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An Introduction to Housing Finance for Council and Housing Association Tenants

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Introduction

'How the money works' is a fundamental question for anyone interested in understanding or improving council or housing association housing.

This Information Sheet aims to provide an overview of housing finance for both local councils and housing associations. It tries to do this in a way which is simple to understand, but which also suggests ways in which more money may be found to spend on housing services or provision.

Council housing services are regulated by the Office of the Deputy Prime Minister (ODPM) and monitored by the Audit Commission's Housing Inspectorate. Housing associations are also monitored by the Housing Inspectorate, but are regulated by the Housing Corporation, who will intervene in cases of serious incompetence or impropriety. Additionally, both councils and housing associations employ external and internal auditors who regularly check on the integrity of financial transactions and internal financial systems.

Two types of money - revenue and capital

Any commentary on housing finance must include an explanation that there are two 'types' of money - Revenue and Capital:

Revenue covers expenditure that occurs on a regular basis as a 'running cost'. This includes normal staff costs, office costs, day-to-day maintenance, insurance and loan repayments. Revenue expenditure is met out of current income (rents etc.), and will normally include anything that has to be paid for at least once every year.

Capital expenditure is money spent on major items or works that add value and will last a long time. Capital expenditure is often covered by borrowing, which is repaid over the life of the asset. Other sources of money for Capital expenditure are grants, and 'capital receipts' from sales. If there is a surplus of annual income over expenditure it is possible to use the surplus on Capital expenditure.

Two types of rented social housing

There are two types of rented social housing:

- **Council housing**, where the landlord is the local authority.
- **Housing association housing**, where the landlord is a Registered Social Landlord (RSL).

Both are subsidised, but each is financed and regulated in a different way. A large amount of council housing is now managed (but not owned) by arms length management organisations (ALMOs). The rules for ALMO managed housing are very similar to the rules for directly managed council housing.

The situation for councils is considered first.

Council housing finance

The Housing Revenue Account

Where a council owns council houses all the revenue finances of running and managing the council houses are included in a special account called the Housing Revenue Account (HRA).

The Housing Revenue Account is 'ring fenced' from other council expenditure - for example the council cannot take money out of the HRA and use it to pay school teachers. Similarly, the council cannot subsidise or make up deficits in the HRA from its other revenue. However, the council can charge the HRA for services provided by other council departments, such as finance or the use of information technology.

All revenue expenditure on council housing is paid out of the HRA. The sources of income for the HRA are rents, service charges, some miscellaneous charges (e.g. garage rentals), and government subsidy.

The Legal Framework
The law setting out the framework for the HRA is contained in the Local Government and Housing Act 1989. However, the specific rules are changed regularly through something called Statutory Instruments. These are laid before Parliament to gain approval for the planned changes. Full details of the current rules relating to how council housing is financed are contained in the 'Housing Revenue Account Manual', published by the Office of the Deputy Prime Minister, (ODPM) which can be downloaded from the ODPM website: www.odpm.gov.uk

What are the spending rules?

The amount of money a council has to manage and maintain its council houses is set by the government. The rules and amount of money the council is allowed to spend change annually. Recent changes to the rules include:

- The introduction of Major Repair allowances.
- Above inflation increases in the amount of money councils can spend on management and maintenance.
- Re-allocation of Management and Maintenance allowances between councils.
- Rent restructuring.
- Separation of service charges from rent.
- Resource Accounting and the introduction of 30 year business plans.
- Prudential Borrowing.
- How Capital Receipts can be used.
- Regional Housing Boards (which have taken over resource allocation decisions from ODPM).

A short commentary on each of these is included later.

While government has generally increased the amount of money available to councils, some councils have done a lot better than others.

In simple terms the government has a formula which says:

- How much rent the council should charge.
- How much of the rent can be kept to spend on:

  - Management
  - Maintenance
  - Major Repairs
  - Empty properties (voids) and bad debts
  - Repaying mortgages/loans taken out to build/improve the properties
  - Other specifically identified items ('reckonable expenditure').

- If the rent set by the government is not enough to fund the above the government gives a subsidy.
- If the rent set by the government is more than enough to fund this, then the government (Treasury) takes the balance.

How can councils increase revenue expenditure on housing?

Councils can get extra money to spend on their properties by:

- Charging a rent higher than the 'formula rent' set by the government (but there is an upper limit, and councils will only be able to keep a proportion of the extra rent collected).
- Being more efficient than the government allows (for example, losing less money to voids and bad debts than the government allows).
- Transferring funds from reserves (that is savings or underspends made in earlier years).
- Being diligent about not charging council tenants for things owner-occupiers would not pay for, such as street lighting or grounds maintenance (other than through the 'general' fund sourced from Council Tax).
- Ensuring that the council does not overcharge the housing department for services provided.
- Separating out the full cost of service charges from the rent, and charging separately for services provided.
- Being alert to new government initiatives which reward councils who take up the initiative.

These rules can also work the other way - for example if management costs were higher than government allowances, then savings would have to be found from elsewhere.

Capital Expenditure (councils' HRA)

Where councils wish to spend 'capital' money on housing, they can find it:

- From their reserves.
- By 'Supported Borrowing'

  - Here the government gives the council permission to borrow a certain amount of money for approved purposes, and provides a revenue subsidy (or allows the council to keep more of its rent) to reduce the cost of the loan.

- By 'Prudential Borrowing'

  - Here the council just borrows the money, but must have identified the income to repay the loan! If replacing leaky gutters or worn out central heating systems this can make sense. There is no government subsidy on Prudential Borrowing.

- From Right to Buy (RTB) receipts, or proceeds of sales of land or empty homes.

  - **However**, the council can only keep a quarter of RTB receipts, the rest must go to the Regional Housing Board, which distributes the money regionally. For sale of land or empty homes the council can keep half of the receipts (or 100% if given to a housing association as grant for new homes) if used on certain regeneration projects, or for improving council houses.

- From government grant (but this is now very limited).

What difference would being an ALMO (or similar) make?

All of the above apply, regardless of whether the properties are managed by the council or an ALMO. Unless ownership of the properties is transferred, all funds provided by the council come through the Housing Revenue Account.

The (financial) differences an ALMO make are:

- The council is allowed to borrow additional money to invest in its properties. The government will then allow the council extra subsidy (or to keep more of its rent) to repay the larger loan.
- Any money the ALMO saves during the year can be kept by the ALMO, and not repaid into the council's reserves (N.B. this does not apply to money managed by the ALMO on behalf of the council).
- Additionally ALMOs may spend money more efficiently and effectively.

Can councils build new homes?

There is no law stopping councils building new homes for rent. However, the government does not give councils any subsidy towards the cost of new homes, and the rent received is much lower than the cost of repaying a loan taken out to fund the cost of the new property.

Additionally, if a council has spare capital it wants to invest in providing new homes, it can get approximately twice as many homes for its money by giving the money to a housing association as a grant.

How can councils increase the amount of money to spend (within the HRA) on their housing?

The following is a useful checklist for consideration. Different options will be relevant in different circumstances, and inclusion of a suggestion on this list does not imply TPAS is recommending it for your landlord or council.

- **Separation of service charges from rents** - This means that tenants who benefit from services in addition to normal management and maintenance pay for these directly, on top of their rent. This frees up money for additional spending on management or maintenance.
- **Checking that the HRA is not being overcharged** for 'recharged services' (such as for information technology) from the council.
- **Checking that key performance indicators are being met**, and then trying to improve them to best practice levels.
- **Identifying properties, schemes or small estates that are very expensive to maintain, manage or let**, and either finding a way to reduce the expenditure, or selling, transferring or demolishing them.
- **Analysing maintenance to identify repair costs that are high due to poor condition** - for example gutters, central heating and roofs become very expensive to maintain when they get too old. Then exploring the use of prudential borrowing to fund a renewal programme, with savings repaying the loan.
- **Examining what is happening to useable Right to Buy receipts** - are they being reinvested back in housing?
- **Considering the transfer or sale of non-housing assets within the HRA**. For example garages and shops are often poorly maintained. Their sale could generate both improved management and investment, and a capital receipt.
- **Selective sale of voids** - for example selling all homes requiring over £5,000 in works to relet, or deliberately selling for affordable home ownership to rebalance communities (e.g. would allow children of older tenants to buy a home on the estate). If done properly 100% of sales proceeds can be reinvested back into existing or new housing.

Some recent changes to council housing finance

In recent years the government has introduced a large number of changes to council housing finance. The intention of most of these changes has been to simplify and make fairer the way in which the subsidy and finance system works. However, the process of change has been complicated, with changes being phased in over several years. Most changes should be complete by between 2010 and 2012. Key changes include:

The introduction of Major Repair allowances - These provided a regular and predictable stream of money for councils to spend on major works, and replaced a complicated "bidding" system for grant.

Reallocation of Management and Maintenance allowances between councils - In addition to significantly increasing the overall amount of money available to councils the share of money for each council to spend on management and maintenance is being adjusted (from April 2004) to reflect the types of property in management. This is resulting in some councils having substantially more money to spend, and others less.

Rent restructuring - The government has introduced a new method for setting the rents of both council and housing association properties. A formula is now used to calculate rents, according to the size of the property, its value (in 1999) and average earnings (Countywide). By 2011 similar properties should have very similar rents.

Separation of service charges from rent - Service charges are used to describe the cost of "services" provided by a landlord which would not normally be provided through the rent. Cleaning and heating of common areas, window cleaning and grounds maintenance are common examples. Housing associations have always charged tenants separately for their services, as an extra charge on their rent, councils have normally included service charges in their rent, spread across all tenants.

Councils are now being encouraged to separate out service charges and only charge tenants who benefit from services. Councils who carry out this separation will have more money to spend on management and maintenance, but some tenants will have to pay more.

Resource Accounting and the introduction of 30 year business plans - This defines many of the detailed accounting rules for councils. It also requires councils to demonstrate that they can reach and maintain the standard of their properties at the government's "Decency Standard" for the next thirty years.

Prudential Borrowing - This allows councils (from April 2004) who meet appropriate performance criteria to borrow additional money without additional government approval. There is, however, no government subsidy on this borrowing, and the council must demonstrate it can repay the loan.

As an example, a large council may budget for an annual surplus of £700,000 a year on its Housing Revenue Account, intending to spend this surplus on extra capital works. This council would now have the option of setting aside £500,000 a year of this money, and "Prudentially Borrowing" money to fund an extra capital expenditure programme of £7 million to £8 million over the next two or three years.

Alternatively, a council may realise that it can save, say, £100,000 a year by speeding up a programme of replacing obsolete heating equipment. This £100,000 a year could be used to fund Prudential Borrowing of around £1 million to help replace the obsolete equipment.

Regional Housing Boards - These bodies, from April 2004, take over decision making from the ODPM on where to invest housing subsidy in their region.

How Capital Receipts can be used - From Right to Buy sales - From April 2004 three quarters of the sales proceeds (capital receipts) of Right to Buy and some similar sales have to be transferred directly to the ODPM, which passes them to the Regional Housing Boards to reinvest in local (regional) housing. The remaining quarter of money is retained by the council. (A few "debt free" councils keep more until 2007). The "retained capital receipts" can be spent by the council on council housing or on any other Capital project (such as schools or roads).

How Capital Receipts can be used - From other housing sales - Where councils sell off assets belonging to the HRA, other than through the Right to Buy (and some similar transactions), then different rules apply. Sales could be of shops, garages, land or empty homes owned within the HRA. In these cases the council can keep at least half of the capital receipts to spend on chosen projects. However, the council can also keep all of this money if it is spent on new housing provision, regeneration, or improvements to existing council homes.

Best Value - A way of testing the cost and quality of services to see if they are what people want, and to ensure that in future they will be delivered at the performance level achieved by the top quarter of landlords similar to your own.

Housing association finance

As with councils' housing departments, housing associations rely on the following for most of their income:

- Rent
- Service Charges
- Some miscellaneous charges (e.g. garage and commercial rentals)
- Government subsidy.

However, unlike councils, most subsidy received is by way of capital grant. This can be for new homes, to acquire and refurbish existing properties, or, in special circumstances, to re-improve existing properties. The only substantial revenue subsidy most housing associations receive is through Supporting People payments for the costs of providing services to their vulnerable tenants and housing benefit, paid via their tenants.

For a housing association, their total income **must** be sufficient to repay all running costs, and all loan repayments. The government makes the rent setting rules, but does not make up any shortfall in revenue expenditure (except on Supporting People projects). This can be a real problem for housing associations whose rents are falling due to "rent convergence". In extreme situations, with the approval of the Housing Corporation, housing associations are allowed to charge higher rents than set by the government, in order to meet their financial obligations.

Housing association income and expenditure is recorded in the 'Income and Expenditure' account as part of their annual accounts.

If a housing association sells land or property it can keep the money (capital receipt) received, except that it must first:

- Repay any loans secured on the property (or 'move' the loans to another property).
- Either repay any grant received on the property, **or**, more usually, place the grant into a 'recycling' fund to be spent on similar approved projects.

A housing association must balance its books (though not necessarily in any single year, provided it has reserves to spend).

If during a year a housing association collects more income than it needs to spend on management, maintenance, debt repayment etc. **it can keep the surplus**.

If, however, the rent is not enough to cover expenditure **there is no government bailout**.

If the rent is not enough to cover expenditure the options available to the housing association can include:

- Using its reserves (if just a 'one off' bad event created the shortfall).
- Rescheduling its borrowings (e.g. repay loans over 30 years not 20, or obtain better interest rates).
- Reducing its costs.
- Increasing its rents (but normally only with specific permission from the Housing Corporation, and lots of attached conditions).
- Increasing other income (if practical).
- Selling assets to reduce borrowings/ generate funds.
- Selling off the properties which are most expensive to manage or repair.
- Being 'rescued' by merging with another housing association.
- Going bankrupt (this has not happened in the past 50 years).

Funding new homes

The Regional Housing Boards, through the Housing Corporation, may give housing associations 'Social Housing Grant' to subsidise the cost of new properties. This is a one off payment of grant and may cover half or more of the cost of a new property. The housing association funds the shortfall through either using its reserves (retained surpluses from previous years), borrowing money, or often a mixture of both. The rent on the property is used to pay off the money borrowed to pay for the home.

Other housing association activity

Housing associations are permitted to carry out a large range of activities beyond renting affordable homes. Some activities on which they receive grant from the Housing Corporation include:

- Innovation and Good Practice.
- Community Training and Enabling Grants (to encourage an increase in resident participation).
- Affordable Home Ownership schemes.

Housing associations can also receive grant funding or payments from local councils, the ODPM and other government departments, and from specialist government funded agencies such as English Partnerships. A major new source of grant funding for many housing associations is likely to be from the 'Housing Market Renewal Pathfinders', where housing associations are funded to become involved in demolition of old homes and rebuilding of new properties.

Some housing associations also provide new homes for rent or affordable home ownership without any subsidy. In these cases the Housing Corporation requires the association to demonstrate that rents from grant funded properties are not being used to subsidise these 'privately financed' activities.

Treasury management

In addition to making sure they have enough income to cover outgoings, housing associations need to manage how they borrow and repay their loans. This process is called treasury management. Large housing associations regularly take out new loans of between £50 million to over £100 million to fund their programmes of developing new homes, and also to repay existing loans that have become too expensive, or are due for repayment.

The process of Treasury Management is very important as:

- Even a small difference in interest rates can make a big difference over the life of a loan, which can often be between 25 and 30 years.
- The housing association needs to know it can always afford the monthly repayments, even if interest rates go up. For this reason many loans are taken out at fixed interest rates.
- Lenders have strict rules regarding the money they lend. It is very important the housing associations do not sign up to rules that would damage the way the association is run, and that they keep to the rules they have signed up to.
- It can be very embarrassing and expensive if a housing association is unable to borrow the money it needs to meet its obligations. For example, to pay for its share of a development programme of new homes, or to redeem a loan that has become due.

No housing associations have actually gone bankrupt in the past 50 years, though a number have had to be rescued by merger with another association. The Housing Corporation has a very good record of intervening when they suspect a housing association is in financial difficulty. For this reason lenders are usually willing to lend to housing associations much more cheaply than to private companies.

Conclusion

Housing Finance is a difficult subject to understand. This Information Sheet has given a broad-brush outline of the subject, and has tried to answer the most commonly asked questions. This should help most people to gain a basic understanding of the framework containing the principal issues involved.

To gain further understanding of this subject there are training courses available, many of which are either free or available at low cost to tenants' groups. If this interests you, ask your landlord, tenants' association or federation for details of what is available in your area. TPAS can also provide training on this topic. Contact us for further details.

Understanding and Monitoring Budgets

A budget identifies the amount of money that is available to spend during a year, and sets out a "spending plan".

Normally, a major budget will be split into lots of separate headings, for example:

- Employee costs
- Insurance
- Security
- Office costs:
  - Rents, rates & service charges
  - Heating & Lighting
  - Telephones
  - Printing, stationary & postage
  - Replacement of office equipment
  - Travel & motor expenses
  - Sundries
  - Rent & debt collection
  - Waiting list
  - Tenant participation

This example is taken from a housing association housing management department. It can be seen that some headings can be "subdivided", as with office costs. In practice the subdivisions can go on a very long way. Each separate office may have its own heating, lighting, and stationery budget etc.

A council housing department, ALMO or housing association will need to have its own budget with its own budget headings, rules on who can authorise expenditure, who is responsible for each budget heading, the maximum amount that any officer can spend without additional authority, and the level or nature of any transaction that has to be approved by the housing association board or council.

An important feature of budgets are the rules governing:

- Who can spend the money in each budget.
- Who is responsible for management of each budget
  (N.B. not necessarily the person who does most of the spending).
- What rules exist for moving money between budgets (this is called "viring"), and who has the authority to do this.

From a committee perspective it is very important:

- **Not to have too much detail** (that is for the officers)

But

- **To have sufficient detail** to be able to follow progress, raise sensible questions, and be able to spot serious variations.

Key things to look for (include):

- **Profiling** - All budgets should indicate the level of expenditure that is expected at any time in the year.
- **Actual Expenditure** - i.e. invoices etc. that have been paid/approved for payment.
- **Commitment** - expenditure is often committed several months before the invoices are paid.
- **Predicted year end out-turn** - is this higher or lower than in the budget?
- **Virements** - in or out - of the budget. N.B. Virements are essential to good management, as they allow flexibility. They are also very dangerous, as they can allow overspends or underspends to be "hidden".

- **Comparing with Others - Key ratios and Financial Performance Indicators**
  A good budgetary report will include information on how expenditure and performance under different budgetary headings compares to other similar councils or housing associations.

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