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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

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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?lId=8220>

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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.

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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.

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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.

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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 updated¹ 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

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

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All Wales Borrowing Requirement		358.1	107.4	465.5
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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.

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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			% share of Borrowing
	WHQS	New Build	Total borrowing allocation	
	£	£	£	%
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.

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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			% share of Borrowing
	WHQS	Allocation based on modified SHG ³	Total borrowing allocation	
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

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

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All Wales	363,100,000	107,985,263	471,085,263	100.0
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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.

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	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

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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.

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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

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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.

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- 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 its “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.

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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)

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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