribution options for the £112 million of borrowing capacity were considered at a WLGA HRA Reform seminar in May 2014, and subsequently at the WLGA co-ordinating committee. The WLGA agreed to support option 3, (see Appendix 2), as this is the distribution option that all eleven authorities could 'live with', although not necessarily the preferred option for some.

This option distributes some borrowing capacity to every authority, with a greater amount being allocated to those authorities that indicated a need for borrowing for new build in their housing 2012-13 business plans.

The WLGA co-ordinating committee also endorsed the prioritisation of borrowing required to achieve WHQS, but rejected the Welsh Government proposal to hold back £5million of borrowing capacity as a contingency. This was on the basis that the maximum level of borrowing capacity should be distributed to authorities to achieve the shared objectives of improving the quality of council housing and increasing supply.

In August 2014 the former Minister confirmed that the borrowing headroom would be distributed to the eleven authorities using the approach that all eleven authorities could 'live with' (Illustrative figures are included in Appendix 2), and no contingency sum would be held by the Welsh Government.

As part of the Welsh Government consultation on the new arrangements, all eleven Authorities supported the need for flexibility in the distribution of the borrowing capacity. The eleven authorities proposed that Authorities which do not wish to use all their borrowing capacity in the short or medium term are able to trade their capacity to borrow for a fixed period of time with another Authority that has reached its borrowing cap for a fixed period of time, to allow the borrowing cap to be used most effectively. Authorities did not support a 'use it or lose it' approach to redistribution of borrowing capacity by Welsh Government.

The former Minister agreed that the Welsh Government will not impose any sanctions or put in place any 'use it or lose it' arrangements in relation to the borrowing headroom, with a review of arrangements in 2018/19. The former Minister also asked the Project Steering Group to consider the details of how the Welsh Government could facilitate the trading or swapping of borrowing headroom. A letter from the former Minister for Housing and Regeneration announcing his decision on the distribution of the settlement value and borrowing cap, and flexibility arrangements is attached at Appendix 4.

The borrowing capacity distributed to each stock retaining authority represents a limit to the Authority's HRA borrowing over the coming 30 years. The extent to which Authorities wish to use some or all of their borrowing capacity will depend on whether it is affordable (i.e. whether revenue is able to support interest payments), and on local priorities.

Over the medium to long term it is expected that authorities will be in a position to create their own additional borrowing headroom by paying off existing debt.

Imposition of an HRA borrowing cap on Welsh Authorities requires UK Government legislation and this is being put in place via the Wales Bill which is progressing through the UK Parliamentary process. However it is uncertain whether the legislation and necessary arrangements will be in place before April 2015. This will make it necessary for the eleven authorities to sign individual voluntary agreements with Welsh Government, agreeing to their individual borrowing cap.

The voluntary agreements must be signed by all eleven authorities otherwise HM Treasury will not allow authorities to exit and the duty for each authority to pay negative HRAS will remain until the Wales Act comes into force.

3.5 Legislative Changes in the UK and Wales

Exit from the HRA subsidy system requires changes to both UK and Welsh legislation.

Changes to Welsh legislation are included in part 4 of the Housing (Wales) Act 2014. The Act also places a statutory duty on landlord Local Authorities to bring their stock up to the Welsh Housing

Quality Standard by 2020. It also includes new powers of entry, inspection and intervention if Authorities fail to meet the standard. The Act also includes new powers for Welsh Ministers to set standards for rents and service charges which relate to homes provided by the authority. Local Authorities will be required to comply with the standards.

Part 5 of the Housing (Wales) Act 2014 makes the legislative changes needed to introduce self financing in Wales and gives powers to Welsh Ministers to decide on the distribution of the settlement figure between Authorities.

Ministers also have new powers to set the timescales and processes that Authorities will need to follow in order to exit from the HRAS system and to require Authorities to respond to requests for information in relation to the HRA.

Changes to UK legislation are required to impose the borrowing cap on authorities in Wales. The Wales Bill was introduced in March 2014 and includes provision for UK Ministers to set the maximum amount of housing debt that can be held in aggregate by authorities with housing stock in Wales. It also allows Welsh Ministers to determine the amount of housing debt to be held by individual housing authorities.

terms of the exit from the HRA subsidy system.

The purpose of the project is to develop the new self-financing arrangements in Wales and support implementation of the changes at a local level.

A steering group and four work-streams have been formed with the involvement of officials from all eleven authorities with housing stock, along with Welsh Government, WLGA, Welsh Tenants, Wales Audit Office and CIPFA.

4. Introduction of the new self-financing arrangements

4.1 The HRAS Reform Project

The Welsh Government established an HRAS Reform Project in February 2014 following the agreement between Welsh Government and the UK Treasury on the

4.2 Timetable for the introduction of new national arrangements

The HRAS Reform project has identified a number of key milestones for the introduction of the new national arrangements. These are included in the table below along with approximate dates

HRAS Reform Milestones	Estimated Dates
The Welsh Government Consultation on the distribution of the settlement value and borrowing cap ended	10th July 2014
Welsh Government issued interim business planning guidance which includes agreed way forward on key accounting matters of interest charges, minimum revenue provision (MRP) & capital receipts	15th August 2014
Welsh Minister confirms his decision on the distribution of the	15th August 2014

settlement and the borrowing cap, as well as the flexibility arrangements	
Housing (Wales) Act gains royal assent, and introduces powers for Welsh Ministers to introduce the new self-financing arrangements and a new Local Government duty to comply with standards for Rents, Service Charges and Quality of Accommodation.	17th September 2014
Authorities develop **first draft** of their self financing business plans for submission by 29th September 2014	July – September 2014
Welsh Government engages with Authorities on the draft voluntary agreement	October 2014
Welsh Government issues the new policy for social housing rents and tables, including target rent bands for implementation by authorities in 2015/16	End October 2014
Welsh Government issues final Housing Revenue Account (HRA) Business Planning Guidance for self financing	end November 2014
Authorities to ensure that the Audited Final HRAS Claim for 2013/14 is agreed and signed off by Wales Audit Office, or their contracted Auditor, and submitted to Welsh Government by the absolute deadline of 28 November 2014.	November 2014
Welsh Government issues final version of the voluntary agreement	December 2014
Welsh Government issues the draft settlement determination for consultation	December 2014
Authorities apply for MRA and submit **final version** of their HRA business plan	7 January 2015
Authorities consider the impact of borrowing for self financing on the HRA budget and Treasury Management strategy and obtain delegated approval to sign voluntary agreement	October 2014 – mid January 2015
Authorities to sign the voluntary agreement	19 January 2015
Welsh Government converts the £40m of interest payments	31st March 2015

into the settlement figure and issues the Settlement Determination to authorities.	
Authorities to request loans from PWLB	31st March 2015
New national rent policy is introduced	1st April 2015
Authorities pay their proportion of the settlement figure to Welsh Government.	2nd April 2015
If all eleven Authorities have made their settlement payment, self financing is introduced	2nd April 2015

5. Preparing for the introduction of Self-Financing in your Authority

The move to self-financing in April 2015 will bring a fundamental change to the funding regime for council housing in Wales. The new arrangements will offer opportunities to improve council owned homes and landlord services if the Authority actively manages the risks and use the freedoms and opportunities self financing offers.

From the start Authorities will have an increase in retained revenue to invest in housing services and in improving homes and neighbourhoods. There will also be opportunities and incentives to increase revenue from efficiencies and increase investment in local priorities such as regeneration. Preparing for self-financing and putting the right policies and processes in place for April 2015 is therefore extremely important.

It will be necessary to make some changes to the way in which the Authority undertakes the landlord role. Some current strategies, policies and processes will need to be reviewed and adjusted, and some will need to be developed for the first time.

Many of the new self-financing arrangements in Wales such as new accounting practices are being put in place, but it is inevitable that some minor uncertainties will remain up until the end of March 2015. There is a great deal to do and it is important that these uncertainties do not unnecessarily delay preparations.

5.1 Putting the Self-Financing Project team in place

Every landlord Authority will need to co-ordinate a significant programme of work in order to put the new arrangements in place by April 2015.

The most effective way of doing this is to establish a project team that includes key authority officers responsible for housing services, housing strategy, accounting, treasury management and asset management. Leadership from a senior officer, your Chief Executive or portfolio leader is important. This may already be in place in your Authority.

A project work plan will be needed which identifies tasks, responsibility and timescales, and ensures that the necessary key political decisions are made at the appropriate time. There is a significant level of interdependency in many of the necessary changes and although some activities can be undertaken by individual departments, many will need the involvement of the whole project team.

The work plan will need to consider the key areas listed in this section (Section 5). Some policies and procedures may only need a change in emphasis, while others may need more fundamental revision. A detailed checklist of all of actions Authorities need to take to be ready for self financing is available on the WLGA website HERE.

5.2 Resources needed for Self-Financing

In the past the HRA subsidy system has limited the freedom of the authority to proactively plan and undertake the landlord role. It has also limited the risks to the Authority. Making full use of the opportunities and managing the risks will require capacity and resources.

While the HRA subsidy system will be coming to an end, the Housing Revenue Account which is the landlord account and ring fenced under primary legislation will remain in place.

After April 2015 self-financed council housing will need to operate much more like a housing association and be more integrated with the wider corporate strategic planning. The HRA will remain ring fenced, but there will be opportunities for council housing and landlord services to address wider corporate priorities including jobs growth, economic regeneration and increasing the supply of affordable housing within the legislative framework.

It is important that the preparations for self-financing and the Authority's future landlord activities have the expertise and staffing resources to ensure that opportunities are fully exploited and any risks mitigated.

The settlement will result in an increase in retained HRA resources for every landlord Authority from April 2015. This will allow authorities to improve the quality of homes and housing services, and increasing staffing resources will play an important role in achieving these improvements and efficiencies.

5.3 The Self-Financing HRA Business Plan

In essence the business plan is a financial model of income, expenditure and debt for the next 30 years, with more detailed modelling for the first 5 years. It provides a strategic planning framework and will be much more central to financial and service planning, monitoring progress and managing risk when self-financing is introduced.

The self-financing HRA business plan will need to be much more actively managed by the authority, rather than passively reported as might have been the case under the HRA subsidy system.
It has a key role as:

- A management tool to financially manage landlord services
- A source of financial advice to assist with planning
- A key aspect of the Authority's strategic housing role
- A tool to inform, and be informed by the asset management strategy
- A management tool for performance and accountability to tenants, the authority and other key stakeholders
- Incorporates HRA investment priorities and the balance between them

Whatever the format of the document, the housing business plan should focus on the next five year period, within a wider 30 year context. Members will need to be able to approve plans for the next five years, in the context of costs being covered over 30 years. The benefits of a detailed five year plan will be in delivering predictable resources over the medium term, enabling better planning and procurement and more certainty for tenants and residents on what investment is going where and when.

Self-financing will provide a much more stable financial environment for council housing and the business plan will be able to provide much better reassurance about the long term financial viability of the authority's landlord activities. Generally, there will also be more revenue available for investment from three sources:

- negative subsidies of £73m will end and be exchanged for £40m of interest payments on PWLB loans
- authorities will keep all future rental income, rather than a proportion going to HM Treasury in negative subsidy
- Authorities will be able to retain the benefit of more efficient services

5.4 Governance arrangements

Authorities will need to consider whether the current governance arrangements for the HRA will need to be strengthened to respond to the significant changes that self-financing will bring.

For example authorities may wish to consider whether it is appropriate to designate a small group of members to sit as a Strategic Panel or 'Board' to oversee the HRA business plan and recommend it for approval to cabinet/executive and the council.

Tenants are key stakeholders of the authority's self financing housing activities as they will provide the primary source of revenue. It is important that they are involved in some way in scrutinising the business plan.

There are a number of options including the involvement of tenant representatives as members of a HRA Strategic Board, as members of an expert tenant panel or as members of the authority's scrutiny committee. Tenants can make a valuable contribution to effective scrutiny, and support will be needed to help to build the necessary knowledge, skills and capacity.

The move to self-financing in April 2015 will not mean that the HRA is less accountable to the Authority and Elected Members. The council will continue to be responsible for ensuring that:

- the HRA remains viable and is able to service and repay HRA debt
- all council homes are brought up to WHQS by 2020 and are maintained at that standard. This will be a statutory duty from April 2015
- services are provided to tenants and leaseholders in an appropriate way and to an agreed standard
- complying with legislation including the new rent and service charge standards
- the statutory ring fencing of the HRA is maintained thus ensuring that tenant's rents are not used to support activities that should be funded by the Council Fund and vice versa

Authorities may wish to review the effectiveness of current scrutiny arrangements, particularly in the early years of self-financing. Many authorities are currently expanding the remit of their scrutiny panels and consideration may need to be given to setting up specific scrutiny arrangements which focus on the HRA.

The monitoring arrangements for the HRA will also need to be reviewed in recognition of the potential for higher levels of risk involved in self-financing. For example monitoring might need to taken place on a quarterly or monthly basis in the early years.

The process of developing and reviewing the business plan may also need to be reviewed and consideration given to a more formal approach to engaging with tenants, leaseholders, council services and Elected Members.

5.5 The Treasury Management Strategy

The Authority will already have a treasury management strategy which is agreed annually by full council as part of the budget setting processes. The move to self-financing will require some changes to be incorporated within the strategy, including borrowing to fund the Authority's share of the settlement figure and any additional borrowing for WHQS and other priorities. Authorities are required by the HRA exit agreement with HM Treasury to take out PWLB loans to fund the settlement figure, but will have freedom to decide where to source any additional HRA borrowing.

An aggregate cap of £1.85 billion on HRA borrowing has been imposed on authorities by HM Treasury. Following consultation with the eleven Authorities and the WLGA the Welsh Government has agreed how to distribute the borrowing capacity between the eleven Authorities. The cap includes existing borrowing, the borrowing required for any future WHQS work, the settlement figure and for local priorities such as new build and regeneration.

Decisions on HRA debt including how it is funded and investments are the responsibility of the Authority. It is very important that the debt is affordable and the debt portfolio actively managed. The HRAS reform steering group is currently considering options for how Authorities should deal with debt (whether Authorities should pool or separate HRA debt and Council Fund debt) under the new self-financing arrangements. Welsh Government guidance will be made available on de-pooling options.

A central theme of all self-financing business plans is the way in which the debt profile moves over time. For a majority of authorities, income exceeds the need to spend over the long term and if desired, debt can be brought down to zero within 30 years. Self-financing debt requires management but does not necessarily require repayment because income rises over time, and will continue to rise if the housing stock is maintained.

Often business plan models are set to reduce debt when possible so as to indicate the viability of the plan. If debt can be reduced to zero within 30 years, this makes a plan viable. Practically however, the business plan will be continually refreshed and several versions developed during the 30 years. In reality therefore, the approach to debt management needs to be flexible enough to cope with changes to the plan over time.

5.6 HRA Asset Management Strategy

The HRA asset management strategy is the foundation of the self-financing business plan. Authorities will already have a corporate asset management strategy and an asset based investment programme for achieving WHQS. It is important that the self-financing HRA asset management strategy is proactive and includes a focus on land and commercial assets of the HRA, as well as the housing stock.

Reasonably good information is available in every authority on the condition of the housing stock which is based on stock condition surveys. This provides a useful basis for a self-financing asset management strategy.

Information on commercial properties, garages and land may not be so comprehensive and may need to be added. The HRA asset management strategy for self financing must be based on a good understanding of all of the assets (land, homes and other buildings) and support a comprehensive, strategic, long term approach to investing in and fully utilising all the HRA assets.

The strategy will need to set out the long term plans for investing in and renewing the asset base, analysed into the different categories of assets and the Authority's long term strategy. For example:

- these homes will be refurbished to x standard and maintained over 30 years
- these homes will result in a net cost over the longer term and will be redeveloped when major improvements are due
- these homes have a very significant backlog of disrepair and improvement is not economically viable
- these are sheltered housing schemes which require remodelling to extra care schemes
- this HRA land is not in an area of housing demand and could be appropriated from the HRA to the

Council Fund and vice versa (subject to legal consent) for land in areas where there is high housing demand

- this HRA land is in an area of high housing demand and can be used to develop new homes

The strategy will also need to link closely with a wide range of other policies and strategies including property and service standards, investment priorities and treasury management.

5.7 Risk Management Strategy

Self-financing will lead to many changes including the transfer of risk from the national subsidy system to the Authority.

In future the housing business will more closely resemble the finances of a housing association with very similar associated risks. The Authority will therefore need to have similar risk management strategies in place. These will need to be robust enough to ensure the HRA business plan can be delivered without any unforeseen costs to the General Fund.

Key areas of risk will be interest rates, inflation, performance and income recovery. A very high proportion of these risks can be managed and mitigated through effective monitoring and basic good management of services and agreed policies and procedures.

Some UK Government policies will also present some potential for risk, particularly the welfare reforms. Authorities are already undertaking work to support tenants who are adversely affected by welfare reforms and further work may be needed in preparation for the introduction of Universal Credit to mitigate the risks to the income stream of the Authority.

In relation to the impact of the right to buy, Authorities have the power to suspend the right to buy for 5 years, subject to consent of Welsh Ministers, and this may be an area for consideration in the new context of self financing and council building.

It is important to recognise that operating a self-financing business plan can never be risk free and innovation will sometimes require risks to be taken. The key is to ensure that the risks are understood and mitigating action taken.

5.8 Investment priorities

The first priority for investment should be bringing existing council homes up to Welsh Housing Quality Standard (WHQS) and maintaining the standard. This will require authorities to make assumptions, based on good information about the housing stock, about the long term renewal needs of the existing housing stock and other assets.

A growing number of Authorities will achieve WHQS in the lead up to 2020 and there will opportunities to use revenue or borrowing to invest in other HRA priorities. Decisions will therefore need to be taken on what the Authorities' future investment priorities will be. It will be important that council tenants are involved in discussions about future priorities.

If it is well managed the self-financing HRA will generate a steady increase in revenue over time. Broadly, there are four ways councils can target additional investment and the balance of priorities are likely to be different in different authorities:

- ***Accelerating or increasing levels of refurbishment***

If the council's houses have not yet been brought up to WHQS, the Authority could decide to accelerate the refurbishment programme so the standard is reached sooner. Consideration could also be given to bringing properties up to a higher standard, for example with higher levels of energy efficiency.

- ***Investing in Services***

Authorities could decide to improve or enhance housing services for their tenants. This could involve enhancing current service standards, for example repair response times. It could also include providing additional services to address the impact of welfare reform and cut backs or closure of public services, for example providing debt and benefits advice or assisting to tenants who are downsizing.

The Authority will need to consider where to strike the balance between improving service standards for existing tenants on one hand, and on investing in additional housing supply or regeneration to meet housing need in the wider community. Both types of investment are legitimate investments for the ring fenced HRA

- ***Regenerating estates***

The term regeneration is used here to describe any investment to address difficult or challenging stock or estates and replace or redevelop it with new or different housing. For example this might include demolition and redevelopment of obsolete stock or remodelling general needs housing or sheltered housing. The Authority may also wish to consider environmental improvements that enhance council owned estates.

Self financing will offer opportunities to bring forward schemes that would have been difficult to fund under the HRA subsidy system but Authorities still need to be mindful of the ring fenced HRA.

- ***Increasing the supply of affordable homes***

A significant number of the eleven landlord authorities have indicated an interest in building new homes in the future, be that on small infill sites or more extensive developments.

Development could take place on HRA owned land or on land appropriated from the Council Fund.

There may also be opportunities to acquire existing properties in poor condition (for example Right to Buy properties) and improve them to provide affordable homes.

5.9 Housing Service Efficiencies

Self-financing from April 2015 will ensure that Authorities can invest all their HRA revenue in landlord activities. This will mean that any revenue from service efficiencies, for example in reduced void periods, reductions in rent arrears or more efficient procurement can be retained and used to increase investment in homes and services.

Service standards may already be in place, but the Authority may wish to review these in the context of self financing. An important aspect of operating a successful and accountable self financing HRA will be to set and monitor performance standards across a wide range of the landlord's services. This will support service improvement and help to improve efficiency.

5.10 The New Rent Policy

The Housing (Wales) Act 2014 introduces new powers for Welsh Ministers to set a rent standard and to issue guidance which amplifies the standard. The Welsh Government will work collaboratively with the Local Authorities and Housing Associations to develop the rent standard and guidance.

The Welsh Government issued a new policy for social housing rents which was introduced for Housing Associations in April 2014 and will apply to Local Authorities from April 2015. It is expected that this rent policy will become the guidance on the rent standard. The policy will set a target rent band for each Authority and if the **average** weekly rent (excluding service charges) is below the target rent, the authority will have to increase **average** rents, and if the **average** is above the target rent, **average** rents will increase at a lower rate. Authorities will be responsible for setting the rents of individual properties.

If an Authority needs to increase their average weekly rent so that it falls within the target rent band, transitional protection for tenants will apply so the rent for an individual tenant cannot be increased by more than £2 per week, in addition to the agreed annual rate of rent increases for the sector as a whole. Between 2015-16 and 2018-19 the maximum increase for any individual tenant is limited to CPI + 1.5% plus £2 per week.

When authorities become self-financing, rental income and the local rent setting policy will be a major factor in the viability of the business plan. As from April 2015 all rental income will be retained by the Authority and used to fund expenditure, service debt and create borrowing headroom for investment in homes and services. Limiting rent increases will restrict the improvements that can be made to homes and services.

A decision on rent increases in any one year will not only affect financial viability of the business for that year, it will continue to affect viability in the long term as well.

5.11 Service Charges

The Housing (Wales) Act 2014 introduces new powers for Welsh Ministers to set a service charge standard and to issue guidance which amplifies the standard. The Welsh Government will work collaboratively with the Local Authorities and Housing Associations to develop the service charge standard and guidance.

Every landlord authority provides some additional services for their tenants and leaseholders, whether this is grass cutting, CCTV or lighting to communal areas. Until recently most Local Authorities have pooled service charges and often paid for services out of rental income. This has resulted in many authorities losing revenue on the services they provide or unfair charging for services in that some tenants have been paying for services they do not receive.

The Welsh Government has not yet set a date when de-pooling has to be completed, but the expectation is that the process should be well underway in April 2015, with completion over the following 18 months – 2 years.

5.12 Tenant Engagement

Ending the HRA subsidy system will mean that rental income will become the primary source of income for the HRA. Engagement with tenants on the use of rental income, the standard of housing services and the priorities for investment will become much more important than in the past.

The Authority will need to review current approaches to engaging with tenants and consider every opportunity to inform tenants about the changes that self-financing will bring and consult on the self-financing business plan.

6. Preparing for Self-Financing: Checklist

We hope this introduction to the new self-financing HRA arrangements has highlighted some of the technical and financial issues involved as well as some of the options, opportunities and risks of the new world of HRA self-financing.

The move to self-financing offers significant opportunities, with scope to increase investment in housing services, regeneration and housing supply at a time when other parts of the public sector are under severe pressure. Ensuring that the transition to the new arrangements is well planned and comprehensive these is absolutely central to making a success of the new self-financing arrangements.

Below is a checklist of the main 'key decisions' to be taken prior to implementation of self-financing:

- **Resources and expertise** – Is a self-financing project team in place to plan for the transition, has a work plan been developed?
- Are the right levels of staffing resources and expertise in place to ensure the Authority will be prepared for self-financing in April 2015?
- What staffing resources will an effective and efficient self-financed housing business need in future?
- **Self financing Business plan** – what progress is being made in developing the self-financing business plan?
- **Governance** – what structures need to be in place to ensure good governance? Are these being developed?
- **Efficiency strategy for services** – What are the Authority's plans to improve service efficiencies?
- **Depreciation/refurbishment policy** – what is the formal policy for renewal and replacement?
- **Does the Authority wish to separate HRA debt from the**

Council Fund debt? – are the options being considered?

- **Treasury Management strategy** – are plans in place to fund the settlement figure and any borrowing for WHQS or other investments incorporated within the strategy? What is the balance between long and short term funding?

- **Is work underway to introduce the new national rent policy?**

- **Is work underway to de-pool service charges?**

- **Is an active HRA asset management strategy being developed?**

- **Has the Authority started to consider self-financing investment priorities?** – a well managed self-financing HRA will generate an increase in revenue from April 2015. This offers opportunities to invest in new ways including housing services, regeneration and increasing the supply of affordable homes. What are the priorities of the authority and tenants for future investment?

- **Tenant Engagement Strategy -** how will you let tenants know about the changes to the funding of council housing, how will you engage with tenants in the future?

7. Experience of Self-Financing in England

Authorities in Wales will become self-financing in April 2015, but the 164 Local Authorities with housing stock in England exited from the HRA subsidy system three years earlier in April 2012. The LGA undertook a survey (1) of English Authorities a little less than 2 years after the introduction of self-financing and their findings included the following key messages:

- Reaching and sustaining the Decent Homes Standard (the English Equivalent of WHQS) is the highest investment priority for all Authorities

- 88% of councils are planning to directly fund new housing through the HRA over the next 5 years

- Council investment priorities include the following:
    - Investment in energy efficiency
    - Environmental improvements
    - Estate regeneration
    - Remodelling general needs housing
    - Spot purchase of property
    - Remodelling sheltered housing

- The key economic benefits are considered to be support for local businesses and contractors, apprenticeships and training opportunities for local young people and increased inward investment into the local economy

- 98% of councils will be using their own land to bring forward housing development over the next 5 years

Appendix 1:

Distribution of the Settlement Figure: Illustrative Figures from the July consultation document

Local Housing Authority	HRAS settlement amounts (1)	Share of annual interest (2)	Reduction	Reduction	Share of estimated settlement value (3)
	£	£	£	%	£
Isle of Anglesey	1,695,873	930,779	765,094	45.12	21,396,292
Caerphilly	5,978,361	3,281,222	2,697,139	45.12	75,427,087
Cardiff	15,095,807	8,285,330	6,810,477	45.12	190,459,015
Carmarthenshire	6,234,522	3,421,816	2,812,706	45.12	78,658,989
Denbighshire	3,105,081	1,704,223	1,400,858	45.12	39,175,823
Flintshire	6,324,826	3,471,379	2,853,447	45.12	79,798,326
Pembrokeshire	6,373,758	3,498,235	2,875,523	45.12	80,415,686
Powys	5,660,823	3,106,941	2,553,882	45.12	71,420,811
Swansea	5,789,100	3,177,346	2,611,754	45.12	73,039,241
The Vale Of Glamorgan	5,011,706	2,750,673	2,261,033	45.12	63,231,107
Wrexham	11,609,836	6,372,055	5,237,781	45.12	146,477,623
	72,879,693	**40,000,000**	**32,879,693**		**919,500,000**

Notes:
(1) HRAS settlement amounts obtained from 2013/14 HRAS 2nd estimate claims HRAS 13-02(W)
(2) Interest payments of circa. £40m required as part of the agreement with Treasury
(3) Estimated settlement value based on PWLB 30 year Maturity rate at 12 March 2013 of 4.35%

Appendix 2:

Illustrative figures for the distribution of the borrowing cap from the July consultation document

Distribution of the borrowing headroom on prioritising WHQS, 4 LHAs receiving 50% of their new build request with balance allocated to 11 LHAs on an indicative basis using the modified SHG formula.

The illustrative figures are broken down into borrowing required to meet WHQS and borrowing available for new build based on 50% of the figures 4 LHAs requested for new build with the balance being distributed across all 11 LHAs. The latter distribution uses official Welsh Government statistics and utilises the most recent data for median incomes and median house prices to create an affordability ratio and combines it with household projections. This data is used to calculate the housing need element of the formula that is used by Welsh Government to distribute SHG to Local Authorities.

	Borrowing Cap Allocation				
	WHQS	**50% of new build requested**	**Allocation based on modified SHG[1]**	**Total borrowing allocation**	**% share of Borrowing**
Authority	**£**	**£**		**£**	
Anglesey	0	10,700,000	2,360,856	13,060,856	2.8
Caerphilly	55,000,000		4,308,047	59,308,047	12.6
Cardiff	0	20,000,000	11,183,046	31,183,046	6.6
Carmarthenshire	14,400,000		4,989,158	19,389,158	4.1
Denbighshire	19,600,000		2,871,128	22,471,128	4.8
Flintshire	25,000,000	10,000,000	4,328,108	39,328,108	8.3
Pembrokeshire	0	13,000,000	4,198,028	17,198,028	3.7
Powys	18,200,000		5,356,877	23,556,877	5.
Swansea	74,000,000		6,793,913	80,793,913	17.2
Vale Of Glamorgan	33,900,000		4,129,355	38,029,355	8.1
Wrexham	118,000,000		3,766,746	121,766,746	25.8
Total	**358,100,000**	**53,700,000**	**54,285,263**	**466,085,263**	
Contingency to be retained by Welsh Government	**5,000,000**			**5,000,000**	**1.1**
All Wales	**358,100,000**	**107,985,263**		**471,085,263**	**100.0**

[1] Based on:
2011 Household Projections published by the Welsh Government
Median Gross Weekly Pay 2013 Resident Analysis published by ONS and
Median House Prices 2011 published by HM Land Registry

Appendix 3:

Welsh Government Consultation on the Distribution of the Settlement and the Borrowing Cap

Consultation Paper

New Local Housing Authority Self-Financing System (HRAS Reform)

The distribution of the Settlement Value of HRAS buy-out and the Housing Related Borrowing Cap for individual Stock Retaining Local Housing Authorities

Background

The Welsh Government has been in discussions with HM Treasury since 2010 with a view to agreeing a financial settlement that would enable the eleven stock retaining local housing authorities (LHAs) to exit from the Housing Revenue Account Subsidy (HRAS) system.

The Welsh Ministers were pleased to announce in June 2013 that an agreement had been reached with HM Treasury, which together with the introduction of new self-financing arrangements is expected to generate revenue savings for the eleven LHAs each year. This will allow LHAs to increase their investment in their existing stock and, where possible, support the delivery of additional housing supply. Some LHAs could bring forward improvement works to their properties to meet the Welsh Housing Quality Standard (WHQS) which will bring real and tangible benefits to their tenants.

Key elements of the agreement are that:

- LHAs are required to buy themselves out of the HRAS;
- The £73m of annual negative subsidy payments will be replaced by interest payments of approximately £40m. This will satisfy HM Treasury's requirement that the agreement is fiscally neutral over the longer term;
- The £40m annual interest payments will be converted to a lump sum settlement value a short period before the agreed implementation date. This will enable LHAs to consider their borrowing requirements in accordance with their local Treasury Management Strategy, to meet current business plan commitments and provide flexibility for LHAs to determine the type and period of loan.
- In order to fund the buy-out, Treasury require LHAs to borrow from the Public Works Loans Board (PWLB). Failure to comply with this will result in sanctions by Treasury. This will mean the Welsh Budget will be reduced and the reduction passed on to each LHA as appropriate. Interest payments made to the PWLB are effectively received by the exchequer;
- HM Treasury requires a housing related borrowing cap to be imposed on each LHA in order to control public sector borrowing.

The Welsh Government has worked closely with HM Treasury to identify timescales for implementation and the appropriate legislative mechanism for the setting of housing related borrowing cap. HM Treasury has advised that the borrowing cap requires UK legislation and is bringing forward provisions within an appropriate UK Bill. If provisions within the UK primary legislation is not in place HM, Treasury have agreed that Wales can exit from the HRAS system in March 2015 on condition that Welsh Government secures and manages the borrowing cap as part of a voluntary agreement with all eleven LHAs.

Legislative Background

Housing (Wales) Bill

The Minister for Housing and Regeneration introduced the Housing (Wales) Bill to the National Assembly for Wales in November 2013. The Bill is currently at Stage 2 of the scrutiny process during which the Communities, Equality and Local Government (CELG) Committee will consider, and vote upon, both Government and non-Government amendments to the Bill.

The provisions in Part 5, Housing Finance will, subject to scrutiny, provide:

- for the Welsh Ministers to make a determination providing for the calculation of the settlement payment that each LHA will be required to pay in order to exit HRAS.
- for the determination to be revised only in the event that there has been an error or change in any matter that was taken into account in the original calculation or determination.
- for the Welsh Ministers to determine the timescales and processes that LHAs will need to follow in order to exit HRAS;
- for LHAs to be required to respond to requests for information; and
- for the existing legislation which supports HRAS system to be repealed.

The provisions in Part 5 may be amended

The provisions in Part 4, Standards for Social Housing will, subject to scrutiny, provide for the Welsh Ministers to:

- set standards to be met by LHAs in connection with the quality of accommodation provided by LHAs and the rent and service charges for such accommodation.
- to issue guidance that relates to, and amplifies, the standard.
- consult with bodies representing the interests of LHAs, tenants and other persons Welsh Ministers consider appropriate when setting, revising, or withdrawing standards and related guidance; and
- have powers of intervention where a LHA has failed, or is likely to fail, to meet the quality of accommodation standard.

The provisions in Part 4 may be amended

The Housing (Wales) Bill, explanatory memorandum and the record of passage through the National Assembly for Wales can be found at:
http://www.senedd.assemblywales.org/mgIssueHistoryHome.aspx?IId=8220

Wales Bill

The Secretary of State for Wales published a draft Wales Bill in December 2013.

The draft Bill was subject to pre introduction scrutiny by the Welsh Affairs Committee. The Committee reported in March 2014. The UK Government introduced the Wales Bill (along with explanatory notes and the Financial Empowerment and Accountability Command Paper) on 20 March 2014.The provisions in clause 23, provide:

- for UK Ministers to set the maximum amount of housing debt that can be held, in aggregate, by LHAs in Wales;
- for Welsh Ministers to determine the amount of housing debt that is to be treated as held by each LHA, and the maximum amount of housing debt that each LHA may hold;
- powers for Welsh Ministers to obtain such information as Welsh Ministers may specify either generally, or in a particular case, from LHAs to enable them to exercise their functions above.

The Wales Bill, explanatory notes and details of progress of the Bill through Parliament can be found at:

http://services.parliament.uk/bills/2013-14/wales.html

Voluntary Agreement

As the timescales for UK Legislation were unclear, HM Treasury agreed that the 11 Welsh LHAs could exit the HRAS system in March 2015, subject to the Welsh Government securing and managing a borrowing cap through a voluntary agreement between each of the eleven LHAs and Welsh Ministers.

The powers for Welsh Ministers and a LHA to enter into a voluntary agreement are provided in section 80B of the Local Government and Housing Act 1989.

It is essential that all eleven LHAs agree and sign the voluntary agreement. Failure to do so will result in the HRAS remaining in place in Wales until appropriate UK legislation is passed.. This means that at least £73 million will continue to be paid back to HM Treasury each year.

The voluntary agreement will act as an interim arrangement until the Wales Bill comes into force and as a fall-back position should the Wales Bill fall for whatever reason. Once the Wales Bill receives Royal Assent and the appropriate provisions are commenced Treasury will need to issue a determination to the Welsh Ministers which will set the macro borrowing cap for Wales. This will enable the Welsh Ministers, subject to consultation, to issue a determination to LHAs which will set the borrowing cap for each LA. There is the potential for the legislative process to replace the need for a voluntary agreement.

Welsh Government Priorities

The Welsh Government believes that everyone in Wales should have the opportunity to live in a good quality home within a safe and secure community.

The Welsh Government is committed to ensuring that all LHAs meet the WHQS by 2020 and has worked closely with LHAs to ensure that their business plans demonstrate that they will meet this target date. LHAs must be able to have access to sufficient borrowing to enable them to meet WHQS by 2020.

The Housing (Wales) Bill will, subject to scrutiny, will enable the existing WHQS guidance to be issued as guidance to the quality of accommodation standard for existing properties. Therefore the Bill will place the requirement for LHAs to meet and maintain the WHQS on a statutory basis for the first time.

The Welsh Government is also committed to increasing housing supply and supporting LHAs that wish to undertake new council house building. However, this should not be to the detriment of meeting WHQS

Governance Arrangements

The Welsh Government has put in place robust governance arrangements to manage and oversee the reforms. This comprises a steering group and four technical work-streams. One of the key responsibilities of the steering group is to make recommendations to the Minister for Housing and Regeneration on the methodology to be used for the distribution of the settlement value and the borrowing cap. The steering group includes representatives from LHAs, WLGA, Welsh Tenants, Wales Audit Office and Welsh Government.

The WLGA and LHA representatives on the steering group support and agree the inclusion of all the options within this consultation paper but have differing views on whether a preferred option should be identified.

In the interests of both landlords and tenants it is essential that agreement is reached on the distribution methodologies. This is necessary as the finally agreed methodologies will form the basis of the voluntary agreement that will need to be signed by all 11 LHAs. In light of this, the Welsh Government considers that Borrowing Cap Option 3 provides a compromise between those LHAs that have firm plans for new build while enabling the remaining LHAs the opportunity to consider their capacity for new build.

The Welsh Government therefore considers that the Settlement Value Option 1 and the Borrowing Cap Option 3 are the preferred options. The final distribution methodologies will be subject to consultation and agreement by the Minister for Housing and Regeneration.

Background

Welsh Government officials have worked closely with appropriate officials from LHA's since June to consider the principles that might underpin the distribution of a settlement figure and a borrowing cap.
There was clear consensus that "***every stock retaining authority should be better off than the current position***". This includes not only the financial benefits from exiting HRAS but also the benefits of becoming self-financing. The Welsh Government and the steering group are committed to maintaining this as a key principle in the distribution arrangements.

The Directors of Housing and Chief Treasurers of the eleven stock retention authorities met and considered options for the distribution of both the settlement value and borrowing limits. They agreed that, although not perfect, the distribution of the settlement value based on negative subsidy values appeared to be the most pragmatic and transparent way forward.

Members of the steering group have worked closely together to model and consider a wide range of options for distribution of the borrowing cap. The group identified those options which were most suitable for further consideration and narrowed these down to those that should be subject to consultation.

When considering the options which are set out in the following part of this consultation paper, it should be noted that the accounting work-stream, the transaction and debt work-stream and the capacity building work-stream will jointly be considering a range of financial and accounting matters and related guidance which will inform the development of financially sustainable business plans following the buy-out and implementation of the new self-financing arrangements. These matters include, but are not limited to, depreciation, minimum revenue provision, treatment of capital receipts and loan pooling arrangements. The work-streams will also be developing new business plan guidance and parameters and these will be made available to LHAs in due course.

It should be noted that all figures contained within the options and the statistics within this consultation paper are illustrative and remain subject to change for a number of reasons before the final settlement date.

The final figures and methodology will be subject to agreement by the Minister for Housing and Regeneration.

Exiting from the HRAS system: The Agreement with HM Treasury

The agreement with HM Treasury, which will allow authorities to exit from the HRAS system and become self financing from April 2015 consists of two parts.

Firstly, the eleven stock retaining authorities are required to buy themselves out of the existing HRAS. The agreement is based on £40m interest payments which will replace the existing negative subsidy payment of £73m. The £40m interest will be converted to a buy-out lump-sum (settlement value) a short period before an agreed settlement date and authorities will be required to take out loans with the PWLB to fund the buy-out. This will result in all authorities being better off under self financing.

The second part of the agreement is that HM Treasury require a housing borrowing cap to be set for each of the eleven authorities.

A borrowing cap of £1.85 billion was agreed with HM Treasury in June 2013. The cap includes the estimated Housing Revenue Account capital finance requirement (HRA CFR) and the estimated settlement value. This leaves potential borrowing headroom of £471 million for authorities to meet their business plan commitments. All estimated figures are subject to change as the HRA CFR will need to be updated[2] and the settlement value will be based on prevailing interest rates when the £40 million is converted to a settlement buy-out value.

Should the figures change significantly it is possible that the headroom will be reduced below £471 million. In the event that the borrowing required by LHAs exceeds the headroom, in order to protect investment in WHQS, the first call will be to reduce the borrowing available for new build.

This consultation considers how the settlement value and the potential borrowing headroom should be distributed given that LHAs need to be able to access sufficient borrowing to enable them to meet WHQS by 2020.

Key Information

The information in Table 1 below has been obtained from each LHA as part of their application for Major Repairs Allowance for 2014/15 and from their Housing Revenue Account (HRA) Business Plan which was submitted to Welsh Government in December 2013. The Welsh Government carried out a further exercise to obtain confirmation from each LHA on the accuracy of the figures below.

Table 1: Stock numbers, WHQS status and estimated borrowing requirement:

Local Housing Authority	Stock at Dec [3] 2013	Met WHQS	Expected to achieve WHQS		Estimated Borrowing Requirement		
			Month	Year	To meet WHQS	For New Build	Total
					£m	£m	£m
Cardiff	13,730	Yes				40.0	40.0
Anglesey	3,802	Yes				21.4	21.4
Pembrokeshire	5,663	Yes				26.0	26.0
Denbighshire	3,454		December	2014	19.6		19.6
Carmarthenshire	9,009		March	2015	14.4		14.4
Vale of Glamorgan	3,940		March	2017	33.9		33.9
Powys	5,419		March	2018	18.2		18.2
Caerphilly	10,900		March	2020	55.0		55.0
Wrexham	11,292		December	2020	118.0		118.0
Swansea	13,590		December	2020	74.0		74.0
Flintshire	7,236		December	2020	25.0	20.0	45.0
All Wales Borrowing Requirement					**358.1**	**107.4**	**465.5**

The Settlement Value and its Distribution

[2] The proposed date of the HRA CFR will be considered by the accounting work-stream, be subject to discussion with Wales Audit Office and approved by the Minister for Housing and Regeneration.
[3] Stock numbers for tenanted properties obtained from HRA Business Plan submitted December 2013

In order to allow Wales to exit the HRAS system, HM Treasury required LHAs to "buy-out" of the system at a settlement figure that is fiscally neutral to the UK Government. The agreement is based on £40m interest payments which will be converted to a lump-sum (settlement value) a short period before an agreed settlement date. The estimated settlement value is considered to be in the region of £919.5 million, which has been used for modelling purposes. HM Treasury requires local authorities to fund the "buy-out" by borrowing from the Public Works Loans Board (PWLB).

Options for distribution of the Settlement Value

Settlement Value Option 1 - To distribute the settlement value based on negative HRA subsidy amounts

Local Housing Authority	HRAS settlement amounts (1)	Share of annual interest (2)	Reduction	Reduction	Share of estimated settlement value (3)
	£	£	£	%	£
Isle of Anglesey	1,695,873	930,779	765,094	45.12	21,396,292
Caerphilly	5,978,361	3,281,222	2,697,139	45.12	75,427,087
Cardiff	15,095,807	8,285,330	6,810,477	45.12	190,459,015
Carmarthenshire	6,234,522	3,421,816	2,812,706	45.12	78,658,989
Denbighshire	3,105,081	1,704,223	1,400,858	45.12	39,175,823
Flintshire	6,324,826	3,471,379	2,853,447	45.12	79,798,326
Pembrokeshire	6,373,758	3,498,235	2,875,523	45.12	80,415,686
Powys	5,660,823	3,106,941	2,553,882	45.12	71,420,811
Swansea	5,789,100	3,177,346	2,611,754	45.12	73,039,241
The Vale Of Glamorgan	5,011,706	2,750,673	2,261,033	45.12	63,231,107
Wrexham	11,609,836	6,372,055	5,237,781	45.12	146,477,623
	72,879,693	**40,000,000**	**32,879,693**		**919,500,000**

Notes:
(1) HRAS settlement amounts obtained from 2013/14 HRAS 2nd estimate claims HRAS 13-02(W)
(2) Interest payments of circa. £40m required as part of the agreement with Treasury
(3) Estimated settlement value based on PWLB 30 year Maturity rate at 12 March 2013 of 4.35%

Advantages

- Every LHA would be better off in revenue terms when compared to the existing HRAS subsidy payments
- The method is as transparent and simple as possible given the inherent complexities of the existing HRAS system
- Each LHA has the same percentage reduction when comparing their existing HRAS amount to their share of the £40m
- Would be relatively straightforward to explain to tenants and members

- Would not replace one complex formula with another

Disadvantages

- Reflects the current and complex HRA subsidy system but some might argue that the current system is not fair
- There is no link to the current condition of the housing stock
- There is no link to the resources required to meet and maintain WHQS
- There is no link to housing supply or demand

Other Options Considered

The other option considered for the distribution of the settlement value was to base it on the stock numbers for each LHA. While this appeared to be a simple and transparent methodology, the results of the modelling showed that two authorities would be expected to pay more in annual interest payments than they currently pay in negative subsidy payments. This option was therefore disregarded on the basis it did not result in every stock retaining authority being better off than within the subsidy system.

Summary

The Welsh Government considers that Settlement Value Option 1 is the preferred option. The final decision will be subject to consultation and agreement by the Minister for Housing and Regeneration.

Options for distributing the Borrowing Cap

Borrowing Cap Option 1 - To distribute the borrowing headroom based on information submitted by each LHA to the Welsh Government in support of their HRA Business Plan for their 2014/15 application for MRA

	Borrowing Cap Allocation			
	WHQS	New Build	Total borrowing allocation	% share of Borrowing
Authority	**£**	**£**	**£**	%
Anglesey	0	21,400,000	21,400,000	4.5
Caerphilly	55,000,000	0	55,000,000	11.7
Cardiff	0	40,000,000	40,000,000	8.5
Carmarthenshire	14,400,000	0	14,400,000	3.1
Denbighshire	19,600,000	0	19,600,000	4.2
Flintshire	25,000,000	20,000,000	45,000,000	9.6
Pembrokeshire	0	26,000,000	26,000,000	5.5
Powys	18,200,000	0	18,200,000	3.9
Swansea	74,000,000	0	74,000,000	15.7
Vale Of Glamorgan	33,900,000	0	33,900,000	7.2
Wrexham	118,000,000	0	118,000,000	25.0
	358,100,000	**107,400,000**	**465,500,000**	
Contingency to be retained by Welsh Government	**5,585,263**		**5,585,263**	**1.2**
All Wales	**363,685,263**	**107,400,000**	**471,085,263**	**100.0**

It is assumed that the information submitted by each LHA reflects what each can "afford" to borrow.

It is further proposed that any balance, between the borrowing requirement identified by authorities and the total borrowing cap, should be retained by the Welsh Government as a contingency (see section on Flexibility below).

Advantages

- Prioritises WHQS by ensuring that LHAs have access to sufficient borrowing to enable them to meet WHQS by 2020.
- Provides access to sufficient borrowing to those LHAs that have included proposals for new build within their existing business plans.

Disadvantages

- Does not reflect housing need or demand.
- Does not allocate any borrowing headroom to the 7 authorities who have not included new build proposals in their latest business plan.

Borrowing Cap Option 2 - To base the distribution of the borrowing headroom on prioritising WHQS and applying a modified Social Housing Grant (SHG) formula using household projections and affordability index

The illustrative figures are broken down into borrowing required to meet WHQS and borrowing available for new build. This approach uses official Welsh Government statistics and utilises the most recent data for median incomes and median house prices to create an affordability ratio and combines it with household projections. This data is used to calculate the housing need element of the formula that is used by Welsh Government to distribute SHG to Local Authorities.

	Borrowing Cap Allocation			
	WHQS	Allocation based on modified SHG[4]	Total borrowing allocation	% share of Borrowing
Authority	**£**	**£**	**£**	
Anglesey	0	4,696,259	4,696,259	1.0
Caerphilly	55,000,000	8,569,648	63,569,648	13.5
Cardiff	0	22,245,524	22,245,524	4.7
Carmarthenshire	14,400,000	9,924,527	24,324,527	5.2
Denbighshire	19,600,000	5,711,302	25,311,302	5.4
Flintshire	25,000,000	8,609,555	33,609,555	7.1
Pembrokeshire	0	8,350,797	8,350,797	1.8
Powys	18,200,000	10,655,999	28,855,999	6.1
Swansea	74,000,000	13,514,579	87,514,579	18.6
Vale Of Glamorgan	33,900,000	8,214,191	42,114,191	8.9
Wrexham	118,000,000	7,492,881	125,492,881	26.6
Total	**358,100,000**	**107,985,263**	**466,085,263**	
Contingency to be retained by Welsh Government	**5,000,000**		**5,000,000**	**1.1**
All Wales	**363,100,000**	**107,985,263**	**471,085,263**	**100.0**

Advantages

[4] Based on:
2011 Household Projections published by the Welsh Government
Median Gross Weekly Pay 2013 Resident Analysis published by ONS and
Median House Prices 2011 published by HM Land Registry

- Prioritises WHQS by ensuring that LHAs have access to sufficient borrowing to enable them to meet WHQS by 2020.
- Provides all LHAs with "notional borrowing headroom" to enable them to consider proposals for new build, if affordable within their business plans.
- Distributes borrowing cap headroom after WHQS by an objective measure that is a reasonable proxy for housing need.
- This formula could be applied as and when Treasury agree an uplift to the macro borrowing cap for Wales.

Disadvantages

- Does not provide for the level of new build that is currently included within the business plans for four LHAs.
- Could be perceived to disadvantage those that have met WHQS.
- LHA may not be able to use full borrowing capacity to build by 2018.

Borrowing Cap Option 3 - To base the distribution of the borrowing headroom on prioritising WHQS, 4 LHAs receiving 50% of their new build request with balance allocated to 11 LHAs on an indicative basis using the modified SHG formula.

The illustrative figures are broken down into borrowing required to meet WHQS and borrowing available for new build based on 50% of the figures 4 LHAs requested for new build with the balance being distributed across all 11 LHAs. The latter distribution uses official Welsh Government statistics and utilises the most recent data for median incomes and median house prices to create an affordability ratio and combines it with household projections. This data is used to calculate the housing need element of the formula that is used by Welsh Government to distribute SHG to Local Authorities.

	Borrowing Cap Allocation				
	WHQS	50% of new build requested	Allocation based on modified SHG[5]	Total borrowing allocation	% share of Borro wing
Authority	**£**	**£**		**£**	
Anglesey	0	10,700,000	2,360,856	13,060,856	2.8
Caerphilly	55,000,000		4,308,047	59,308,047	12.6
Cardiff	0	20,000,000	11,183,046	31,183,046	6.6
Carmarthenshir e	14,400,000		4,989,158	19,389,158	4.1
Denbighshire	19,600,000		2,871,128	22,471,128	4.8
Flintshire	25,000,000	10,000,000	4,328,108	39,328,108	8.3
Pembrokeshire	0	13,000,000	4,198,028	17,198,028	3.7
Powys	18,200,000		5,356,877	23,556,877	5.
Swansea	74,000,000		6,793,913	80,793,913	17.2
Vale Of Glamorgan	33,900,000		4,129,355	38,029,355	8.1
Wrexham	118,000,000		3,766,746	121,766,746	25.8
Total	**358,100,000**	**53,700,000**	**54,285,263**	**466,085,263**	
Contingency to be retained by Welsh Government	**5,000,000**			**5,000,000**	**1.1**
All Wales	**358,100,000**	**107,985,263**		**471,085,263**	**100.0**

Advantages

- Prioritises WHQS by ensuring that LHAs have access to sufficient borrowing to enable them to meet WHQS by 2020.
- Provides those LHAs with a percentage share of the borrowing capacity they requested for new build to ensure part of their new build plans are deliverable.
- Provides all LHAs with an "indicative allocation" of borrowing headroom for new build, if affordable within their business plans.
- Distributes remaining borrowing cap headroom after WHQS and initial proportion for new build by an objective measure that is a reasonable proxy for housing need.
- This latter formula could be applied as and when Treasury agree to uplift to the macro borrowing cap for Wales.

Disadvantages

- Does not provide for the level of new build that is currently included within the business plans for four LHAs.
- Could be perceived to disadvantage those that have met WHQS.

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[5] Based on:
2011 Household Projections published by the Welsh Government
Median Gross Weekly Pay 2013 Resident Analysis published by ONS and
Median House Prices 2011 published by HM Land Registry

- LHA may not be able to use full borrowing capacity to build by 2018.

Summary

A summary of the borrowing capacity that each LHA would obtain from each of the options and the difference between the borrowing capacity each LHA requested and the outcome of options 2 and 3 are shown below:

	Outcome Option 1	Outcome Option 2	Difference between Options 1 and 2	Outcome Option 3	Difference between Options 1 and 3
Authority	**£**	**£**	**£**	**£**	**£**
Anglesey	21,400,000	4,696,259	-16,703,741	13,060,856	-8,339,144
Caerphilly	55,000,000	63,569,648	8,569,648	59,308,047	4,308,047
Cardiff	40,000,000	22,245,524	-17,754,476	31,183,046	-8,816,954
Carmarthenshire	14,400,000	24,324,527	9,924,527	19,389,158	4,989,158
Denbighshire	19,600,000	25,311,302	5,711,302	22,471,128	2,871,128
Flintshire	45,000,000	33,609,555	-11,390,445	39,328,108	-5,671,892
Pembrokeshire	26,000,000	8,350,797	-17,649,203	17,198,028	-8,801,972
Powys	18,200,000	28,855,999	10,655,999	23,556,877	5,356,877
Swansea	74,000,000	87,514,579	13,514,579	80,793,913	6,793,913
Vale Of Glamorgan	33,900,000	42,114,191	8,214,191	38,029,355	4,129,355
Wrexham	118,000,000	125,492,881	7,492,881	121,766,746	3,766,746
Total	**465,500,000**	**466,085,263**		**466,085,263**	
Held by WG for future distribution	**5,585,263**	**5,000,000**		**5,000,000**	
All Wales	**471,085,263**	**471,085,263**		**471,085,263**	

Option 1 should be regarded as the baseline as this is what each LHA identified as the borrowing capacity they each required to meet their business plan commitments at a certain point in time. Earlier versions of this data were used to form the basis for the calculation of the borrowing cap and for agreement with Treasury.

Steering group members noted that, for a range of reasons, not all LHAs had included plans for new build in the data submitted to Welsh Government and there were also concerns about whether the data was based on consistent assumptions. Therefore some members of the steering group felt that option 1 would not be considered fair and equitable to all LHAs.
Option 2 prioritises the borrowing each LHA requires to meet WHQS in the first instance. The balance of the borrowing capacity is then distributed using the modified SHG statistical formula and provides borrowing capacity to all 11 LHAs. As can be seen, this creates significant differences, particularly for the 4 LHAs that have consistently requested capacity for new build and have developed firm plans for new homes to be built or to demolish and re-develop some of their existing stock. Steering group members recognise that developing plans for new build is a lengthy process and will depend on for example housing need, the availability of land, planning consents and appointment of contractors etc.

It is also possible that some LHAs may not wish to consider new build within the next few years. Alternatively the borrowing capacity under this option may not be "affordable" within the business plan for a LHA.

Some members of the steering group felt that there was a need to match the distribution of the borrowing cap with outcomes and deliverability. Option 2 would not provide 4 LHAs with sufficient borrowing capacity to meet their existing plans for development. It was also noted that the borrowing capacity may not be maximised as some LHAs may not wish or be able to utilise their allocated borrowing cap.

It was therefore considered necessary to develop an option that would provide a compromise that could be supported by all 11 LHAs which appear to fall within two groups, those with firm plans for new build and those that only submitted figures for WHQS for various reasons.

The steering group members were keen to strike a balance between ensuring that the distribution methodology for the borrowing cap could be regarded as fair and equitable to all LHAs whilst ensuring the deliverability of new build plans.

Option 3 again prioritises borrowing for WHQS. It then provides a percentage share of the borrowing 4 LHAs identified as required for new build and distributes the balance to all 11 LHAs on an indicative basis using the modified SHG statistical formula which was used for option 2. The modelling for this option is based on the 4 LHAs receiving a 50% share of the new build capacity they require.

There has been significant discussion as to the potential for future flexibility in the distribution of the borrowing cap as it is considered important that borrowing capability should be fully utilised where possible. However it is also recognised that this should not negate the enormous benefit of self-financing and moving away from annual announcements which will provide LHAs the ability to plan over the medium to longer term and deliver and measure key outcomes and outputs. It is expected that any change to a LHA's borrowing cap, whether temporary or permanent, would need to be accounted for within "a Limit on Indebtedness Determination", subject to the Wales Bill coming into force.

The steering group noted that the flexible approach would need to be taken during both the initial setting of the borrowing cap and during any future reviews and recommended that a review of the borrowing cap should be undertaken every 3 years, starting in 2018. This periodic review would apply regardless of what option is taken forward.

The Welsh Government are seeking to ensure that the methodology to be applied to the borrowing cap will distribute borrowing capacity to where it can be fully utilised by achieving WHQS and maximising the delivery of new housing supply. It is therefore important that each LHA is realistic about its ability to use their "indicative allocation" by 2018 which will be reflected in its submission to the Welsh Government in October 2014.

One of the consultation questions is seeking views on what sanctions could be used by Welsh Government in the event that there is a significant difference between the LHA's borrowing capacity and what it has utilised. However, if sanctions were to be applied then provision will need to allow for further flexibility during the period prior to the 2018/19 review. This should be on an "exceptional basis" but would enable a LHA to advise the Welsh Government where it is unable to use their borrowing capacity for whatever reason. This surplus borrowing capacity could then be re-distributed to a LHA e.g. those with shovel ready schemes. It is expected that this type of flexibility which would result in the transfer of borrowing capacity from one LHA to another would require a revised “Limit on Indebtedness Determination” to be issued.

The Welsh Government considers that Borrowing Cap Option 3 is the preferred option. The final decision will be subject to consultation and agreement by the Minister for Housing and Regeneration. Option 3 is supported by the following process:

- Each LHA will be allocated an “indicative allocation” of the borrowing headroom” under the methodology set out in option 3.

- Each LHA will need to advise the Welsh Government by end of October 2014 on whether they will take up their “indicative allocation” for new build up until March 2018.

- If a LHA wishes to take up their “indicative allocation ”, the LHA will need to submit proposals to the Welsh Government by end of October 2014 which sets out how and when they could utilise this for new build and whether this together with their allocation for WHQS and % share for new build was "affordable" within the business plan.

- The LHA’s submission will need to set out whether land has been identified, an assessment of housing need, the number and type of properties to be developed, timescales for development (up to 2018) and any potential barriers to deliverability.

- As part of the submission, each LHA to advise if they could afford to, and wish to, take on any further borrowing capacity over and above their "indicative allocation" and, if agreed, what additional units could be delivered and whether these would be shovel ready.

- Where a LHA is not able, or does not wish, to utilise their “indicative allocation” for new build, this could be re-distributed to those LHAs that wished to take on further borrowing capacity. This could either be re-distributed to those LHAs that have indicated they could deliver more units or to all remaining LHAs using the modified SHG formula.

- Exceptional arrangements will be introduced to enable a LHA that is not able to fully utilise it “actual allocation” of the borrowing cap before March 2018 to notify the Welsh Government and the surplus borrowing capacity will be re-allocated to LHAs.

- New systems and processes need to be developed to allow for the annual monitoring of compliance with the borrowing cap. This work will be undertaken by one of the work-streams and will consider the data that will need to be gathered by, and collected from, LHAs on what has been delivered in terms of all key outcomes and outputs. This is expected to cover all aspects including achievement and ongoing maintenance of WHQS, re-modelling of existing schemes, regeneration and the development of new properties etc. The work-stream will also be looking at ways of collecting data on the community benefits that are achieved and can be evidenced by LHAs in respect of tackling poverty, jobs and growth, apprenticeships, workless households (LIFT project) etc.

- The borrowing cap will be subject to review every three years with the first review being undertaken during 2018/19. Where a LHA makes a decision not to take up their "indicative allocation of the borrowing cap" for new build under this first distribution, this period of review will enable them to develop new build proposals to feed into the 2018/19 review. LHAs may also be able to develop new build from existing resources or any revenue savings arising from exiting the HRAS system.

Other options considered and reasons for being disregarded

Members of the steering group carried out extensive modelling, and considered the outputs, for the distribution of the borrowing cap which reflected both prioritising and not prioritising the borrowing each LHA requires enabling them to meet WHQS. Where borrowing for WHQS was not prioritised within the modelling, in each case, there were between 3 and 6 LHAs that would not receive enough borrowing capacity to enable them to achieve WHQS by 2020. Since this is a shared Welsh Government and Local Government priority and is to be made a statutory obligation, all options where the borrowing required for WHQS was not prioritised were disregarded.

The options that were considered and which prioritised borrowing capacity for WHQS together with the reason why each option was disregarded are set out in the table below:

Modelled by:	Reason for being disregarded
Data provided by LHAs in response to the Welsh Government's request in July 2013	This data was no longer current as LHAs recently submitted updated data to the Welsh Government (**see Option 1**)
Existing housing stock /dwelling numbers	Since the borrowing capacity required to achieve WHQS has been prioritised then the existing stock numbers has no bearing on the borrowing capacity required for future new build plans
Housing projection figures for 2020 (published 2011)	The outputs were very similar to the outputs from the modified SHG formula which the steering group considered was a more objective measure and a reasonable proxy for housing need and affordability (**see Option 2**)
Housing projection figures by the change in housing projections from 2013 to 2020	While this was based on the change in household projections over time, the time period involved was considered too small to be a robust measure of the typical change over a 30 year business planning period.
Each LHA receiving the same percentage headroom over and above the sum of their existing debt plus the settlement figure	This did not reflect future housing need and may also amplify any issues with the distribution of the settlement amount
Each LA receiving the same value headroom (an equal share)	This does not reflect the differences between authorities in terms of size and housing need
Distributing based on current negative subsidy settlement value	This does not reflect future housing need and may also continue any inequalities inherent within the current subsidy system.
Allocating a percentage share to those LHAs that identified a requirement for new build with the balance being distributed to the 7 remaining LHAs using the modified SHG formula	The further modification of the SHG formula to only allocate borrowing capacity to 7 out of the 11 LHAs could impact upon weighting and was not considered to be equitable and fair to all. The setting aside of a percentage for the 4 LHAs for new build and distributing the balance to all 11 LHAs was considered an appropriate compromise option which could be supported by all LHAs (**see Option 3**)

Contingency and Future Distribution of the Borrowing Cap

The setting of a housing related borrowing cap for each LHA is a Treasury requirement and is new to Wales. As part of the agreement for LHAs to exit the HRAS system Treasury has advised that any breach of the borrowing cap would be supported by sanctions. This means that, in the event that the borrowing cap is breached, Treasury would make a compensatory reduction to the Welsh Government Budget which would be passed on to LHA(s) accordingly. Therefore it is in all of our interest to ensure that the borrowing cap is maintained.

The Welsh Government propose the setting aside of a small part of the borrowing cap as a contingency in the first instance. The amount included in the options is approximately £5 million. This contingency will help to safeguard Welsh Budgets whilst the Welsh Government and LHAs adjust to the new borrowing cap arrangements. Whilst this contingency could provide LHAs with access to additional borrowing in the event of an emergency or a change in circumstances it is expected that LHAs will have prudent plans in place to enable them to act in the event of an emergency

The Welsh Government are currently in discussion with Treasury to ensure that there is equity between LHAs in England and Wales in that any increase to the borrowing cap in England should be replicated in Wales.

This consultation is aiming to identify the methodology that will be used in the setting of the initial borrowing cap for each LHA. Subject to the analysis of consultation responses, and Ministerial agreement, it is the expectation that a defined methodology will be identified.

In the event that Treasury does agree to uplift the borrowing cap, it may be possible for such an amount to be distributed using the defined methodology that arises from this consultation process.

Appendix 4:

Minister's decision on Distribution of the Settlement and Borrowing Cap, and Flexibility Arrangements

Carl Sargeant AC / AM
Y Gweinidog Tai ac Adfywio
Minister for Housing and Regeneration

Llywodraeth Cymru
Welsh Government

Ein cyf/Our ref SF/CS/2217/14

Dyfed Edwards Leader
Gwynedd Council
Council Offices Shirehall Street Caernarfon Gwynedd
LL55 1SH

13 August 2014

Dear Dyfed.

The purpose of this letter is to advise you that I have noted the responses to the consultation paper on the distribution of the settlement value of HRAS buy-out and the housing related borrowing cap for individual stock retaining local housing authorities. I have also considered the recommendations made by the Steering Group in relation to the consultation responses and have made the following decisions:

- Settlement Value- The settlement value will be distributed based on negative subsidy amounts in line with "Settlement Value Option 1". The 2013/14 Audited Final HRAS claim will be used for this calculation which will be finalised by authorities and the Wales Audit Office by end of November.

- Borrowing Cap -The distribution of the borrowing cap will be based on "Borrowing Cap Option 3". I note from the responses that this is a compromise option which every local authority has accepted.

- Contingency Sum - The Welsh Government will not be retaining a proportion of the £1.85bn borrowing cap as a contingency sum.

- Unallocated borrowing - I have asked that the Steering Group gives further consideration to how any unallocated borrowing headroom now or in the future is used and distributed. They will be reporting back me in the Autumn.

- Review- A review will be undertaken in 2018/19 to consider the broader aspects of moving to the new self-financing system. This will mean that the new self-financing arrangements will have been in place for a period of three financial years.

- **Sanctions relating to ability to utilise the borrowing cap-** The Welsh Government will not impose any sanctions or put in place any arrangements that would require authorities to either "use their borrowing headroom or lose it". This will be considered again as part of the borrowing cap review in 2018/19. I have asked the Steering Group to consider the details of how the Welsh Government should undertake a co-ordinating role and facilitate the trading or swapping of borrowing headroom. I have asked that that Steering Group provide me with recommendations on this aspect by Summer 2015.

I would like to thank the WLGA and each local authority for responding to this consultation in such a positive and supportive manner and for your very helpful and constructive feedback. I am also very pleased with the collaborative working between the Welsh Government, the WLGA, local authorities and all the other organisations that are directly involved in the steering group and work streams.

Yours sincerely,

Carl Sargeant AC / AM
Y Gweinidog Tai ac Adfywio
Minister for Housing and Regeneration

Appendix 5

DRAFT FIGURES							
Breakdown of the Estimated Limit on Indebtedness at October 2014							
Authority	**LHA's estimated existing borrowing (1)**	**Borrowing to meet WHQS (2)**	**Borrowing for new build (3)**	**Modified SHG (4)**	**Sub Total**	**Settlement Value (5)**	**Estimated Limit on Indebtedness**
	£	**£**	**£**	**£**	**£**	**£**	**£**
Caerphilly	44,359,608	55,000,000		5,398,136	**104,757,744**	75,427,087	**180,184,831**
Cardiff	96,360,476		20,000,000	14,012,754	**130,373,230**	190,459,015	**320,832,245**
Carmarthenshire	125,470,702	14,400,000		6,251,593	**146,122,295**	78,658,989	**224,781,284**
Denbighshire	29,507,731	19,600,000		3,597,626	**52,705,357**	39,175,823	**91,881,180**
Flintshire	24,929,168	25,000,000	10,000,000	5,423,274	**65,352,442**	79,798,326	**145,150,768**
Isle of Anglesey	16,557,736		10,700,000	2,958,237	**30,215,973**	21,396,292	**51,612,265**
Pembrokeshire	4,214,860		13,000,000	5,260,279	**22,475,139**	80,415,686	**102,890,824**
Powys	14,734,526	18,200,000		6,712,357	**39,646,883**	71,420,811	**111,067,693**
Swansea	66,378,044	74,000,000		8,513,014	**148,891,058**	73,039,241	**221,930,299**
Vale Of Glamorgan	2,079,670	33,900,000		5,174,229	**41,153,899**	63,231,107	**104,385,006**
Wrexham	26,086,114	118,000,000		4,719,866	**148,805,980**	146,477,623	**295,283,604**
Total of 11	**450,678,635**	**358,100,000**	**53,700,000**	**68,021,365**	**930,500,000**	**919,500,000**	**1,850,000,000**
					930,500,000		1,850,000,000

Notes:

(1) LHA's "estimated" existing borrowing has been obtained from the 2013/14 Advance Final HRAS claims.
LHA's "actual" existing borrowing will be obtained from 2013/14 Audited Final which will be available December 2014

(2) The borrowing required to meet WHQS as identified in the Consultation in the distribution methodologies.

(3) The borrowing required for New Build will provide four LAs with 50% of the amount requested and identified in the Consultation.

(4) Modified SHG amount is the amount that will be allocated across the 11 LAs using this agreed formula. This will be used as the balancing figure to ensure that the total of existing borrowing, WHQS, new build & SHG adds to £930,500,000

(5) The estminated settlement is as set out in the Consultation. The Actual Settlement Value will be known on 31 March 2015 using the 30 yr maturity rate.

References:

1. LGA (2014) LGA Housing Self financing survey 2014

CITY OF CARDIFF COUNCIL
CYNGOR DINAS CAERDYDD

CARDIFF
CAERDYDD

CABINET MEETING: 17 JULY 2014

HOUSING SUBSIDY FINANCE REFORM

REPORT OF DIRECTOR OF COMMUNITIES, HOUSING AND CUSTOMER SERVICES.

AGENDA ITEM: 16

PORTFOLIO: HEALTH, HOUSING & WELLBEING (COUNCILLOR SUSAN ELSMORE)

Reason for this Report

1. To approve the City of Cardiff Council's response to the terms of the Welsh Government / Local Housing Authority voluntary agreement to establish a new Local Housing Authority Self-Financing Scheme for Wales.

2. To delegate authority to enter into the voluntary Housing Revenue Account self-financing agreement for the City of Cardiff Council to the Director of Communities, Housing and Customer Services in consultation with the Director of Resources and the Cabinet Member for Heath, Housing and Social Care and the Cabinet Member for Corporate Services & Performance.

Background

3. The Housing Revenue Account (HRA) is a separate account required by legislation to be kept by councils to record income and expenditure relating to the management and maintenance of the housing stock. The HRA must be ring-fenced and funds kept separate so that council house rents are not used to subsidise the General Fund and vice versa. Since 1989 the UK Housing finance system operated within a subsidy system based on notional parameters determined by central and devolved government.

4. English Authorities exited the subsidy system in 2012/13 via individual agreements entered into with the Treasury and moved to a system of what is often termed 'self financing' by buying themselves out of the subsidy system if they were net contributors, or receiving payments where they were net recipients of subsidy. Welsh authorities still remain within the subsidy system. All 11 Welsh Authorities that retain their housing stock make net payments to the treasury via Welsh Government. Appendix 1 provides background to what the HRA is and the subsidy system.

5. The Welsh Government has been in discussions with HM Treasury since 2010 with a view to agreeing a financial settlement that would enable the 11 Local Authorities in Wales that have retained their Housing Stock to exit from the Housing Revenue Account Subsidy (HRAS) system. The discussions have focussed on the opportunity to end the HRAS system through a voluntary agreement rather than waiting for an unspecified period of time for UK Legislation to be enacted.

6. The current HRAS system is a complex, formula based system that has operated to the financial detriment of council Housing in Wales since 1989. Currently £73m in total is paid annually from the 11 Local Authorities to HM Treasury via Welsh Government. In Cardiff the subsidy amount paid for 2013/14 was £15.1m.

7. The ending of the subsidy system would introduce self-financing for landlord authorities with each authority retaining its full rental income and taking responsibility for the repayment of the debt incurred in "buying out" from HM Treasury

8. In July 2013 the Welsh Government and the UK Treasury reached an agreement on a "buy out" figure that will allow landlord authorities to exit from HRAS in March 2015.

9. The terms of the agreement require all 11 authorities to agree the distribution of the "buy-out" figure and also to agree to the allocation of the HM Treasury imposed borrowing cap for Wales.

10. The borrowing cap sets the limit for HRA borrowing across Wales. The figure of £1.85 billion was agreed between HM Treasury and Welsh Government in June 2013. Once the increase in debt related to the "buy-out" has been added to existing housing debt, borrowing "headroom" of £471m remains available for LHAs to meet their business plan commitments.

11. If Authorities are unable to agree on the distribution of the "buy-out" figure and the debt cap then the HRAS system will remain in place with £73m continuing to be paid annually to the Treasury until legislation can be enacted through the UK Government Wales Bill.

Welsh Government Consultation

12. A Welsh Government consultation paper (Appendix 2) on HRAS reform has been issued in order to obtain the views and agreement of all 11 landlord Authorities with responses required by 10 July 2014. A response based on Appendix 3 was sent to Welsh Government on the 10 July, subject to Cabinet Approval on the 17 July.

13. The Welsh Local Government Association held a seminar on 16 May 2014 to provide an opportunity for the 11 stock retaining Authorities to discuss the options proposed in the Welsh Government consultation document. The objective of the seminar was to arrive at a consensus to enable a voluntary agreement to proceed.

14. The seminar informally concluded that, although Authorities differed on their first option of choice, that consensus could be reached on the basis of a compromise option that was acceptable across all 11 authorities.

15. The Consultation document asks 7 key questions to the 11 Landlord Authorities in Wales and the recommended responses are attached (Appendix 3)

Financial and Treasury Management Implications

16. Ultimately the Council is responsible for any deficit made by the HRA which cannot be met from retained Housing reserves including any borrowing. The sections below highlight the key financial issues in the consultation, in particular the method for distributing the settlement i.e how much we need to borrow and also how any excess borrowing capacity within the overall £1.850billion Cap set by Treasury can initially be distributed.

Settlement Value Distribution (Indicative values)

17. The agreement between the Treasury and Welsh Government allows exit from the subsidy system if Local Authorities agree to take on additional borrowing from the PWLB that will generate circa £40 million per annum for HM Treasury. Based on estimated returns for 2013/14, the WG preferred option is to distribute any share of the £40 million on the basis of how much net rental income each local authority pays over to the WG as part of the subsidy system. Whilst precise terms from the treasury are still being finalised, this is the WG and Council preferred option for a number of reasons, primarily the aim of every local authority being better off in revenue terms than current position and on an equal basis.

Local Housing Authority	HRAS settlement amounts (1)	Share of annual interest (2)	Reduction	Reduction	Share of estimated settlement value (3)
	£	£	£	%	£
Isle of Anglesey	1,695,873	930,779	765,094	45.12	21,396,292
Caerphilly	5,978,361	3,281,222	2,697,139	45.12	75,427,087
Cardiff	15,095,807	8,285,330	6,810,477	45.12	190,459,015
Carmarthenshire	6,234,522	3,421,816	2,812,706	45.12	78,658,989
Denbighshire	3,105,081	1,704,223	1,400,858	45.12	39,175,823
Flintshire	6,324,826	3,471,379	2,853,447	45.12	79,798,326
Pembrokeshire	6,373,758	3,498,235	2,875,523	45.12	80,415,686
Powys	5,660,823	3,106,941	2,553,882	45.12	71,420,811
Swansea	5,789,100	3,177,346	2,611,754	45.12	73,039,241
The Vale Of Glamorgan	5,011,706	2,750,673	2,261,033	45.12	63,231,107
Wrexham	11,609,836	6,372,055	5,237,781	45.12	146,477,623
	72,879,693	**40,000,000**	**32,879,693**		**919,500,000**

What could the impact be for Cardiff Council HRA in 2015/16?

18. The Council will be required to fund its share of the settlement by taking a 'basket of loans' totalling £190 million from the Public Works Loans Board. New borrowing would need to be included in and be consistent with the Council's revised treasury management strategy to be determined at the time following advice from the Council's Treasury Management advisors. Cardiff HRA debt will increase from £94 million to £284 million. To put the settlement into context, the actual level of external borrowing for the Council as a whole is £473 million at 31 March 2014. Whilst the £190 million is a significant figure, it is deemed affordable as shown by summary indicative revenue budget impact below.

	£
Net Subsidy Income Retained (2013/14 est)	(15,095,807)
Additional Interest Cost per annum	8,285,330
Assumed Prudent Repayment (MRP) circa 40 Years	5,000,000
(£190,459,015 / 40 years) – Rounded to £5 million per annum	
Retained to support business plan inc HPP	(2,010,477)

19. The Council will under the new system, retain all income, but will be required to pay interest costs on new borrowing of £8.3 million per annum. After making a prudent provision for the eventual repayment of new borrowing, the rate of which is to be determined by WG and Local Authorities, this results in a financial benefit of circa £2 million per annum. It should be noted that the Council's HRA business plan assumes that the Major Repair Allowance Capital Grant of £9.6 million per annum continues to be received for the next thirty years. Given the nature and risks of public sector funding, this has not been committed to by WG.

Borrowing Cap Distribution (Indicative values)

20. This was deemed to be the key issue for local authorities in order to ensure that any borrowing cap allowed them to meet Welsh Housing Quality Standards as well as supporting those authorities who had firm plans for new build. Whilst a number of options were considered, only those options for distribution that prioritised allocations to those authorities who needed to meet the Welsh Housing Quality Standards by the revised 2020 target date were considered.

Authority	Option 1 Business Plan 2014/15 £	Option 2 Meet WHQS – Modified Social Housing Grant & Projections £	Option 3 Meet WHQS - 50% of initial new build request and balance split equally £
Anglesey	21,400,000	4,696,259	13,060,856
Caerphilly	55,000,000	63,569,648	59,308,047
Cardiff	40,000,000	22,245,524	31,183,046
Carmarthenshire	14,400,000	24,324,527	19,389,158
Denbighshire	19,600,000	25,311,302	22,471,128
Flintshire	45,000,000	33,609,555	39,328,108
Pembrokeshire	26,000,000	8,350,797	17,198,028
Powys	18,200,000	28,855,999	23,556,877
Swansea	74,000,000	87,514,579	80,793,913
Vale Of Glamorgan	33,900,000	42,114,191	38,029,355
Wrexham	118,000,000	125,492,881	121,766,746
Total	**465,500,000**	**466,085,263**	**466,085,263**
Held by WG for future distribution	**5,585,263**	**5,000,000**	**5,000,000**
All Wales	**471,085,263**	**471,085,263**	**471,085,263**

21. Of the circa £465 million for potential distribution by WG, Option 3 is an acceptable option for all councils to be able to enter into a voluntary agreement whilst recognising that this is not necessarily the preferred option for an individual council. Welsh Government has also proposed that a small element of Cap is retained for contingency.

22. The consultation indicates that the indicative distribution of the Cap is to be reviewed every three years by WG starting in 2018/19, with any requested headroom over existing debt to be demonstrated for achievability, deliverability and affordability as part of the Annual Business Plan Process. This is to ensure any borrowing cap initially set can be amended to take account of property condition as well as demand for housing need and supply, not only in Cardiff but across Wales.

<u>What could the impact be for Cardiff Council HRA in 2015/16?</u>

23. Entering into a voluntary agreement will set a maximum limit for indebtedness measured by what is termed the Capital Financing Requirement (CFR) for the HRA which must not be breached. This represents Capital expenditure incurred, but not yet financed by charges to the revenue account. via a prudent minimum revenue provision. Additional expenditure funded by borrowing increases the CFR, prudent minimum revenue provision and use of capital receipts to repay debt, reduces the CFR.

24. The WG preferred option would create an initial level of HRA Limit to Indebtedness for Cardiff of £315 million (£94 million (original CFR) +

£190 million (settlement) + £31 million (Headroom)). Whilst the Council would be entering into additional debt of £190 million it should be noted that this is replacing and is less then the current payment of HRA subsidy to WG which would no longer be paid.

25. Based on the business plan for 2014/15 approved in December 2013 and which assumes the continuity of the £9.6 million annual Major Repair Allowance grant to Cardiff, this level of Cap does not cause the Council a short term issue. The Council would however be keen to ensure that a review process is included to ensure that any unutilised borrowing amounts within the cap across Wales can be redistributed.

26. Appropriations of land from the General Fund to the HRA will no longer be as financially beneficial to the Council as a whole compared to the existing housing subsidy system.

Consultation

27. The Council's Audit Committee received a paper entitled 'Housing Finance Reform' on the 25 June 2014. This report outlined the provided members with the proposals and their potential implication and asked for their input into this Cabinet report. No adverse comments were received and Audit Committee requested for further updates on progress and for the borrowing implications, benefits and risks to be included in the future treasury management strategy reports that would be submitted to Audit Committee for review prior to the budget being set in February 2015.

28. The report was also presented to the Community and Adult Services Scrutiny Committee on the 2 July 2014, the views of that committee (attached in Appendix 4) have been taken into account when deciding on the authorities response to the WG Consultation.

Reasons for Recommendations

29. To respond to the Welsh Government Consultation and allow the Council to enter in to a voluntary agreement required by Welsh Government and Treasury to allow all eleven Local Housing Authorities to exit from the Housing Revenue Account Subsidy System

Legal Implications

30. The HRAS is a financial mechanism and does not directly impact on the HRA and legal framework for the HRA. The report therefore highlights under other sections the relevant legal implications such as the need for the voluntary agreement.

Financial Implications

31. The Housing Revenue Account requires income and expenditure on landlord functions to be ring-fenced and kept separate so that council house rents are not used to subsidise the General Fund and the general council taxpayer does not subsidise council housing. Welsh Government

has issued guidance on what should and should not be paid for by rent payers.

32. Ultimately the Council is responsible for any deficit made by the HRA which cannot be met from retained Housing reserves including any borrowing.

33. Should the Council enter into an acceptable voluntary agreement, there are a number of treasury management and financial issues that need to be considered. These are included in the main body of the report. Whilst the consultation is based on indicative figures, it is essential that the most up to date figures are included as a basis for the settlement, those being the final audited 2013/14 subsidy return at least.

34. Based on indicative figures, the settlement will require the Council to take on additional borrowing of £190m. Whilst precise details are the subject of ongoing discussions with WG and HM Treasury, this will require the council to ensure it takes a prudent approach to the basket of loans it takes in accordance with a revised Treasury Management Strategy and prudential indicators to be considered by Council in February 2015 as part of the budget proposals. New borrowing undertaken will need to consider the maturity profile of existing Council borrowing, the views of treasury advisors and be consistent with the HRA business plan.

35. In terms of the HRA revenue budget impact, based on indicative figures and assumptions about the prudent repayment of any additional debt undertaken, the table in the report indicates a potential surplus of £2million p.a. Whilst the additional borrowing will increase the gearing of the HRA the proposal contained in the consultation is deemed affordable. This can be used to support the HRA business plan objectives, including investment in stock as well as acting as a contingency particularly in the early years of the new system.

36. Accepting a voluntary agreement will require the Council to adhere to a 'Limit to Indebtedness' or debt cap. Based on indicative figures this is £315million. In accordance with the Prudential code for capital finance in local authorities, Councils already have established procedures to monitor and report position against such limits. Whilst the debt cap initially allocated to Cardiff may be acceptable in the short term, the need for a periodic review of the debt cap is essential in order to ensure that the Council is not stuck with a limit which hinders its ability to invest in its housing responsibilities in the medium to longer term as both Welsh Government and Council priorities change.

37. Each year the Council must update and revise a 30 year HRA Business Plan, with the 2014/15 plan submitted to Cabinet in January 2014. This will need to be updated for 2015/16 and the next thirty years to demonstrate performance measures that demonstrate it is providing value for money to rent payers. In addition it will need to demonstrate, affordability and sustainability of housing objectives under the new finance system over the thirty years. In determining the Capital or investment programme, this will require a clear understanding of the

condition of the existing stock, planned stock changes and including investment required to sustain Welsh Housing Quality Standards. Key assumptions such as realisable income, risks and mitigations with associated individual and cluster sensitivity analysis will need to be included and where new build plans are included in the strategy the Council will need to demonstrate availability of land as well as deliverability of proposals to justify to Welsh Government any additional headroom requested.

38. The HRA business plan and the Council's assessment that the settlement is affordable is based on the continued receipt of Major Repair Allowance grant from WG of £9.6million p.a for the next thirty years. Given the nature and risks of public sector funding, this has not been committed to by WG and would remain a significant financial risk.

RECOMMENDATIONS

Cabinet is recommended to:

1) approve Cardiff Council's response to the terms of the Welsh Government/Local Housing Authority voluntary agreement to establish a new Local Housing Authority Self-Financing Scheme for Wales.

2) delegate authority to the Director of Communities , Housing and Customer Services in consultation with the Director of Resources and the Cabinet Members for Health, Housing & Wellbeing and for Corporate Services & Performance, to enter into the voluntary agreement for Cardiff Council.

SARAH McGILL
Director
11 July 2014

The following Appendices are attached

Appendix 1 Housing Revenue Account – Background
Appendix 2 New Local Housing Authority Self-Financing System (HRAS Reform) Consultation Paper
Appendix 3 Proposed Cabinet Response
Appendix 4 Community and Adult Services Scrutiny Committee Letter

Appendix 1

HOUSING REVENUE ACCOUNT – Background and Key Issues

HOUSING REVENUE ACCOUNT

The Housing Revenue Account (HRA) is a separate landlord account that any council with more than 50 council dwellings must keep. It includes income and expenditure relating to the management and maintenance of the housing stock, including major repairs and any associated debt charges, and the provision of services to tenants.

The HRA must be ring-fenced and funds kept separate so that council house rents are not used to subsidise the General Fund and the general council taxpayer does not subsidise council housing. Welsh Government has issued guidance on what should and should not be paid for by rent payers.

INCOME AND EXPENDITURE

Expenditure principally includes

- Employees - Direct and indirect costs of staff employed within the HRA providing services to the rent payer.
- Council House Repairs - In Cardiff, this budget is managed by CMS which provides all related services and any surplus achieved within either the operations of CMS and/or the Housing Repairs Account is transferred back to the HRA generally.
- Other Premises - This will include non council housing premises related spend, e.g. office accommodation costs at Wilcox House, hostels and the remaining housing offices, insurance premiums and claims, Council Tax on vacant properties etc.
- Transport, Supplies and Services, Third Party
- Support Services - This relates to the controllable recharges for central support and also includes. £1.5m staff recharges from H&NR for those staff working part to the HRA and part to the Housing General Fund.
- Capital Financing - This will include all borrowing and capital financing charges relating to capital expenditure
- Contributions to Funds/Doubtful Debts - Bad debts provision movement mainly relating to rents and service charges.
- Housing Subsidy Payable - A payment to WG based on a set formula calculation.

Income principally includes

- Rents
- Service charges which are now required to identified separately to tenants in order to ensure they are only paying for services they receive.
- Other items include fees and charges,
- Support Services - Recharges will include staff recharges for those staff supporting the General Fund and eligible capital schemes.

Any surplus in the year must be retained within the HRA and any deficit met from the HRA, subject to availability of reserves.

HRA SUBSIDY SYSTEM

The HRA subsidy system in Wales collects assumed housing surpluses from authorities based on a a series of complex notional calculations which takes into account a number of factors including:

A. Notional Dwelling Rent Income
B. Less: Management and Maintenance Allowance
C. Less: Eligible Capital Financing costs

A. Notional Dwelling Rent Income
This calculation takes into account the average number of dwellings in any year and multiplies this by a guideline rent determined by WG to give a notional total rental income.

B. Management and Maintenance Allowance
The WG calculates an estimated level of funding requirement for management and maintenance per property

C. Less: Eligible Capital Financing costs
The subsidy calculation makes provision for a level of capital financing costs arising from previous capital expenditure approved by WG. The subsidy is based on annual determinations / formula issued by WG

BUSINESS PLANNING

Local Housing Authorities are required to submit to WG an annually updated HRA 30 year Business Plan. As well as setting out the mission statement and the objectives for the Housing service, the Plan should include detailed financial forecasts identifying resources required and sources of funding for the chosen strategies.

The long term nature of the plan necessitates many assumptions including inflation and interest rates, stock and rent levels, voids and bad debt levels, and an overall analysis and forecast of fixed and variable revenue costs.

In line with this, it is necessary to determine future levels of planned capital investment in new and existing stock, cyclical and responsive repairs across the various types of dwellings. Accordingly it is important that there is an excellent understanding of housing stock and their condition in order to know investment priorities. The plan includes risks and sensitivities and its primary purpose is to demonstrate the operational and financial sustainability of the Housing Revenue Account.

The business plan is used as a bidding document for an annual Major Repair Allowance grant of £9.6m from WG for investment in the Housing Stock.

OTHER ISSUES

New Social Rent Policy
To determine

Appendix 2

Consultation Paper

New Local Housing Authority Self-Financing System (HRAS Reform)

The distribution of the Settlement Value of HRAS buy-out and the Housing Related Borrowing Cap for individual Stock Retaining Local Housing Authorities

Background

The Welsh Government has been in discussions with HM Treasury since 2010 with a view to agreeing a financial settlement that would enable the eleven stock retaining local housing authorities (LHAs) to exit from the Housing Revenue Account Subsidy (HRAS) system.

The Welsh Ministers were pleased to announce in June 2013 that an agreement had been reached with HM Treasury, which together with the introduction of new self-financing arrangements is expected to generate revenue savings for the eleven LHAs each year. This will allow LHAs to increase their investment in their existing stock and, where possible, support the delivery of additional housing supply. Some LHAs could bring forward improvement works to their properties to meet the Welsh Housing Quality Standard (WHQS) which will bring real and tangible benefits to their tenants.

Key elements of the agreement are that:

- LHAs are required to buy themselves out of the HRAS;
- The £73m of annual negative subsidy payments will be replaced by interest payments of approximately £40m. This will satisfy HM Treasury's requirement that the agreement is fiscally neutral over the longer term;
- The £40m annual interest payments will be converted to a lump sum settlement value a short period before the agreed implementation date. This will enable LHAs to consider their borrowing requirements in accordance with their local Treasury Management Strategy, to meet current business plan commitments and provide flexibility for LHAs to determine the type and period of loan.
- In order to fund the buy-out, Treasury require LHAs to borrow from the Public Works Loans Board (PWLB). Failure to comply with this will result in sanctions by Treasury. This will mean the Welsh Budget will be reduced and the reduction passed on to each LHA as appropriate. Interest payments made to the PWLB are effectively received by the exchequer;
- HM Treasury requires a housing related borrowing cap to be imposed on each LHA in order to control public sector borrowing.

The Welsh Government has worked closely with HM Treasury to identify timescales for implementation and the appropriate legislative mechanism for the setting of housing related borrowing cap. HM Treasury has advised that the borrowing cap requires UK legislation and is bringing forward provisions within an appropriate UK

Bill. If provisions within the UK primary legislation is not in place HM, Treasury have agreed that Wales can exit from the HRAS system in March 2015 on condition that Welsh Government secures and manages the borrowing cap as part of a voluntary agreement with all eleven LHAs.

Legislative Background

Housing (Wales) Bill

The Minister for Housing and Regeneration introduced the Housing (Wales) Bill to the National Assembly for Wales in November 2013. The Bill is currently at Stage 2 of the scrutiny process during which the Communities, Equality and Local Government (CELG) Committee will consider, and vote upon, both Government and non-Government amendments to the Bill.

The provisions in Part 5, Housing Finance will, subject to scrutiny, provide:

- for the Welsh Ministers to make a determination providing for the calculation of the settlement payment that each LHA will be required to pay in order to exit HRAS.
- for the determination to be revised only in the event that there has been an error or change in any matter that was taken into account in the original calculation or determination.
- for the Welsh Ministers to determine the timescales and processes that LHAs will need to follow in order to exit HRAS;
- for LHAs to be required to respond to requests for information; and
- for the existing legislation which supports HRAS system to be repealed.

The provisions in Part 5 may be amended

The provisions in Part 4, Standards for Social Housing will, subject to scrutiny, provide for the Welsh Ministers to:

- set standards to be met by LHAs in connection with the quality of accommodation provided by LHAs and the rent and service charges for such accommodation.
- to issue guidance that relates to, and amplifies, the standard.
- consult with bodies representing the interests of LHAs, tenants and other persons Welsh Ministers consider appropriate when setting, revising, or withdrawing standards and related guidance; and
- have powers of intervention where a LHA has failed, or is likely to fail, to meet the quality of accommodation standard.

The provisions in Part 4 may be amended

The Housing (Wales) Bill, explanatory memorandum and the record of passage through the National Assembly for Wales can be found at:
http://www.senedd.assemblywales.org/mgIssueHistoryHome.aspx?IId=8220

Wales Bill

The Secretary of State for Wales published a draft Wales Bill in December 2013. The draft Bill was subject to pre introduction scrutiny by the Welsh Affairs Committee. The Committee reported in March 2014. The UK Government introduced the Wales Bill (along with explanatory notes and the Financial Empowerment and Accountability Command Paper) on 20 March 2014.The provisions in clause 23, provide:

- for UK Ministers to set the maximum amount of housing debt that can be held, in aggregate, by LHAs in Wales;
- for Welsh Ministers to determine the amount of housing debt that is to be treated as held by each LHA, and the maximum amount of housing debt that each LHA may hold;
- powers for Welsh Ministers to obtain such information as Welsh Ministers may specify either generally, or in a particular case, from LHAs to enable them to exercise their functions above.

The Wales Bill, explanatory notes and details of progress of the Bill through Parliament can be found at:

http://services.parliament.uk/bills/2013-14/wales.html

Voluntary Agreement

As the timescales for UK Legislation were unclear, HM Treasury agreed that the 11 Welsh LHAs could exit the HRAS system in March 2015, subject to the Welsh Government securing and managing a borrowing cap through a voluntary agreement between each of the eleven LHAs and Welsh Ministers.

The powers for Welsh Ministers and a LHA to enter into a voluntary agreement are provided in section 80B of the Local Government and Housing Act 1989.

It is essential that all eleven LHAs agree and sign the voluntary agreement. Failure to do so will result in the HRAS remaining in place in Wales until appropriate UK legislation is passed.. This means that at least £73 million will continue to be paid back to HM Treasury each year.

The voluntary agreement will act as an interim arrangement until the Wales Bill comes into force and as a fall-back position should the Wales Bill fall for whatever reason. Once the Wales Bill receives Royal Assent and the appropriate provisions are commenced Treasury will need to issue a determination to the Welsh Ministers which will set the macro borrowing cap for Wales. This will enable the Welsh Ministers, subject to consultation, to issue a determination to LHAs which will set the borrowing cap for each LA. There is the potential for the legislative process to replace the need for a voluntary agreement.

Welsh Government Priorities

The Welsh Government believes that everyone in Wales should have the opportunity to live in a good quality home within a safe and secure community.

The Welsh Government is committed to ensuring that all LHAs meet the WHQS by 2020 and has worked closely with LHAs to ensure that their business plans demonstrate that they will meet this target date. LHAs must be able to have access to sufficient borrowing to enable them to meet WHQS by 2020.

The Housing (Wales) Bill will, subject to scrutiny, will enable the existing WHQS guidance to be issued as guidance to the quality of accommodation standard for existing properties. Therefore the Bill will place the requirement for LHAs to meet and maintain the WHQS on a statutory basis for the first time.

The Welsh Government is also committed to increasing housing supply and supporting LHAs that wish to undertake new council house building. However, this should not be to the detriment of meeting WHQS

Governance Arrangements

The Welsh Government has put in place robust governance arrangements to manage and oversee the reforms. This comprises a steering group and four technical work-streams. One of the key responsibilities of the steering group is to make recommendations to the Minister for Housing and Regeneration on the methodology to be used for the distribution of the settlement value and the borrowing cap. The steering group includes representatives from LHAs, WLGA, Welsh Tenants, Wales Audit Office and Welsh Government.

The WLGA and LHA representatives on the steering group support and agree the inclusion of all the options within this consultation paper but have differing views on whether a preferred option should be identified.

In the interests of both landlords and tenants it is essential that agreement is reached on the distribution methodologies. This is necessary as the finally agreed methodologies will form the basis of the voluntary agreement that will need to be signed by all 11 LHAs. In light of this, the Welsh Government considers that Borrowing Cap Option 3 provides a compromise between those LHAs that have firm plans for new build while enabling the remaining LHAs the opportunity to consider their capacity for new build.

The Welsh Government therefore considers that the Settlement Value Option 1 and the Borrowing Cap Option 3 are the preferred options. The final distribution methodologies will be subject to consultation and agreement by the Minister for Housing and Regeneration.

Background

Welsh Government officials have worked closely with appropriate officials from LHA's since June to consider the principles that might underpin the distribution of a settlement figure and a borrowing cap.

There was clear consensus that "***every stock retaining authority should be better off than the current position***". This includes not only the financial benefits from exiting HRAS but also the benefits of becoming self-financing. The Welsh Government and the steering group are committed to maintaining this as a key principle in the distribution arrangements.

The Directors of Housing and Chief Treasurers of the eleven stock retention authorities met and considered options for the distribution of both the settlement value and borrowing limits. They agreed that, although not perfect, the distribution of the settlement value based on negative subsidy values appeared to be the most pragmatic and transparent way forward.

Members of the steering group have worked closely together to model and consider a wide range of options for distribution of the borrowing cap. The group identified those options which were most suitable for further consideration and narrowed these down to those that should be subject to consultation.

When considering the options which are set out in the following part of this consultation paper, it should be noted that the accounting work-stream, the transaction and debt work-stream and the capacity building work-stream will jointly be considering a range of financial and accounting matters and related guidance which will inform the development of financially sustainable business plans following the buy-out and implementation of the new self-financing arrangements. These matters include, but are not limited to, depreciation, minimum revenue provision, treatment of capital receipts and loan pooling arrangements. The work-streams will also be developing new business plan guidance and parameters and these will be made available to LHAs in due course.

It should be noted that all figures contained within the options and the statistics within this consultation paper are illustrative and remain subject to change for a number of reasons before the final settlement date.

The final figures and methodology will be subject to agreement by the Minister for Housing and Regeneration.

Exiting from the HRAS system: The Agreement with HM Treasury

The agreement with HM Treasury, which will allow authorities to exit from the HRAS system and become self financing from April 2015 consists of two parts.

Firstly, the eleven stock retaining authorities are required to buy themselves out of the existing HRAS. The agreement is based on £40m interest payments which will replace the existing negative subsidy payment of £73m. The £40m interest will be converted to a buy-out lump-sum (settlement value) a short period before an agreed settlement date and authorities will be required to take out loans with the PWLB to fund the buy-out. This will result in all authorities being better off under self financing.

The second part of the agreement is that HM Treasury require a housing borrowing cap to be set for each of the eleven authorities.

A borrowing cap of £1.85 billion was agreed with HM Treasury in June 2013. The cap includes the estimated Housing Revenue Account capital finance requirement (HRA CFR) and the estimated settlement value. This leaves potential borrowing headroom of £471 million for authorities to meet their business plan commitments. All estimated figures are subject to change as the HRA CFR will need to be updated[1] and the settlement value will be based on prevailing interest rates when the £40 million is converted to a settlement buy-out value.
Should the figures change significantly it is possible that the headroom will be reduced below £471 million. In the event that the borrowing required by LHAs exceeds the headroom, in order to protect investment in WHQS, the first call will be to reduce the borrowing available for new build.

This consultation considers how the settlement value and the potential borrowing headroom should be distributed given that LHAs need to be able to access sufficient borrowing to enable them to meet WHQS by 2020.

Key Information

The information in Table 1 below has been obtained from each LHA as part of their application for Major Repairs Allowance for 2014/15 and from their Housing Revenue Account (HRA) Business Plan which was submitted to Welsh Government in December 2013. The Welsh Government carried out a further exercise to obtain confirmation from each LHA on the accuracy of the figures below.

Table 1: Stock numbers, WHQS status and estimated borrowing requirement:

Local Housing Authority	Stock at Dec [2] 2013	Met WHQS	Expected to achieve WHQS		Estimated Borrowing Requirement		
			Month	Year	To meet WHQS	For New Build	Total
					£m	£m	£m
Cardiff	13,730	Yes				40.0	40.0
Anglesey	3,802	Yes				21.4	21.4
Pembrokeshire	5,663	Yes				26.0	26.0
Denbighshire	3,454		December	2014	19.6		19.6
Carmarthenshire	9,009		March	2015	14.4		14.4
Vale of Glamorgan	3,940		March	2017	33.9		33.9
Powys	5,419		March	2018	18.2		18.2
Caerphilly	10,900		March	2020	55.0		55.0
Wrexham	11,292		December	2020	118.0		118.0
Swansea	13,590		December	2020	74.0		74.0
Flintshire	7,236		December	2020	25.0	20.0	45.0
All Wales Borrowing Requirement					**358.1**	**107.4**	**465.5**

[1] The proposed date of the HRA CFR will be considered by the accounting work-stream, be subject to discussion with Wales Audit Office and approved by the Minister for Housing and Regeneration.
[2] Stock numbers for tenanted properties obtained from HRA Business Plan submitted December 2013

The Settlement Value and its Distribution

In order to allow Wales to exit the HRAS system, HM Treasury required LHAs to "buy-out" of the system at a settlement figure that is fiscally neutral to the UK Government. The agreement is based on £40m interest payments which will be converted to a lump-sum (settlement value) a short period before an agreed settlement date. The estimated settlement value is considered to be in the region of £919.5 million, which has been used for modelling purposes. HM Treasury requires local authorities to fund the "buy-out" by borrowing from the Public Works Loans Board (PWLB).

Options for distribution of the Settlement Value

Settlement Value Option 1 - To distribute the settlement value based on negative HRA subsidy amounts

Local Housing Authority	HRAS settlement amounts (1)	Share of annual interest (2)	Reduction	Reduction	Share of estimated settlement value (3)
	£	£	£	%	£
Isle of Anglesey	1,695,873	930,779	765,094	45.12	21,396,292
Caerphilly	5,978,361	3,281,222	2,697,139	45.12	75,427,087
Cardiff	15,095,807	8,285,330	6,810,477	45.12	190,459,015
Carmarthenshire	6,234,522	3,421,816	2,812,706	45.12	78,658,989
Denbighshire	3,105,081	1,704,223	1,400,858	45.12	39,175,823
Flintshire	6,324,826	3,471,379	2,853,447	45.12	79,798,326
Pembrokeshire	6,373,758	3,498,235	2,875,523	45.12	80,415,686
Powys	5,660,823	3,106,941	2,553,882	45.12	71,420,811
Swansea	5,789,100	3,177,346	2,611,754	45.12	73,039,241
The Vale Of Glamorgan	5,011,706	2,750,673	2,261,033	45.12	63,231,107
Wrexham	11,609,836	6,372,055	5,237,781	45.12	146,477,623
	72,879,693	**40,000,000**	**32,879,693**		**919,500,000**

Notes:
(1) HRAS settlement amounts obtained from 2013/14 HRAS 2nd estimate claims HRAS 13-02(W)
(2) Interest payments of circa. £40m required as part of the agreement with Treasury
(3) Estimated settlement value based on PWLB 30 year Maturity rate at 12 March 2013 of 4.35%

Advantages

- Every LHA would be better off in revenue terms when compared to the existing HRAS subsidy payments
- The method is as transparent and simple as possible given the inherent complexities of the existing HRAS system
- Each LHA has the same percentage reduction when comparing their existing HRAS amount to their share of the £40m
- Would be relatively straightforward to explain to tenants and members
- Would not replace one complex formula with another

Disadvantages

- Reflects the current and complex HRA subsidy system but some might argue that the current system is not fair
- There is no link to the current condition of the housing stock
- There is no link to the resources required to meet and maintain WHQS
- There is no link to housing supply or demand

Other Options Considered

The other option considered for the distribution of the settlement value was to base it on the stock numbers for each LHA. While this appeared to be a simple and transparent methodology, the results of the modelling showed that two authorities would be expected to pay more in annual interest payments than they currently pay in negative subsidy payments. This option was therefore disregarded on the basis it did not result in every stock retaining authority being better off than within the subsidy system.

Summary

The Welsh Government considers that Settlement Value Option 1 is the preferred option. The final decision will be subject to consultation and agreement by the Minister for Housing and Regeneration.

Options for distributing the Borrowing Cap

Borrowing Cap Option 1 - To distribute the borrowing headroom based on information submitted by each LHA to the Welsh Government in support of their HRA Business Plan for their 2014/15 application for MRA

	Borrowing Cap Allocation			
	WHQS	**New Build**	**Total borrowing allocation**	**% share of Borrowing**
Authority	**£**	**£**	**£**	%
Anglesey	0	21,400,000	21,400,000	4.5
Caerphilly	55,000,000	0	55,000,000	11.7
Cardiff	0	40,000,000	40,000,000	8.5
Carmarthenshire	14,400,000	0	14,400,000	3.1
Denbighshire	19,600,000	0	19,600,000	4.2
Flintshire	25,000,000	20,000,000	45,000,000	9.6
Pembrokeshire	0	26,000,000	26,000,000	5.5
Powys	18,200,000	0	18,200,000	3.9
Swansea	74,000,000	0	74,000,000	15.7
Vale Of Glamorgan	33,900,000	0	33,900,000	7.2
Wrexham	118,000,000	0	118,000,000	25.0
	358,100,000	**107,400,000**	**465,500,000**	
Contingency to be retained by Welsh Government	**5,585,263**		**5,585,263**	**1.2**
All Wales	**363,685,263**	**107,400,000**	**471,085,263**	**100.0**

It is assumed that the information submitted by each LHA reflects what each can "afford" to borrow.

It is further proposed that any balance, between the borrowing requirement identified by authorities and the total borrowing cap, should be retained by the Welsh Government as a contingency (see section on Flexibility below).

Advantages

- Prioritises WHQS by ensuring that LHAs have access to sufficient borrowing to enable them to meet WHQS by 2020.
- Provides access to sufficient borrowing to those LHAs that have included proposals for new build within their existing business plans.

Disadvantages

- Does not reflect housing need or demand.
- Does not allocate any borrowing headroom to the 7 authorities who have not included new build proposals in their latest business plan.

Borrowing Cap Option 2 - To base the distribution of the borrowing headroom on prioritising WHQS and applying a modified Social Housing Grant (SHG) formula using household projections and affordability index

The illustrative figures are broken down into borrowing required to meet WHQS and borrowing available for new build. This approach uses official Welsh Government statistics and utilises the most recent data for median incomes and median house prices to create an affordability ratio and combines it with household projections. This data is used to calculate the housing need element of the formula that is used by Welsh Government to distribute SHG to Local Authorities.

	Borrowing Cap Allocation			
	WHQS	**Allocation based on modified SHG**[3]	**Total borrowing allocation**	**% share of Borrowing**
Authority	**£**	**£**	**£**	
Anglesey	0	4,696,259	4,696,259	1.0
Caerphilly	55,000,000	8,569,648	63,569,648	13.5
Cardiff	0	22,245,524	22,245,524	4.7
Carmarthenshire	14,400,000	9,924,527	24,324,527	5.2
Denbighshire	19,600,000	5,711,302	25,311,302	5.4
Flintshire	25,000,000	8,609,555	33,609,555	7.1
Pembrokeshire	0	8,350,797	8,350,797	1.8
Powys	18,200,000	10,655,999	28,855,999	6.1
Swansea	74,000,000	13,514,579	87,514,579	18.6
Vale Of Glamorgan	33,900,000	8,214,191	42,114,191	8.9
Wrexham	118,000,000	7,492,881	125,492,881	26.6
Total	**358,100,000**	**107,985,263**	**466,085,263**	
Contingency to be retained by Welsh Government	**5,000,000**		**5,000,000**	**1.1**
All Wales	**363,100,000**	**107,985,263**	**471,085,263**	**100.0**

[3] Based on:
2011 Household Projections published by the Welsh Government
Median Gross Weekly Pay 2013 Resident Analysis published by ONS and
Median House Prices 2011 published by HM Land Registry

Advantages

- Prioritises WHQS by ensuring that LHAs have access to sufficient borrowing to enable them to meet WHQS by 2020.
- Provides all LHAs with "notional borrowing headroom" to enable them to consider proposals for new build, if affordable within their business plans.
- Distributes borrowing cap headroom after WHQS by an objective measure that is a reasonable proxy for housing need.
- This formula could be applied as and when Treasury agree an uplift to the macro borrowing cap for Wales.

Disadvantages

- Does not provide for the level of new build that is currently included within the business plans for four LHAs.
- Could be perceived to disadvantage those that have met WHQS.
- LHA may not be able to use full borrowing capacity to build by 2018.

Borrowing Cap Option 3 - To base the distribution of the borrowing headroom on prioritising WHQS, 4 LHAs receiving 50% of their new build request with balance allocated to 11 LHAs on an indicative basis using the modified SHG formula.

The illustrative figures are broken down into borrowing required to meet WHQS and borrowing available for new build based on 50% of the figures 4 LHAs requested for new build with the balance being distributed across all 11 LHAs. The latter distribution uses official Welsh Government statistics and utilises the most recent data for median incomes and median house prices to create an affordability ratio and combines it with household projections. This data is used to calculate the housing need element of the formula that is used by Welsh Government to distribute SHG to Local Authorities.

	Borrowing Cap Allocation				
	WHQS	50% of new build requested	Allocation based on modified SHG[4]	Total borrowing allocation	% share of Borrowing
Authority	**£**	**£**		**£**	
Anglesey	0	10,700,000	2,360,856	13,060,856	2.8
Caerphilly	55,000,000		4,308,047	59,308,047	12.6
Cardiff	0	20,000,000	11,183,046	31,183,046	6.6
Carmarthenshire	14,400,000		4,989,158	19,389,158	4.1
Denbighshire	19,600,000		2,871,128	22,471,128	4.8
Flintshire	25,000,000	10,000,000	4,328,108	39,328,108	8.3
Pembrokeshire	0	13,000,000	4,198,028	17,198,028	3.7
Powys	18,200,000		5,356,877	23,556,877	5.
Swansea	74,000,000		6,793,913	80,793,913	17.2
Vale Of Glamorgan	33,900,000		4,129,355	38,029,355	8.1
Wrexham	118,000,000		3,766,746	121,766,746	25.8
Total	**358,100,000**	**53,700,000**	**54,285,263**	**466,085,263**	
Contingency to be retained by Welsh Government	**5,000,000**			**5,000,000**	**1.1**
All Wales	**358,100,000**	**107,985,263**		**471,085,263**	**100.0**

Advantages

- Prioritises WHQS by ensuring that LHAs have access to sufficient borrowing to enable them to meet WHQS by 2020.
- Provides those LHAs with a percentage share of the borrowing capacity they requested for new build to ensure part of their new build plans are deliverable.
- Provides all LHAs with an "indicative allocation" of borrowing headroom for new build, if affordable within their business plans.
- Distributes remaining borrowing cap headroom after WHQS and initial proportion for new build by an objective measure that is a reasonable proxy for housing need.
- This latter formula could be applied as and when Treasury agree to uplift to the macro borrowing cap for Wales.

[4] Based on:
2011 Household Projections published by the Welsh Government
Median Gross Weekly Pay 2013 Resident Analysis published by ONS and
Median House Prices 2011 published by HM Land Registry

Disadvantages

- Does not provide for the level of new build that is currently included within the business plans for four LHAs.
- Could be perceived to disadvantage those that have met WHQS.
- LHA may not be able to use full borrowing capacity to build by 2018.

Summary

A summary of the borrowing capacity that each LHA would obtain from each of the options and the difference between the borrowing capacity each LHA requested and the outcome of options 2 and 3 are shown below:

	Outcome Option 1	Outcome Option 2	Difference between Options 1 and 2	Outcome Option 3	Difference between Options 1 and 3
Authority	**£**	**£**	**£**	**£**	**£**
Anglesey	21,400,000	4,696,259	-16,703,741	13,060,856	-8,339,144
Caerphilly	55,000,000	63,569,648	8,569,648	59,308,047	4,308,047
Cardiff	40,000,000	22,245,524	-17,754,476	31,183,046	-8,816,954
Carmarthenshire	14,400,000	24,324,527	9,924,527	19,389,158	4,989,158
Denbighshire	19,600,000	25,311,302	5,711,302	22,471,128	2,871,128
Flintshire	45,000,000	33,609,555	-11,390,445	39,328,108	-5,671,892
Pembrokeshire	26,000,000	8,350,797	-17,649,203	17,198,028	-8,801,972
Powys	18,200,000	28,855,999	10,655,999	23,556,877	5,356,877
Swansea	74,000,000	87,514,579	13,514,579	80,793,913	6,793,913
Vale Of Glamorgan	33,900,000	42,114,191	8,214,191	38,029,355	4,129,355
Wrexham	118,000,000	125,492,881	7,492,881	121,766,746	3,766,746
Total	**465,500,000**	**466,085,263**		**466,085,263**	
Held by WG for future distribution	**5,585,263**	**5,000,000**		**5,000,000**	
All Wales	**471,085,263**	**471,085,263**		**471,085,263**	

Option 1 should be regarded as the baseline as this is what each LHA identified as the borrowing capacity they each required to meet their business plan commitments at a certain point in time. Earlier versions of this data were used to form the basis for the calculation of the borrowing cap and for agreement with Treasury.

Steering group members noted that, for a range of reasons, not all LHAs had included plans for new build in the data submitted to Welsh Government and there were also concerns about whether the data was based on consistent assumptions.

Therefore some members of the steering group felt that option 1 would not be considered fair and equitable to all LHAs.
Option 2 prioritises the borrowing each LHA requires to meet WHQS in the first instance. The balance of the borrowing capacity is then distributed using the modified SHG statistical formula and provides borrowing capacity to all 11 LHAs. As can be seen, this creates significant differences, particularly for the 4 LHAs that have consistently requested capacity for new build and have developed firm plans for new homes to be built or to demolish and re-develop some of their existing stock. Steering group members recognise that developing plans for new build is a lengthy process and will depend on for example housing need, the availability of land, planning consents and appointment of contractors etc.

It is also possible that some LHAs may not wish to consider new build within the next few years. Alternatively the borrowing capacity under this option may not be "affordable" within the business plan for a LHA.

Some members of the steering group felt that there was a need to match the distribution of the borrowing cap with outcomes and deliverability. Option 2 would not provide 4 LHAs with sufficient borrowing capacity to meet their existing plans for development. It was also noted that the borrowing capacity may not be maximised as some LHAs may not wish or be able to utilise their allocated borrowing cap.

It was therefore considered necessary to develop an option that would provide a compromise that could be supported by all 11 LHAs which appear to fall within two groups, those with firm plans for new build and those that only submitted figures for WHQS for various reasons.

The steering group members were keen to strike a balance between ensuring that the distribution methodology for the borrowing cap could be regarded as fair and equitable to all LHAs whilst ensuring the deliverability of new build plans.

Option 3 again prioritises borrowing for WHQS. It then provides a percentage share of the borrowing 4 LHAs identified as required for new build and distributes the balance to all 11 LHAs on an indicative basis using the modified SHG statistical formula which was used for option 2. The modelling for this option is based on the 4 LHAs receiving a 50% share of the new build capacity they require.

There has been significant discussion as to the potential for future flexibility in the distribution of the borrowing cap as it is considered important that borrowing capability should be fully utilised where possible. However it is also recognised that this should not negate the enormous benefit of self-financing and moving away from annual announcements which will provide LHAs the ability to plan over the medium to longer term and deliver and measure key outcomes and outputs. It is expected that any change to a LHA's borrowing cap, whether temporary or permanent, would need to be accounted for within "a Limit on Indebtedness Determination", subject to the Wales Bill coming into force.

The steering group noted that the flexible approach would need to be taken during both the initial setting of the borrowing cap and during any future reviews and recommended that a review of the borrowing cap should be undertaken every 3 years, starting in 2018. This periodic review would apply regardless of what option is taken forward.

The Welsh Government are seeking to ensure that the methodology to be applied to the borrowing cap will distribute borrowing capacity to where it can be fully utilised by achieving WHQS and maximising the delivery of new housing supply. It is therefore important that each LHA is realistic about its ability to use their "indicative allocation" by 2018 which will be reflected in its submission to the Welsh Government in October 2014.

One of the consultation questions is seeking views on what sanctions could be used by Welsh Government in the event that there is a significant difference between the LHA's borrowing capacity and what it has utilised. However, if sanctions were to be applied then provision will need to allow for further flexibility during the period prior to the 2018/19 review. This should be on an "exceptional basis" but would enable a LHA to advise the Welsh Government where it is unable to use their borrowing capacity for whatever reason. This surplus borrowing capacity could then be re-distributed to a LHA e.g. those with shovel ready schemes. It is expected that this type of flexibility which would result in the transfer of borrowing capacity from one LHA to another would require a revised "Limit on Indebtedness Determination" to be issued.

The Welsh Government considers that Borrowing Cap Option 3 is the preferred option. The final decision will be subject to consultation and agreement by the Minister for Housing and Regeneration. Option 3 is supported by the following process:

- Each LHA will be allocated an "indicative allocation" of the borrowing headroom" under the methodology set out in option 3.
- Each LHA will need to advise the Welsh Government by end of October 2014 on whether they will take up their "indicative allocation" for new build up until March 2018.
- If a LHA wishes to take up their "indicative allocation ", the LHA will need to submit proposals to the Welsh Government by end of October 2014 which sets out how and when they could utilise this for new build and whether this together with their allocation for WHQS and % share for new build was "affordable" within the business plan.
- The LHA's submission will need to set out whether land has been identified, an assessment of housing need, the number and type of properties to be developed, timescales for development (up to 2018) and any potential barriers to deliverability.
- As part of the submission, each LHA to advise if they could afford to, and wish to, take on any further borrowing capacity over and above their "indicative allocation" and, if agreed, what additional units could be delivered and whether these would be shovel ready.

- Where a LHA is not able, or does not wish, to utilise their "indicative allocation" for new build, this could be re-distributed to those LHAs that wished to take on further borrowing capacity. This could either be re-distributed to those LHAs that have indicated they could deliver more units or to all remaining LHAs using the modified SHG formula.

- Exceptional arrangements will be introduced to enable a LHA that is not able to fully utilise it "actual allocation" of the borrowing cap before March 2018 to notify the Welsh Government and the surplus borrowing capacity will be re-allocated to LHAs.

- New systems and processes need to be developed to allow for the annual monitoring of compliance with the borrowing cap. This work will be undertaken by one of the work-streams and will consider the data that will need to be gathered by, and collected from, LHAs on what has been delivered in terms of all key outcomes and outputs. This is expected to cover all aspects including achievement and ongoing maintenance of WHQS, re-modelling of existing schemes, regeneration and the development of new properties etc. The work-stream will also be looking at ways of collecting data on the community benefits that are achieved and can be evidenced by LHAs in respect of tackling poverty, jobs and growth, apprenticeships, workless households (LIFT project) etc.

- The borrowing cap will be subject to review every three years with the first review being undertaken during 2018/19. Where a LHA makes a decision not to take up their "indicative allocation of the borrowing cap" for new build under this first distribution, this period of review will enable them to develop new build proposals to feed into the 2018/19 review. LHAs may also be able to develop new build from existing resources or any revenue savings arising from exiting the HRAS system.

Other options considered and reasons for being disregarded

Members of the steering group carried out extensive modelling, and considered the outputs, for the distribution of the borrowing cap which reflected both prioritising and not prioritising the borrowing each LHA requires enabling them to meet WHQS. Where borrowing for WHQS was not prioritised within the modelling, in each case, there were between 3 and 6 LHAs that would not receive enough borrowing capacity to enable them to achieve WHQS by 2020. Since this is a shared Welsh Government and Local Government priority and is to be made a statutory obligation, all options where the borrowing required for WHQS was not prioritised were disregarded.

The options that were considered and which prioritised borrowing capacity for WHQS together with the reason why each option was disregarded are set out in the table below:

Modelled by:	**Reason for being disregarded**
Data provided by LHAs in response to the Welsh Government's request in July 2013	This data was no longer current as LHAs recently submitted updated data to the Welsh Government (**see Option 1**)
Existing housing stock /dwelling numbers	Since the borrowing capacity required to achieve WHQS has been prioritised then the existing stock numbers has no bearing on the borrowing capacity required for future new build plans
Housing projection figures for 2020 (published 2011)	The outputs were very similar to the outputs from the modified SHG formula which the steering group considered was a more objective measure and a reasonable proxy for housing need and affordability (**see Option 2**)
Housing projection figures by the change in housing projections from 2013 to 2020	While this was based on the change in household projections over time, the time period involved was considered too small to be a robust measure of the typical change over a 30 year business planning period.
Each LHA receiving the same percentage headroom over and above the sum of their existing debt plus the settlement figure	This did not reflect future housing need and may also amplify any issues with the distribution of the settlement amount
Each LA receiving the same value headroom (an equal share)	This does not reflect the differences between authorities in terms of size and housing need
Distributing based on current negative subsidy settlement value	This does not reflect future housing need and may also continue any inequalities inherent within the current subsidy system.
Allocating a percentage share to those LHAs that identified a requirement for new build with the balance being distributed to the 7 remaining LHAs using the modified SHG formula	The further modification of the SHG formula to only allocate borrowing capacity to 7 out of the 11 LHAs could impact upon weighting and was not considered to be equitable and fair to all. The setting aside of a percentage for the 4 LHAs for new build and distributing the balance to all 11 LHAs was considered an appropriate compromise option which could be supported by all LHAs (**see Option 3**)

Contingency and Future Distribution of the Borrowing Cap

The setting of a housing related borrowing cap for each LHA is a Treasury requirement and is new to Wales. As part of the agreement for LHAs to exit the HRAS system Treasury has advised that any breach of the borrowing cap would be supported by sanctions. This means that, in the event that the borrowing cap is breached, Treasury would make a compensatory reduction to the Welsh Government Budget which would be passed on to LHA(s) accordingly. Therefore it is in all of our interest to ensure that the borrowing cap is maintained.

The Welsh Government propose the setting aside of a small part of the borrowing cap as a contingency in the first instance. The amount included in the options is approximately £5 million. This contingency will help to safeguard Welsh Budgets whilst the Welsh Government and LHAs adjust to the new borrowing cap arrangements. Whilst this contingency could provide LHAs with access to additional borrowing in the event of an emergency or a change in circumstances it is expected that LHAs will have prudent plans in place to enable them to act in the event of an emergency

The Welsh Government are currently in discussion with Treasury to ensure that there is equity between LHAs in England and Wales in that any increase to the borrowing cap in England should be replicated in Wales.

This consultation is aiming to identify the methodology that will be used in the setting of the initial borrowing cap for each LHA. Subject to the analysis of consultation responses, and Ministerial agreement, it is the expectation that a defined methodology will be identified.

In the event that Treasury does agree to uplift the borrowing cap, it may be possible for such an amount to be distributed using the defined methodology that arises from this consultation process.

Consultation Questions:

1 **Do you agree with the proposal to distribute the settlement value based on negative subsidy amounts?**

2 **Do you agree with the proposal to distribute the borrowing cap based upon option 3 to allow for new build commitments whilst also providing potential headroom for new build to every local authority?**

3 **Do you agree that the Welsh Government should retain a small proportion of the borrowing headroom as a contingency?**

4 **What are your views on how we allocate any unallocated borrowing headroom now or in the future?**

5 **Do you agree that the borrowing cap should be reviewed every three years with the 1st review in 2018/19?**

6 **What action should the Welsh Government take on a LHA who has not delivered on their ability to utilise their borrowing cap?**

7 **Do you have any further comments to make?**

Consultation Responses

This consultation is only relevant to the eleven stock retaining local housing authorities in Wales who are currently part of the existing Housing Revenue Account Subsidy system.

It would be appreciated if these eleven LHAs could respond to the questions as set out above and email the response to:

Jen Welsby at: Jen.welsby@wales.gsi.gov.uk

Anshu Verma at: Anshumail.verma@wales.gsi.gov.uk and

Michelle Herneman at: Michelle.herneman@wales.gis.gov.uk

by close of business Thursday 10 July 2014

If you have any queries please contact Jen Welsby on 0300 062 8161 or

at jen.welsby@wales.gsi.gov.uk

Proposed Cabinet Response to the Welsh Governments Consultation on the Housing Revenue Account Subsidy Reform

Q1	**Do you agree with the proposal to distribute the settlement value based on negative subsidy amounts?**
R1	**Context:** In order to distribute the share of the £40m interest payments to be borrowed from the Public Works Loan Board the Welsh Government is recommending that the settlement should be based on the negative subsidy amounts being paid by each local authority. Appendix 2 shows the impact for each authority of such a settlement agreement. In all cases the estimated reduction in annual payments is 45.12%. **Recommended response**: City of Cardiff Council agrees with the proposal to distribute the settlement value based on negative subsidy amounts. The final subsidy claim for the period 2013/14 should be used as the basis for the calculation as this provides the most accurate assessment of settlement amounts.
Q2	**Do you agree with the proposal to distribute the borrowing cap based upon option 3 to allow for new build commitments whilst also providing potential headroom for new build to every local authority?**
R2	**Context:** This issue has provided difficulties in terms of obtaining consensus across the 11 LHA's. The three options are : 1. To distribute the borrowing headroom based on information submitted by each LHA to the Welsh Government in support of their HRA business plan for their 2014/15 application for MRA 2. To base the distribution of the borrowing headroom on prioritising WHQS and applying a modified Social Housing Grant (SHG) formula using household projections and affordability mix 3. To base the distribution of the borrowing headroom on prioritising WHQS, 4 LHA's receiving 50% of their new build request with balance allocated to 11 LHAs on an indicative basis using the modified SHG formula. Appendix 2 shows the impact in terms of borrowing cap options across the 11 LHAs Option 1 reflects the position based on Cardiff's existing HRA business plan. The Plan reflects the fact that Cardiff achieved WHQS in 2012 as required by Welsh Government and included the delivery of new build Council Homes in the city. Option 1 would give Cardiff a total borrowing allocation of £40m in line with our current requirements and give significant opportunity for further new build housing. A number of LHAs including Cardiff preferred Option 1. However a significant number of LHAs strongly preferred option 2 At a seminar hosted by the WLGA on 16th May 2014 it was clear that neither option 1 nor option 2 would achieve consensus. Consequently it became clear that option 3 remained the only viable acceptable option if a voluntary agreement was to be achieved. If Option 3 is to be the acceptable option, this will leave Cardiff with a funding shortfall (based on existing HRA Business Plan) of £8,816,954. I.E. option 1 £40,000,000 as opposed to option 3 £31,183,046. (see Appendix 2 – page 13 of consultation paper). Whilst Cardiff will still be able to deliver on much of it aspirations for new build, there will have to be a review and production of a new HRA Business Plan to reflect this shortfall and highlight the

	implications and options available in respect of the potential funding gap. **Recommended response**: Whilst the City of Cardiff Council would prefer to opt for Option 1, it is clear that option 3 is the only option that will succeed in all 11 LHA's obtaining the required voluntary agreement. In order to allow the voluntary agreement to succeed the City of Cardiff agrees to option 3.
Q3	**Do you agree that the Welsh Government should retain a small proportion of the borrowing headroom as a contingency?**
R3	**Context:** Should a Council's business plan in future years take its borrowing close to its Cap, there a risk there various external factors could cause a technical breach in any limit, e.g capital programme expenditure being more advanced than planned, the need to undertake urgent unplanned expenditure. Such risks are already carefully monitored by the Local authority during the business plan period and expenditure monitoring process. Whilst understandable that WG wish to ensure any risk to Welsh Government budgets as a result of any inadvertent breach is minimised, well established and audited systems are already in place within local authorities in the form of prudential indicators required to be set each year in the budget. This includes an affordable borrowing limit, where a worst case scenario approach is already adopted by local authorities when determining their affordable borrowing limit to ensure no inadvertent breach. To have both local authorities and WG holding a level of contingency is not deemed necessary **Recommended response**: City of Cardiff Council does not agree that WG should hold a £5 million contingency. Local authorities already have established procedures to ensure that can operate within any Cap set.
Q4	**What are your views on how we allocate any unallocated borrowing headroom now or in the future?**
R4	**Context:** The Welsh Government are currently in discussion with Treasury to ensure that there is equity between LHAs in England and Wales in that any increase to the borrowing cap in England should be replicated in Wales **Recommended response**: Should there be agreement on an increase in the Welsh Borrowing Cap prior to the finalisation of the settlement for the voluntary agreement to be entered into, then it would seem appropriate to split this on the basis of option 3, the preferred option, to allow a voluntary agreement to be reached. Should there be an agreement between the WG and Treasury following implementation of an approved voluntary agreement, it is suggested that consideration be given to distributing using alternative methods that consider housing need, such as Population and Household Growth and focuses on increasing housing supply only. This is particularly the case as the initial cap already prioritises and allocates headroom to allow local authorities to meet Welsh Housing Quality Standards.
Q5	**Do you agree that the borrowing cap should be reviewed every three years with the 1st review in 2018/19?**
R5	**Context:** As mentioned above, the distribution of any set borrowing cap was a difficult area in securing consensus between all 11 authorities. With securing a voluntary agreement being a priority, option 3 remained the only viable acceptable option if a voluntary agreement was to be

	achieved. This met the key priorities of WG to prioritise WHQS first for those who have not met this requirement in 2012 and then allowing headroom to increase housing supply. Given the above issued, to fix any such headroom allocated to an authority in perpetuity has a number of risks including:- • Changes in business plan parameters including affordability over the 30 year plan period. There is uncertainty as to how a cap set now which will impact on authorities in the future • Changes in population and housing need over time • Authorities with a need not being able to achieve housing policy, given the restraint of a cap, especially where it may not be required in other authorities or not be required for a longer period • The overall all Wales borrowing cap not being fully utilised to improve housing policy objectives across Wales where deemed affordable Authorities must by October 2014 be able to demonstrate that they can take up the indicative allocation of borrowing capacity for new build by 2018/19 and also for WHQS by 2020. This would need to consider deliverability, details of whether land is available, assessment of housing need, number and type of property and timescales. Unused borrowing capacity can then be redistributed to authorities that wish to take on further borrowing if their business plans allow. **Recommended response:** A periodic review and flexibility in individual council borrowing caps from those initially set is essential for the City of Cardiff Council to enter into a voluntary agreement. Accordingly we agree with the proposal that that any borrowing cap should be reviewed every three years starting 2018/19, with revised indebtedness determinations issued by WG accordingly following this review. This should be done centrally rather than on a voluntary basis between individual local authorities.
Q6	**What action should the Welsh Government take on a LHA who has not delivered on their ability to utilise their borrowing cap?**
R6	**Context:** A number of factors could have a significant impact on deliverability of plans, particularly in relation to capital expenditure. It should also be recognised that self financing will be new to both local authorities and Welsh Government. Accordingly sanctions for not being able to use any headroom where there are justifiable reasons would be unfair and unhelpful. This clearly is an area that can be considered when the initial distribution of the Cap is reviewed in 2018/19, including consideration of progress in meeting the revised deadline for achieving Welsh Housing Quality Standards. **Recommended response:** City of Cardiff Council does not agree that actions should be considered against local authorities who have not delivered on their ability to utilise their borrowing cap.
Q7	**Do you have any further comments to make?**
R7	**Recommended response:** It needs to be recognised that a number of key variable impact on the viability of the Housing Business plan. In particular the current annual £9.6 million allocation of Major Repair Allowance received from WG to support investment in the Council's Stock. Whilst this has been protected by WG for some years, its continued availability at similar levels is essential to ensure that local authorities do not have borrow more than they have initially assumed in their business plans and in agreeing to the voluntary settlement. Reductions could have a significant impact on the affordability of any agreed settlement and sustainability of borrowing required to be taken.

Appendix 4

My Ref: Scrutiny/Correspondence/Cllr Groves

7th July 2014

CARDIFF
CAERDYDD

Councillor Susan Elsmore
Cabinet Member (Health, Housing and Wellbeing)
c/o Room 520
County Hall
Cardiff
CF10 4UW

Dear Susan

Community & Adult Services Scrutiny Committee Meeting – 2nd July 2014

Thank you for attending the above committee. This letter captures the agreed comments and observations of the Committee with regard to the items detailed below.

Housing Finance Subsidy Reform
Members thank you for the opportunity to undertake pre-decision scrutiny of this item. Having considered the evidence provided with regards to the various options and their implications, Members are content with the proposed consultation response and support its' submission to the Welsh Government.

With regards to whether new-build council housing will be within the HRA ring-fence or not, Members would like to receive further clarification on whether or not this is the case, bearing in mind the statement that was previously presented to committee, as detailed at point 12 of the cover report for this item – *'the building of significant levels of housing to be retained by the Council, will require consideration of maintaining such housing outside of the HRA Subsidy system'*.

Members note that there is a requirement to recast the HRA Business Plan 2015-16 by October 2014 to take into account the proposed changes, including the borrowing cap of £31 million. Members are holding a work programming forum on Monday 7th July 2014 and will consider whether to include this item in our work for the forthcoming year.

Cabinet Response to Welfare Reform Inquiry
Members wish to thank you for ensuring that our Inquiry into the Under Occupation of Social Housing Welfare Reform received a Cabinet Response. Members will discuss when to programme in a progress report on the implementation of the agreed recommendations at our work programming forum.

In relation to Recommendation Five, Members were pleased to hear Sarah McGill say that she will explore with colleagues the use of the existing reorientation teams to ensure that tenants with sensory impairments who move to new properties are given assistance with external reorientation, as well as with any adaptations that are required.

Members are aiming to agree a draft work programme in July and I will ensure you receive a copy of the work programme once it has been approved by Committee.

This letter contains a request for further information and so requires a response.

Yours sincerely,

COUNTY COUNCILLOR DAVID GROVES
Chairperson - Community & Adult Services Scrutiny Committee

Cc: Sarah McGill
Claire Deguara   Liz Patterson   Nick Blake