A Brief Introduction to Local Authority Housing Finance

This introduction to housing finance is in addition to the briefing that will be presented to the Tenant Services Management Board on 10 June 2010

Summary

This introduction to housing finance explains 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.

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.

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).

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.

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,
- Sheltered Accommodation – usually schemes for elderly or vulnerable people, sometimes with communal facilities

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

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. 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 nonpayment).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 cleaning communal areas in sheltered schemes, and specific grounds maintenance work.

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 and communal lighting.

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).

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 an end of year 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.

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). This is a key target for local authorities with housing stock.
Examples of capital spend are:

- Replacement windows
- 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. 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.