



HM TREASURY



REVIEW OF THE COUNCIL HOUSING FINANCE SYSTEM

Narrative No 5 HRA RULES

May 2008

Introduction

Communities and Local Government and HM Treasury are undertaking a fundamental review of the council housing finance system, reporting jointly to the Minister for Housing and Planning, Caroline Flint MP, and the Chief Secretary to the Treasury, Yvette Cooper MP.

The Chartered Institute of Housing has been commissioned to support the Review by facilitating expert and practitioner workshops and producing a series of narratives for the sector to keep people informed of progress.

The Review is wide ranging, as described in Narrative 1. Although many of the issues are interlinked, the Review has been divided into four workstreams to make it manageable – Costs and Standards; Rents and Service Charges; Mechanisms for Delivering Finance; and HRA Rules. Narratives 2-5 identify and discuss issues emerging from each of the workstreams and the associated expert and practitioner workshop. Narrative 5 discusses some of the issues that will be addressed in the workstream on HRA Rules.

The overall objective of this workstream is to review the rules governing the operation of the Housing Revenue Account (HRA), i.e. the local authority landlord account, determine whether changes to the rules could improve the efficiency and effectiveness of the delivery of landlord services included in the HRA and produce recommendations for change or amendment.

Background

All councils that own housing stock are required to keep a Housing Revenue Account. The HRA is a statutory account based on the Local Government and Housing Act 1989 and subsequent amendments. The 1989 Act established the HRA as a ring-fenced landlord account separate from a council's general fund revenue account, containing the income and expenditure arising from the landlord function. The ability to transfer monies across the ring-fence was limited with certain specific exceptions and the transfer of surpluses from rents to keep down local taxation was ended. Schedule 4 to the 1989 Act specifies the credit and debit items that are required to be shown in the HRA.

The 1989 Act requires LAs to keep their HRA in accordance with proper practices as defined in section 21 of the Local Government Act 2003. The Chartered Institute of Public Finance & Accountancy (CIPFA) produces the codes for LA accounting known as the Statement of Recommended Practice (SORP) and Best Value Accounting Code of Practice (BVACOP), both of which are identified as sources of proper practices by virtue of regulations made under section 21 of the 2003 Act.

Clarification on items to be accounted for within the HRA was set out in the HRA DoE circular 8/95. Guidance on the operation of the HRA is available in CLG's 'HRA Manual' and CIPFA's 'Introductory Guide to Housing Finance in England' and on the CIPFA website.

The HRA Ring-Fence

The HRA ring fence policy and the focus on having a 'landlord account' has ended the transfer of large sums to the General Fund (GF) and has removed some previous perceived abuses of the system. There is still however a lot of variability in practice between councils – for example whether and to what extent they recharge corporate and democratic costs.

The debate about the ring fence is philosophical as well as technical, and there are differing views about the proper degree of separation or integration between council housing and the parent council. The Government's objective that tenants should pay similar rents for similar services across landlords suggests that landlords' financial arrangements must be similar too and a tighter ring fence might make this more feasible.

Although the ring fence brings greater clarity on what is chargeable or not, there is still a lot of movement across the ring fence that is not transparent to tenants. Tenants feel that they are paying twice for some services, through council tax and through their rents. For example, it could be argued that significant costs associated with work on Anti-Social Behaviour (ASB) is routinely charged to the HRA but should be borne by the General Fund, as it would be for private housing areas. Similar arguments apply to the charging of other services such as some grounds maintenance, highway services, refuse collection, recycling, and the apportionment of council support costs and overheads to the HRA. It could be argued that these practices distort the real costs of council housing but also affect affordability, not only for tenants but also for leaseholders having to meet these extra costs through their service charges.

One way of deciding the proper boundary of the ring fence would be to look at the experience of stock transfers and especially what services and responsibilities transferred across with the stock. If it isn't transferred to the new landlord, it could be argued that it shouldn't be in the ring fence in the first place. Some stock transfers would have been unviable if extra costs had been included.

An alternative view is that flexibility between the GF and the HRA has positive benefits to both sides and is not always a problem or a tension. Tenants might get a better deal overall by being close to or more integrated with the council, with funds crossing the ring fence in both directions to suit the circumstances. The GF contributed greatly to the supply of homes in the past and councils should perhaps have the flexibility to take a little back to meet the wider needs of the community, especially if the GF does not have money to deliver the service. A one size fits all approach may be too restrictive and

councils should have greater freedom and flexibility to act on behalf of their communities as part of devolution. One approach might be to guarantee greater transparency within rules that more clearly allow some cross subsidy in both directions. It would then be possible to engage with tenants on decisions to breach the ring fence, especially if they feel a service is essential but cannot be funded through the GF to the right level. A mature debate might encourage tenant involvement in devolved decision-making but would also help manage tenant expectations.

It may also be that focussing on leakage to the GF distracts from the major issues facing the HRA. The resources involved might represent a small proportion of the total and, if so, are insignificant compared to the volatility caused by the annual changes in allowances.

At present there is no national HRA and no ring fence between housing and other services at Government level. This reflects normal accounting practice but it means that tenants cannot see directly the relationship between the rents they pay and the services they receive and the deployment of surpluses when they arise.

The local ring fence does not extend to capital. When tenants exercise the right to buy, the HRA loses income but does not gain the capital receipt. Councils vary considerably in their practice and whether they give retained capital receipts back to housing. A significant amount of investment is lost from housing to other services as a result despite the high long term requirement for investment in council housing. Of course, extending the ring fence to capital might cause major problems for other council services unless other sources were available. Tenants might support community investment in some circumstances, and the switch between services might be justifiable in the local democratic context.

Mixed tenure

Council estates are becoming much more mixed – with leaseholders, buy to lets, sub-tenants, mixed tenure infill development, and, increasingly, shared owners will be added to the mix. This is creating a more complex environment for managers but also for HRA accounting with a rising share of communal, neighbourhood and environmental costs not being attributable to the tenanted stock.

Many leasehold sales were of flats and some of these owners now face large bills for decent homes work or other repairs – over £50,000 in some cases. Some leaseholders have become asset-rich but remain cash-poor, while others have not benefited greatly from the asset either. It can be argued that LA leaseholders should be treated in the same way as any other owner occupier but there is deemed to be a stronger local and national social responsibility towards them and a desire on behalf of councils to alleviate the burden of service charges where possible.

If the system as a whole was less volatile, the capital programme could be better planned and it might be easier to overcome current obstacles to establishing sinking funds or helping leaseholders to save in other ways. The weaknesses in sinking fund schemes are that the cost of administration is high and that contributors have to balance their loss (due to their funds not being reimbursed when they move) against their likely gain (in the value of their property because they have contributed to the fund). LAs could pay for works in exchange for equity by putting a charge on the property, but it

might be many years before the property is sold and the money recovered. Leasehold services could be excluded from the HRA altogether.

There are issues to do with freehold houses on estates where services are provided paid for from HRA but there is no means of recovery because recharges were not put in the original conveyance. Management of leasehold property is also complicated by the existence of a wide variety of leases with different responsibilities set out in them. Some leases make it difficult to recharge a share of the cost of new services introduced since the lease was signed. Others are poorly worded and add to the problems of enforcement. Leaseholders may not, for example, be required to contribute to the tenant participation service or the costs of the residents association, which benefits everyone. These may appear to be marginal amounts, but it can be a significant cost for the individuals concerned and poses a difficult issue for politicians. The subsidy system could allow for the fact that there are some leaseholder costs that cannot be recovered.

Guidance and accounting issues

Guidance on appropriate charging to the HRA was contained in HRA Circular 8/95. This was produced after extensive consultation but is now significantly out of date. This workstream will identify the main areas needing amendment and bring forward proposals to update it. It will be important to ensure that CLG guidance and CIPFA guidance and other relevant documents are consistent with one another.

Accounting and the presentation of information in the HRA accounts could be more helpful for business planning. As housing debt is held by the LA and not separated for housing, there is no expression of the value of the stock as there is in RSL accounts. There is an argument for capturing capital in an HRA balance sheet, if only as a management accounting tool and to make HRA accounts more comparable with RSL accounting.

It was announced in the 2007 Budget that Whole of Government Accounts from 2008/09 will be based on the provisions of IFRS. The impact of this decision on local authority accounts is under consideration by CIPFA.

Some key questions

- 1. Should the HRA ring-fence be abolished, be more prescriptive, or relaxed?*
- 2. What changes are needed to take account of the fact that estates are increasingly mixed tenure?*
- 3. Is there sufficient clarity regarding what should and should not be included in the HRA and what changes are needed to the guidance contained in Circular 8/95?*
- 4. What changes to HRA accounting would help improve the cost effectiveness of council housing management and maintenance of the stock?*
- 5. Is the HRA picking up the costs of services never envisaged to be borne by the account?*

6. *To what extent are there differing practices between LAs and do these affect outcomes?*
7. *How should the sector prepare for the requirements of International Financial Reporting Standards (IFRS)?*

*Steve Hilditch
May 2008*

This narrative is based on a range of views, including those expressed during the workshop, and is published to encourage wider debate. It does not necessarily reflect the view or imply the agreement of CLG, HMT, CIH, or any individual participant.