An Introduction to Local Authority Housing Finance

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Date: September 2007
Updated: September 2009

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An Introduction to Local Authority Housing Finance

Summary

This introduction to housing finance explains to tenants how local authorities with housing stock account for their spending and income. It outlines how a separate account for the housing stock has to be maintained; the Housing Revenue Account. This Introduction also explains the accounting differences between revenue and capital. It includes a brief summary of the proposed review of the Housing Revenue Account announced by the government in July 2009.
Local authorities have to follow government regulations in accounting for the money they receive and the money they spend.

An Introduction to Local Authority Housing Finance

Introduction

Local Authorities have to account for their spending and income in a way that satisfies government regulations. Local authorities include most day-to-day spending and income within an account called the General Fund. The General Fund includes spending and income from a range of services including refuse collection, leisure facilities and community development work. There are also housing-related elements included within the General Fund, such as homelessness and maintaining the housing register.

Those authorities with a council-owned housing stock have a duty to maintain an additional account called the Housing Revenue Account (HRA). The HRA specifically accounts for spending and income relating to the management and maintenance of the council-owned housing stock. By law it must be kept separate from other council accounts. It is therefore termed a “ring-fenced” account (Local Government and Housing Act 1989). The HRA receives no income and incurs no expenditure through the Council Tax.

Additionally, local authorities have to differentiate between spending on day-to-day items and other items. Day-to-day spending, such as on salaries, and day-to-day income such as from rents, is called revenue. On the other hand spending to maintain, improve or add to the property and assets held by the council is called capital. Capital expenditure generally involves large sums of money.

This Information Guide will outline:

- the key headings within the HRA
- what is charged to the capital accounts
- how revenue and capital accounts are funded.

The Housing Revenue Account (HRA)

The HRA is a “ring-fenced” account held by local authorities. It contains all the spending and income related to the dwellings owned by the council, acting as landlord. Local authority housing consists mainly of:

- General Needs housing – houses, flats, bungalows, maisonettes
- Sheltered Accommodation – usually schemes for elderly or vulnerable people, often with communal facilities
Where the money comes from.

- Shared Ownership – an increasingly more common approach whereby buyers own a proportion of the property and pay rent on the remainder.

In addition to the housing stock outlined above, the HRA may also account for spending and income relating to other facilities such as:

- Garages
- Shops

Each authority will have varying levels and types of housing and additional facilities, and so the HRA for any particular local authority will be unique to their individual circumstances.

However, the format of the HRA is laid down by the government. It must contain spending and income items relating to the landlord function. The HRA is split between income and spending. The items under these headings are shown below:

**Income**

**Rental Income**

The main source of income for the HRA is rental income; the rents paid to the local authority by tenants. Local authority rents are now decided by a formula set by the government which sets a target for rents to reach by 2011-12, although there are limits to the increases allowed in any one year.

This rent policy was introduced from April 2002. The government’s aim is to ensure that similar properties in the same area will have a similar rent no matter if the dwelling is owned by a local authority or a housing association.

The calculation is based on:

- Capital values (30%)
- Regional income factor and size of dwelling (number of bedrooms) (70%).

The HRA accounts for the expected rental income due in the year, but there is provision for bad debts (i.e. rent not received in the year due to non-payment). There is an adjustment to reflect empty properties which, for any period of time, do not provide rent.

**Charges for Services and Facilities**

The HRA will also receive income called Service Charges. This is money received for services and facilities provided that are not already covered by the rent. Examples of such charges are community alarm systems, cleaning communal areas in sheltered schemes, and specific grounds maintenance work.
The HRA may also receive income on properties where the leasehold has been sold (i.e. flats). If work is carried out to the shared parts of a block of flats then the costs will be charged to the HRA as the freehold of the property remains with the HRA. However, money can be claimed back off leaseholders living in the block of flats. This will show as income within the HRA.

**Housing Subsidy Grant/Payment**

Housing subsidy is calculated by the government based on estimated income and spending for each local authority’s HRA. The calculation involves a number of assumptions. Where the government’s subsidy estimates show that expenditure for a local authority is greater than its income, then subsidy will be paid to the local authority. However, where the government’s subsidy estimates show that income is greater than expenditure, then the local authority will have to make a payment to the government. This calculation changes annually.

The assumptions used in the calculation of the government’s estimates are:

- Guideline rents
- Major repairs allowance
- Management and maintenance allowances
- The HRA’s share of the cost of previous local authority borrowing
- Other specific items of income and expenditure.

Most of the information needed by local authorities to calculate their subsidy entitlement is given by the government in the annual HRA Subsidy Determination. The subsidy claim completed by the local authorities has to be independently audited each year to ensure the claim is correct.

**Spending**

**Management costs**

A large proportion of the money local authorities spend is paid in salaries to its staff. As well as salaries there are a number of other management costs that the authority must account for, for example:

- Office accommodation costs
- Information technology
- Tenant participation
- Sheltered accommodation

Management costs can be categorised as either general management or special management.
General management will cover costs associated with the landlord services of the HRA, and so will include spending on policy initiatives, rent collection, and managing tenancies.

Special management covers the costs of services provided to tenants that are usually shared, such as spending on managing sheltered schemes, grounds maintenance, communal lighting and caretaking.

**Maintenance costs**

The HRA includes repair costs to the housing stock. These usually fall under these headings:

- Responsive work (day-to-day repairs)
- Voids (work on empty properties)
- Cyclical maintenance (rolling programmes of work).

These costs are defined as revenue expenditure and so will be held within the HRA. In addition to this revenue programme of maintenance there will also be a capital programme of expenditure. This will be funded with capital money separate from the HRA (see the “Capital Account” section below).

**Revenue Contribution to Capital (RCCO)**

The HRA accounts for day-to-day expenditure whereas the capital account will deal with purchasing or improving assets. However, there may be surplus money available within the HRA to part-finance capital expenditure. In this case money would transfer to the capital account from the HRA. This is known as revenue contributions to capital outlay (RCCO).

**Capital Charges**

Local authority housing departments will have borrowed money in the past to fund the building of their council houses and flats. Interest payments on this borrowing have to be paid for out of the HRA.

Local authorities will manage their overall borrowing debt for the council as a whole. This means that they will not know precisely their HRA borrowings. Councils calculate an estimated assessment of their HRA borrowing levels. This is called the capital financing requirement (CFR). The CFR will increase if new borrowings are undertaken and will reduce if debt is repaid.

The local authority then applies a calculated interest rate to the CFR. This in turn gives a capital charge to the HRA. This shows as spending within the HRA but is transferred to the council’s main account, the General Fund.

**Major Repairs Allowance**

This allowance is received through the subsidy system but is required to be spent on capital items (see the “Capital Account” section below).
How does a local authority draw up its HRA?

Therefore it is shown within the HRA as both income (within subsidy) and, because it is transferred to a reserve account to fund capital expenditure, as a cost. The two sums equal each other so there is no overall effect on the HRA.

The HRA account will also show depreciation. This is a charge for the use of assets and is spread over the length of their life. Depreciation generally mirrors the Major Repairs Allowance.

Other Costs

There may be other costs for which the HRA is liable. These may include:

- Council tax
- Water rates
- Lease rents.

These costs will vary from authority to authority depending on local circumstances.

HRA Budgeting/HRA Balances

Every local authority must set its own HRA budget (i.e. plan future years’ spending and income). A key requirement, set down in law, is that the budget-setting must avoid a deficit. In other words, outgoings in the year must not exceed income, unless there is an HRA reserve to cover the deficit.

The HRA must also ensure that there are sufficient balances held (i.e. surplus money available) in order to cope with unforeseen circumstances. The level of these balances will be at the local authority’s discretion but will be decided in consultation with their external auditors.

Transfers between the HRA and the General Fund

Although the HRA is described as a “ring-fenced” account, there are occasions when transferring costs between the General Fund and the HRA is allowed.

It may be that the cost of grounds maintenance on HRA land is shown within the management costs of the HRA. However, due to right-to-buy sales, the work undertaken may affect areas where right-to-buy owner residents now live. In this instance it is appropriate that money is transferred from the General Fund to the HRA to reflect the work undertaken for those residents with their own property.

Housing Green Paper (Homes for the Future: More Affordable, More Sustainable)

The Housing Green Paper was issued by the Government in July 2007. It
Capital spending: paying for things that will last.

aimed to provide more homes to buy and rent which are affordable and well-designed.

Within the paper there is mention of the desire to reform the HRA. To achieve this, the government has allowed some pilot councils to leave the subsidy system and retain their income. If implemented across all authorities this would significantly change the structure of the HRA, although it is not expected to occur in the short-term. See below for further details.

**Arms-Length Management Companies (ALMOs)**

An ALMO is an organisation set up by a local authority to manage and improve all or part of its housing stock. ALMOs are companies which are owned by the local authority and are non-profit distributing, but, as the name suggests, ALMOs retain a degree of independence.

A key characteristic of an ALMO is the separation of the local authority’s housing management role from its strategic housing function.

The financial arrangements between the ALMO and the local authority are subject to a legal agreement.

**CAPITAL SPENDING AND FUNDING**

**Definition of Capital Spending**

The Local Government and Housing Act states that capital expenditure involves buying, building, replacing or enhancing an asset. Enhancing an asset will:

- Increase the value of that asset, and/or
- Increase the life of the asset, and/or
- Increase substantially the use of the asset.

**Examples of Capital Spending**

Housing capital expenditure is undertaken on both HRA and General Fund areas of responsibility. For example, providing work or grants for private dwellings will be a General Fund service.

The main capital spending for local authority housing departments is on the renovation and improvement of its housing stock. There is a government requirement for council housing to meet a required standard (Decent Homes) by 2010. This is a key target for local authorities with housing stock. Examples of capital spend include:

- Replacement windows
- Re-roofing
Where does the money for capital spending come from?

New kitchens
New bathrooms.

Sources of Capital Funding

Local authorities must ensure that spending is allocated correctly between revenue and capital accounts. This is not only because of legal requirements, but also because the money comes from different sources (funding streams). As we have already seen, the costs within the HRA are mainly funded through the rental income from the housing stock. For HRA housing capital expenditure, the main funding areas are:

- **Right-to-buy capital receipts** – local authorities sell houses and flats through the right-to-buy scheme to tenants, and will receive money for these sales. This income is called capital receipts. Local authorities are allowed to use 25% of these receipts for capital spend.

- **Other capital receipts** - There may be land and other HRA properties sold (e.g. shops and garages). In these instances, 50% of the receipts may be used for capital expenditure.

- **Prudential Borrowing** – The Local Government Act 2003 enabled local authorities to borrow money to use for capital spend without requiring government consent (previous law had restricted the ability of local authorities to borrow). However, local authorities must show that they have future resources available to pay the interest on the loan.

- **Major Repairs Allowance** – this is money provided through the revenue subsidy system to enable authorities to maintain the HRA properties in their current condition.

- **Revenue Contribution to Capital (RCCO)** – If there is surplus money within the HRA, then the local authority may wish to transfer money to fund capital spending.

- **Government grants** - mainly for such items as providing disabled facilities.

Budgeting for Capital Spending

When producing their capital plans local authorities will take the following steps:

- Identify housing capital spending requirements
- Decide which capital spending requirements are the most important
- Identify available capital resources
- Draw up a capital spending programme that meets the most important priorities within the available resources.
HRA Finance Review

The government published a consultation paper on 21 July 2009 on options for the reform of housing finance for local authorities. The consultation paper follows the long-running review of the current system. In particular it considers the future of the Housing Revenue Account subsidy system and replacing it with a devolved system of responsibility and funding. In essence, the aim is to give local authorities greater responsibility for managing the HRA.

The consultation lays out two options for future HRA funding. Under both of them authorities would:

- Manage their stock according to their 30-year business plan
- Maintain a new account which will record all transfers between the HRA and General Fund
- Retain 100% of the proceeds from Right-to-Buy sales, with 75% of such receipts ring-fenced for reinvestment in housing
- Account to the Tenant Services Authority for the value for money and efficiency secured for local tenants.

The first of the HRA funding options is a modified version of the existing subsidy arrangements. The changes are aimed at providing greater long-term stability than at present. The modifications include subsidy allowances to be specified 3 to 5 years in advance (compared with the current annual determinations). While this option provides some of the improvements that local authorities have requested for some time, it falls short of the Minister’s stated intention to “dismantle” the existing subsidy system.

The second option is a self-financing option which is more radical. It appears to be the government’s preferred option. This would provide:

- An end to the current subsidy system
- Redistribution of the current national housing debt of £17bn to stock-owning housing authorities, based on the value of their housing stock
- Authorities to retain any surpluses made on their HRA, for reinvestment in local housing.

Consultation responses are due by 27 October 2009. If, following consultation, self-financing is the preferred option, further details of the terms for the self-financing regime will be published in spring 2010. The Minister expects that the primary legislation required to deliver self-financing will be in place to enable the change from 2012/13.
Local Authority Finance Terms

**Asset** – An item having a monetary value and may be classified as either "current" - expected to be used within the next year or "capital" - having an expected life longer than a year.

**Balances** – Reserves of money which can pay for unplanned spending in the future

**Budget** – A plan of specified spending and income over a set period, usually one year

**Capital Spend** – This is spending on assets that adds to the value of an existing asset, or is the purchase of a new asset (e.g. improvements to a property such as a new updated kitchen)

**Capital Resources** - Income used to finance capital spending, usually borrowing, major repairs allowance and capital receipts

**Capital Receipts** – Income from the sale of assets such as land and buildings

**CFR** – The Capital Financing Requirement is an assessed calculation of the level of debt for a local authority

**Deficit** – a deficit occurs in the accounts when spending exceeds income

**Funding Stream** – income specific to a particular type of spending (e.g. capital receipts are a funding stream for capital spending)

**General Fund** – A summary account for all council services with the exception of the HRA

**Housing Subsidy** – This is a grant paid from government to local authorities to meet any shortfall between spending and income, based on a notional model of their HRA. Local authorities pay money back to the government if their HRA notional model shows more income than expenditure

**HRA** – The Housing Revenue Account is the spending and income relating to the provision of rented housing stock for a local authority

**HRA Subsidy Determination** – The determination is produced by the government each year and provides information to local authorities to allow them to calculate their subsidy entitlement

**Income** – an amount of money received for goods or services

**Major Repairs Allowance** – This is money paid to the HRA from government and represents the estimated annual amount required to maintain the HRA properties in their current condition
Prudential Borrowing – The Prudential Borrowing system allows local authorities to borrow money for capital spending as long as they can meet future borrowing costs without government support

RCCO – surplus money in a revenue account used to fund capital spend

Revenue spend – this is the expenditure on day-to-day goods and services by a local authority (e.g. salaries of staff)

Right-to-buy – this is the right given to eligible tenants to purchase their rented home from the local authority

Ring-fenced accounts – these accounts must operate independently from other accounts, and will show spending and income for a particular service, such as the HRA

Service Charges – tenants and leaseholders may incur additional charges for the provision of certain services. Service charges are paid in addition to rent (e.g. for communal lighting in a block of flats)

Tenant Services Authority (TSA) – the new body responsible for regulating affordable housing providers
Further Information
[Contact points for further information and assistance]

Useful Websites
CLG Housing Finance information http://www.communities.gov.uk/index.asp?id=1154203

Useful Contacts
InSTEP: Information Services for Tenants. Freephone helpline 0500 844 111. Email: info.instep@tribalgroup.co.uk
www.instепservices.co.uk
Information services for tenants: empowerment and participation

InSTEP provides information and training services to tenants in social housing.

InSTEP is a national service which offers a number of services to help tenants and landlords to work together, to inform and empower residents and to encourage tenant participation.

We offer a variety of services including:

- a free telephone helpline service 0500 844 111
- free information on tenant participation and housing
- training for tenants
- events to promote participation.

Funded by the Tenant Empowerment Programme