

CIPFA February 2011

CONSULTATION ON PROPOSED CAPITAL FINANCE ARRANGEMENTS UNDER THE NEW HOUSING FINANCE SYSTEM

The abolition of the housing subsidy system will require changes to the capital financing arrangements for housing, particularly with the change in Item 8 determination. This paper sets out CIPFA's proposals for changes to the capital financing arrangements under the new arrangements and focuses on two key areas:

- Management of Debt
- Depreciation

These proposals have been drawn up by a sub group of CIPFA's Local Authority Housing Panel, Treasury Management Panel and Local Authority Accounting Panel and our thanks go to these Members who have helped to formulate the proposals.

We are seeking both general comments on the proposals as set out and comments on the specific issues highlighted by Thursday 31 March 2011. Comments should be sent by email to julian.smith@cipfa.org.uk.

1. MANAGEMENT OF DEBT

1.1. INTRODUCTION

- 1.1.1. The abolition of the housing subsidy system will either require housing authorities to take on additional borrowing to buy themselves out of the subsidy system or will give some authorities a lump sum with which to repay existing borrowing. In addition local authorities will need to allocate existing borrowing between housing and the general fund as the current statutory method of apportioning debt charges between the general fund and HRA will cease.
- 1.1.2. The consolidated rate of interest has long been quoted as a bar to authorities' ability to take advantage of the freedoms available to them under the Prudential Code. It is argued that the impact of new borrowing on the Consolidated Rate of Interest (CRI) distorts investment decisions. The abolition of the housing subsidy system and removal of the CRI provides a unique opportunity to remove this barrier.
- 1.1.3. This paper sets out a methodology for splitting debt to meet the requirements of the new system. The Government has signalled its intention not to impose a single solution and authorities may pursue other methods provided that they achieve the underlying principles.

Principles

- 1.1.4. The underlying principle for the splitting of loans, at transition, must be that of no detriment to the General Fund. Local authorities are required to deliver a solution that is broadly equitable between the Housing Revenue Account (HRA) and General Fund.
- 1.1.5. A further principle is that the future charges to the HRA in relation to borrowing are not influenced by General Fund decisions, giving a greater degree of independence, certainty and control.
- 1.1.6. A further principle is that the uninvested balance sheet resources which allow borrowing to be below the CFR are properly identified between General Fund and HRA. (Any short term cash flow management will be treated as General Fund initially and then credited to the HRA according to the Interest on Short Term Balances calculation)

Definitions relating to Housing Debt

- 1.1.7. There are a number of key definitions used throughout this paper.

Capital Financing Requirement (CFR)	The Capital Financing Requirement represents the authority's underlying indebtedness for capital purposes.
Supported Capital Financing Requirement (SCFR)	The amount of borrowing supported by the current subsidy system (plus Arms Length Management Organisation (ALMO) debt for round 1

	and 2 ALMOs)
Settlement Net Present Value (NPV) Debt	The amount of borrowing which can be sustained under the self-financing model. Also the expected capping level.
Settlement Figure (SF)	The difference between the SCFR and Settlement NPV Debt which will be payable to/receivable from the Department for Local Government and Communities (CLG) at settlement.
HRACFR	The HRA share of the authority's total CFR – this may be lower than the SCFR due to the application of capital receipts or revenue resources.
GFCFR	The General Fund (residual) share of the CFR.
HCFR	The housing CFR post settlement.

- 1.1.8. The Capital Financing Requirement is made up of two components: other long term liabilities and a borrowing requirement. In this paper we recognise that, for some, other long term liabilities will need to be deducted from the HCFR to produce the underlying long term borrowing requirement for housing. It is this figure that is used as the basis for determining the amount of actual loans attributed to housing. The actual amount of loans varies on a day to day basis and is determined by the treasury manager based on strategy, market conditions and cash flows.
- 1.1.9. It is expected that only long term loans will be split. Revenue balances and short term loans for cash purposes are likely to continue to be managed as part of an authority's overall cash balances with interest being credited/charged as part of a separate calculation of interest on balances.
- 1.1.10. CIPFA's Treasury Management Code states that:

"Where external funds are managed on behalf of a third party or pension fund, these funds should be separately identifiable and income and expenditure attributed in line with an agreed policy."

It is accepted that HRA funds are not third party funds but funds of the authority and so will not necessarily be separately identifiable. That said, local authorities should have a clearly agreed policy for how income and expenditure are to be attributed and for how risks are to be shared. There may need to be statutory provision to allow default costs to be charged to the HRA.

Accounting for HRA loans

1.1.11. The Capital Financing Requirement arises from capital expenditure to be financed from borrowing so reflects the cash values of borrowing. Debt should therefore be split according to the nominal loan value. The charge to the HRA for HRA borrowing should be made in line with proper accounting practice, e.g. taking into account effective interest rates etc. as well as any statutory adjustments for the deferred write off of premiums and discounts etc. However, the separate calculation for unfinanced HCFR and hence cash overdrawn will need to be calculated by reference to nominal loans, rather than the loans outstanding figure on the balance sheet, which is influenced by accounting adjustments.

Understanding The Basis Of The Settlement

1.1.12. This paper has been produced based on the following understanding of the settlement process:

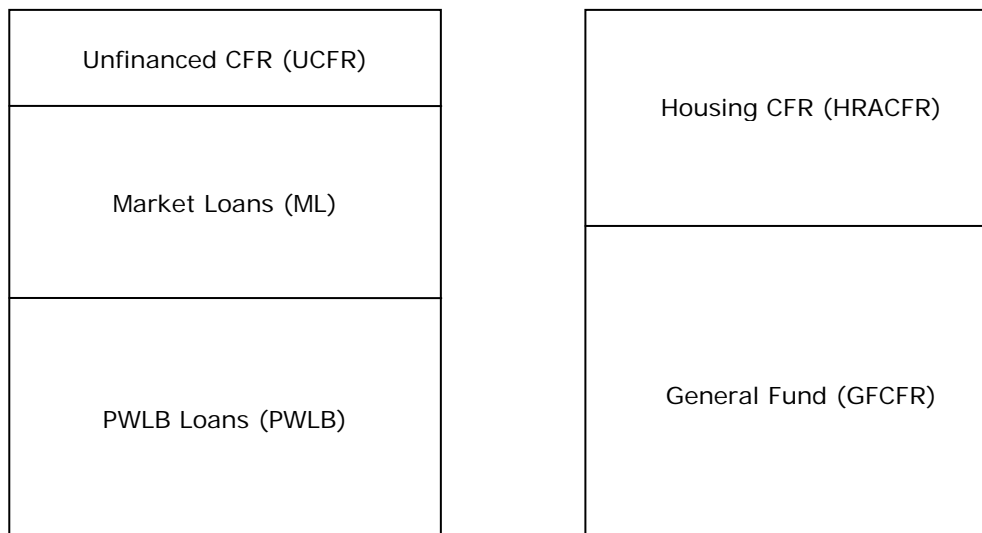
- The settlement NPV Debt relates to the borrowing which the business plan can sustain after recognising the costs of other existing indebtedness, especially leasing and Private Finance Initiative (PFI). (NB it is not yet clear whether balance sheet premiums and discounts will be included in this calculation)
- the settlement figure is the transaction required between the CLG and the local authority and is the difference between the settlement NPV debt and the SCFR; and applies equally to all settlements whether the SCFR is positive or negative.
- SCFR relates purely to borrowing and not the wider elements debt.
- Where authorities are reducing borrowing, CLG will make a payment to reduce the existing PWLB portfolio and cover any resultant premiums and discounts.
- Where authorities are increasing borrowing to buy out of the subsidy system, the source of borrowing will not be defined.
- Any headroom between SCFR and HRACFR will be maintained.

1.2. PROPOSED SOLUTION

Splitting Existing Debt

1.2.1. Currently the underlying borrowing requirement in local authorities may be made up of a mixture of Public Works Loan Board (PWLB) loans, market loans and unfinanced CFR.

1.2.2. The diagram overleaf/below provides an example of an authority with all three elements satisfying the CFR for HRA and General Fund (again, this relates only to the borrowing requirement and not to any other long term liabilities within the CFR):



- 1.2.3. Unfinanced CFR is matched by authorities' use of the cash from reserves, revenue balances and favourable cash flow to reduce the need to borrow up to the level of the CFR.
- 1.2.4. In the main, this available cash relates to General Fund reserves and balances and consequently the HRACFR is, where possible, fully borrowed. The exception is interest on HRA balances which is covered by the calculation mentioned in paragraph 1.3.4.
- 1.2.5. Where sufficient loans exist (market or PWLB), the loans taken on by the HRA are calculated as follows:

Housing share of PWLB $PWLB (H) = HRACFR / \text{total loans} \times PWLB \text{ loans}$

Housing share of Market Loans $ML (H) = HRACFR / \text{total loans} \times \text{Market Loans}$

Where insufficient loans exist ($HRACFR > \text{total loans}$), the balance is represented by unfinanced CFR.

This is illustrated in the example below:

CFR Split	£	Existing Debt	£
HRACFR	20,000,000	PWLB	28,000,000
GFCFR	24,000,000	ML	12,000,000
		UCFR	4,000,000
CFR	<u>44,000,000</u>	CFR	<u>44,000,000</u>
 HOUSING			
Housing Share 50% of loans		PWLB	14,000,000
		ML	6,000,000
		HCFR	<u>20,000,000</u>

- 1.2.6. Where the HRA takes on unfinanced CFR, the choice is to take on additional borrowing to fully borrow up to the level of HCFR or retain unfinanced CFR and pay interest to General Fund in line with the policy on interest on balances. This choice will need to be exercised on a corporate basis.
- 1.2.7. In order to ensure equity, all types of loans should be split between the HRA and General Fund. It is recognised that this will have practical implications but as the General Fund and HRA are likely to have different optimum debt profiles and restructuring requirements it is likely to be a preferable long term solution. Splitting loans may result in a minimal increase in administration but interest payments are already aggregated so there should be no additional transaction charges.
- 1.2.8. For PWLB debt it should be possible to split all the loans between the two funds, although it is accepted that this does not have to be physically done by the PWLB from day one; indeed it could be done in the new financial year to ease the administrative burden for PWLB and recognising that CFRs will not be finalised on 31st March.
- 1.2.9. Only Market loans taken as long term loans should be shared with the HRA. All short term loans remain GF loans, and any short term exposure of the HRA will be calculated via the interest on balances calculation (further discussed below). For market loans it will not be possible to physically split the loans but instead they can be split notionally and separated when they are next restructured. This does mean that decisions on initial restructuring of these loans will need to be taken balancing the corporate needs of the HRA and General Fund.
- 1.2.10. Where authorities can achieve the same impact, including interest and maturity profiles, by allocation of complete individual loans between the two funds then this may be an easier route for them to adopt.

Authorities with an increased debt requirement at Settlement

- 1.2.11. Where authorities make a payment to the Government at the settlement date, a capitalisation direction will result in the expenditure being capital expenditure which will automatically increase the HCFR. The authority can then take out additional borrowing up to the level of the HCFR. The cash for the payment to the government will come from the loan.

	£
Settlement Figure	10,000,000
Additional Borrowing (assume PWLB)	10,000,000
New Borrowing Figures	
PWLB	24,000,000
ML	6,000,000
HCFR	<u>30,000,000</u>

Authorities with a reduced debt requirement at settlement

- 1.2.12. Where authorities receive a settlement from the Government, there is a requirement that they repay PWLB debt. In order to ensure that debt can be repaid to the PWLB it will be necessary to repay the PWLB loans before splitting the residual loans between the HRA and General Fund. The repayment will reduce the HRACFR and hence reduce the amount to be apportioned to the HRA.

CFR Split	£	Existing Debt	£
HRACFR	20,000,000	PWLB	28,000,000
GFCFR	24,000,000	ML	12,000,000
		UCFR	4,000,000
CFR	<u>44,000,000</u>	CFR	<u>44,000,000</u>

Debt repayment

Settlement	-15,000,000
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CFR Split	£	Existing Debt	£
HRACFR	5,000,000	PWLB	13,000,000
GFCFR	24,000,000	ML	12,000,000
		UCFR	4,000,000
CFR	<u>29,000,000</u>	CFR	<u>29,000,000</u>

HOUSING

Housing Share 20% of loans		PWLB	2,600,000
		ML	2,400,000
		HCFR	<u>5,000,000</u>

1.3. SPECIFIC SITUATIONS

Debt Free Authorities

- 1.3.1. Several local authorities are known as being debt free. In strict terms they have a nil or negative debt requirement or CFR. In some instances, the General Fund CFR is positive and the HRACFR is negative, making the overall CFR negative or zero.
- 1.3.2. The examples below illustrate how the solution would work in debt free authorities:

CFR Split	£
HRACFR	- 15,000,000
GFCFR	2,000,000
CFR	<u>-13,000,000</u>

The negative CFR of £13M is supported by capital cash balances. £15m is HRA set aside capital receipts, of which £2m is used in lieu of borrowing for General Fund. Actual borrowing is zero.

Settlement

Settlement NPV Debt	10,000,000
SCFR	-10,000,000
Settlement Figure (Payment to CLG)	20,000,000
Funded by:	
Cash balances	13,000,000
New GF borrowing	2,000,000
New HRA borrowing	5,000,000
	<u>20,000,000</u>

Post Settlement CFRs

Payment to CLG	20,000,000
HRACFR	<u>-15,000,000</u>
HCFR	5,000,000
GFCFR	2,000,000
CFR	<u>7,000,000</u>

- 1.3.3. It should be noted that the flexibility offered by the current rules enables no Minimum Revenue Provision (MRP) to be made on General Fund, as the overall CFR is negative. At settlement the CFR increases to become positive, and the flexibility is no longer effective requiring an MRP on General Fund and therefore being detrimental to General Fund. DCLG are giving consideration as to how this issue may be addressed.

Unfinanced/Over-financed HCFR

- 1.3.4. It is likely that due to differences in timing between expenditure and loans being drawn down that the identified HRA loans will not always match the HCFR. In this case the unfinanced or over-financed element will need to be taken into account in the interest on balances calculation. On the housing balance sheet the difference will show as either cash overdrawn or cash in hand with the analysis of the variation being reported as part of the treasury management reporting arrangements.
- 1.3.5. Where an authority undertakes borrowing that is short term in nature this should be managed centrally as part of overall

cashflow management. The HRA element will be carried as unfinanced/over-financed CFR and any charge to the HRA calculated as part of interest on balances. This allows the HRA to determine its own short term / long term borrowing mix by choosing whether to fully fund the HCFR from long term loans.

Maturing HRA Loans

- 1.3.6. Once the loans are split they remain totally separate. Therefore, when an HRA loan matures it will need to be replaced by a new HRA loan dependent on the borrowing requirement at the time and the treasury management position. If no new loan is taken out this may create an unfinanced HCFR position resulting in cash overdrawn to be dealt with through the interest on balances calculation.

Borrowing in Advance of Need

- 1.3.7. Where an authority, as a result of an identified need and in line with their Treasury Management Strategy for the HRA, borrows in advance of need this will create an over-financed HCFR position which will result in cash in hand to be dealt with through the interest on balances calculation. It is expected that this will give a strong disincentive for HRAs to borrow in advance of need. Any permissible facility for borrowing in advance of need must be clearly stated in the treasury management strategy at the beginning of the year.

Debt Rescheduling after settlement date

- 1.3.8. PWLB will already be split so can be rescheduled according to needs of the HRA. For existing market loans the initial rescheduling will have to be carried balancing the needs of the GF and HRA which are likely to be different. Future rescheduling will relate to loans that are already placed in one or the other pool.

Transitional Issues

- 1.3.9. Settlement will take place at the 1st April, however, CFR and debt figures will not be finalised until the accounts are closed. The suggested approach deals with the difference in timing:
- Budgets and treasury management strategies can be compiled based on estimates.
 - New Borrowing from 1st April can be allocated to the new pools.
 - Existing debt should be frozen at the 1st April and apportioned as soon as final figures are known.

Where restructuring or replacement debt cannot be managed outside of this period, the replacement loan will need to be added to the pool of debt to be split once final figures are known. Accordingly, the actual request to PWLB to split debt would include all transactions from 1/04 to date.

1.4. ALTERNATIVE SOLUTIONS

Three-Pool Approach

- 1.4.1. As an alternative to splitting existing debt, authorities may wish to pursue a three pool approach. Under this approach the existing debt pool will become one residual pool, which will reduce in value as debt is repaid at maturity or earlier. Borrowing for new capital expenditure, including the settlement payment, additional debt to cover under-borrowing and replacement debt would then be allocated to the two new separate pools, one for Housing and one for General Fund.
- 1.4.2. Whilst initially this approach may seem attractive as it avoids the need to split existing debt, authorities will need to consider the method of allocating the costs of servicing the debt in the residual pool and impact of transactions moving forward.
- 1.4.3. Authorities will need to decide how to make the notional allocation of the pool for charging purposes. There are three options:
 - Housing is allocated the amount equal to the HRACFR, as with the two pool option.
 - Housing is allocated the same amount, but reduced by the HRA capital balances.
 - Housing is allocated a proportion of the debt determined by comparative CFRs, but this would be arbitrary as it doesn't reflect the separate HRA and General Fund balances used in lieu of borrowing.

Subsequent charging would be based on this allocation. Authorities would need to give consideration as to whether this allocation would be made on a permanent basis or whether it would be adjusted annually to reflect different repayment patterns.

- 1.4.4. The CFR will automatically be reduced by General Fund CFR payments, changing the ratio of Housing to GF CFR. This will also require the level of debt attributed to the residual pool to be reduced. On the other hand unless specific money is attributed to the Housing element for debt repayment, the housing element of the residual debt will remain constant and no debt repayment of this element will take place. As a result, authorities will need to determine a mechanism for allocating any housing debt repayment between the residual and new pools and for allocating General Fund repayments between the residual and new pools.
- 1.4.5. Interest charged to housing could be frozen at the average external rate of interest at the time of transfer; however, this would leave the General Fund with the risks and /or benefits which would be against the general principles adopted for splitting the debt. This means that interest rates would need to be variable which would bring considerable uncertainty into the housing account without the ability to manage it.

- 1.4.6. Debt restructuring decisions will need to be taken after properly balancing the needs of both the general fund and housing.
- 1.4.7. Because of the difficulties around debt repayment and interest rate management the two pool approach would appear to be preferable in the long run.

One-Pool Approach

- 1.4.8. It may initially seem attractive to local authorities to continue with a single pool moving forward and continue to apportion costs through a consolidated interest rate approach. Whilst administratively it definitely has advantages there are a number of considerations that authorities will need to take into account before deciding to pursue a one pool approach.
- 1.4.9. Most authorities will have materially different debt levels as a result of the settlement under the proposals. This change in debt is likely to have a significant impact on the apportionment of interest moving forward:
 - The ratio of housing to general fund debt will be materially different moving forward and will vary according to future capital expenditure profiles;
 - The repayment of debt or taking on of new debt is likely in itself to have an impact on the CRI to be charged moving forward. This will result in a change in costs to the general fund purely as a result of the housing settlement;
 - Capital investment decisions made on the general fund will impact on the interest rates charged to the HRA and vice versa.
- 1.4.10. The impact on the CRI of the settlement and the HRA business plan should not be under-estimated. Authorities will need to give careful consideration to the impact of the CRI on the business plan and the impact of any future volatility in the CRI. Maintaining a single pool approach will restrict the authority's ability to manage interest rates according to the HRA's debt and risk profile moving forward and ensure that treasury management supports the business plan.

1.5. POSSIBLE ISSUES FOR CONSULTATION

- 1.5.1. Comments are requested on whether Treasury Management systems will be able to manage two portfolios.
- 1.5.2. There may be authorities whose debt reduction exceeds their PWLB borrowing, resulting in early settlement premiums becoming payable on market loans. We are seeking to establish how widespread this is and whether these authorities would seek to repay debt and what the potential costs might be.
- 1.5.3. Debt free authorities may become liable to MRP, again we are seeking to establish how widespread this is and what the cost implications might be.

2. DEPRECIATION

2.1. INTRODUCTION

- 2.1.1. Under current arrangements depreciation is charged to the Housing Revenue Account (HRA) in line with proper accounting practice. This tends to be done in one of two ways, either the Major Repairs Allowance (MRA) is used directly as a proxy for depreciation or a separate depreciation calculation is undertaken (applying to both dwelling and non-dwellings) which is then reversed out below the line and MRA substituted in its place. In order to ensure that the MRA is used for its intended purpose, it is then moved into the Major Repairs Reserve.
- 2.1.2. The abolition of the housing subsidy system will require a revised mechanism for charging depreciation to the HRA. Under the new system MRA will no longer exist and a new method of providing for asset renewal is needed.
- 2.1.3. This paper sets out the elements of an approach to valuation and depreciation under HRA self financing. Until implementation, authorities with HRAs will continue to utilise the existing methodology for valuation, depreciation entries and the use of the Major Repairs Reserve.

Aims and objectives

- 2.1.4. The aims and objectives of the paper are:
- To set out a methodology for the calculation of depreciation which:
 - Is consistent with IFRS;
 - Is affordable to HRA business plans by not giving vastly different values to the long term component renewal and replacement costs in council housing; and
 - Where possible, minimises the additional administrative burden of data collection and analysis required to make an appropriate calculation.
 - To set out proposals to ensure that authorities act appropriately in recognising the economic cost maintaining stock over the long term.
 - To identify the entries required to the HRA and associated reserves to take effect from the date of self financing.

2.2. VALUATION

- 2.2.1. The accepted methodology for the valuation of dwellings in the Housing HRA is 'Existing Use Value – Social Housing' (EUV-SH). This is calculated in line with guidance issued by DCLG. In summary, the valuation for dwellings is undertaken as follows:
- Identification of beacon properties representing archetypes and geographical areas

- Assessment of Open Market Value in residential use (Existing Use Value) for each beacon
- Application of discount to beacon properties to reflect that dwellings are used for social housing – these discounts apply on a geographical basis and are set by DCLG as part of its guidance
- Cloning of EUV-SH from beacons across all dwellings to arrive at balance sheet valuation.

Other assets are valued according to accepted valuation methodologies adopted locally.

- 2.2.2. The EUV-SH is therefore made up of the Gross Residential Value (including land and buildings) less a discount applying to the land element. The EUV-SH therefore represents the value of the building and a discounted value for land.
- 2.2.3. International Financial Reporting Standards (IFRS) require the identification of significant component values within the overall building element and the separate depreciation of elements where useful lives vary materially.
- 2.2.4. There will be a requirement to identify specific component values plus a residual element totalling the building value. The remaining element of the value is attributed to the discounted land and therefore not depreciated under IFRS. The total building value could be greater than or less than the EUV-SH. In each circumstance, it is appropriate to apply depreciation to the total building element valuations only.

2.3. **PROPOSED METHODOLOGY FOR THE CALCULATION OF DEPRECIATION**

Dwellings

- 2.3.1. A number of components should be identified separately utilising asset maintenance/stock condition date and assigned a value, component life and remaining life. The determination of components, values and useful lives will be a professional judgement based on valuation guidelines but is expected to reflect local circumstances. Value should be gross replacement cost.
- 2.3.2. Components may be grouped together for depreciation purposes where:
- Individual component costs are de minimis
 - Components with similar lives can be reasonably combined.

Practice suggests that there may be up to 12 components or component groups separately identified in this way.

- 2.3.3. In addition to separate components, there will be a residual element relating to the structure and the sum of all of those other elements that have not been componentised. An appropriate useful life should be applied to the combination of all of these

elements on the basis of data held on long term replacement costs. The value attributable to the residual (non-componentised) element can be assigned on the basis of an additional gross replacement cost calculated in line with stock condition data.

- 2.3.4. Depreciation should be applied on a straight line basis over remaining lives for each component and the residual amount.
- 2.3.5. Where an authority is planning to make improvements to the stock and wishes to build up cash to allow this it will be possible to make additional voluntary contributions to the Major Repairs Reserve (MRR).

Non-dwellings

- 2.3.6. Valuations should be calculated according to best practice and depreciation applied based on the long term renewal and replacement costs of the assets.
- 2.3.7. The depreciation charge within a self financing HRA will therefore be the total of dwelling and non-dwelling depreciation.

2.4. TREATMENT OF DEPRECIATION IN THE HRA

- 2.4.1. Local authority accounting is rooted in a principle of separate financial treatment for revenue and capital. The treatment of capital receipts (the so-called 'capital receipts principle') means that receipts arising from the disposal of local authority assets are only able to be utilised in specific ways. The revenue/capital principle contrasts with the approach to asset accounting in the private sector. These principles mean that specific arrangements need to be put in place to ensure that resources arising as a result of depreciation in the HRA are retained within the capital ringfence.
- 2.4.2. The depreciation charge will be debited to the HRA and eventually credited to the Major Repairs Reserve. Existing rules on the use of resources held within the MRR are unchanged ie funds must be used either for capital expenditure on HRA assets or to reduce the Housing Capital Financing Requirement. Such an approach obviates any need for the reintroduction of a Minimum Revenue Provision from the HRA. Authorities are still able to make voluntary provision of set aside to reduce the HRA CFR either from the MRR or direct from the HRA.

2.5. IMPAIRMENT

- 2.5.1. Impairment occurs when a specific event leads to a reduction in value of an asset. Where impairment occurs IFRS requires a provision for impairment, over and above any accumulated balance held in the revaluation reserve, to be charged to the HRA. If the impact on the revenue account is to be mitigated, new regulations would be required to enable the impairment to be reversed out.

2.6. POSSIBLE ISSUES FOR CONSULTATION

- 2.6.1. This proposal requires impairment to be charged to the HRA, which under current regulations could not be reversed out. We are seeking comments on whether local authorities see this as a significant issue and, if so, how this could be mitigated.
- 2.6.2. This proposal charges depreciation to the HRA in relation to assets. Where an asset is funded from a source other than borrowing, it would still receive a depreciation charge. We are seeking comments on whether this would cause a significant adverse impact to the HRA compared to the current arrangements, remembering that even debt free authorities have an MRA charge.

Worked example of the potential steps towards a depreciation calculation for a HRA dwelling

Component		Life	Value	Depreciation
Bathroom		20	£2,500	£125
Kitchen		15	£3,300	£220
Boiler		15	£1,500	£100
Heating distribution		30	£2,000	£67
Roof/chimney		50	£4,000	£80
External doors		30	£1,000	£33
Rewiring		30	£2,500	£83
Windows		30	£3,000	£100
Componentised depreciation			£19,800	£808
Residual/non-componentised		80	£23,000	£288
Total			£42,800	£1,096
Stock survey capital profile 30 years				£33,000
Annual amount for business planning				£1,100

Steps involved in generating a charge for dwelling depreciation

1. Identify separate components (see also guidance within DCLG Valuation Guidance chapter 13) based on asset management/stock condition databases, suitably cloned or grossed up as appropriate; in this example there are 8 components separately identified; in some cases, authorities may feel it appropriate to increase or reduce the number of components separately identified, perhaps where there are specific conditions for specific groups of properties.
2. Assign values to each component based on replacement costs – this will generally be in line with replacement/unit costs which are included in the current stock condition/asset management database.
3. Assign useful/remaining life to each component - this will generally be in line with life cycles adopted within the current stock condition/asset management database. Guidance can also be found from the lifecycles utilised within the Decent Homes Standard definition and (current) Major Repairs Allowance methodology. Note that in the example above, there could be the scope to adopt a single calculation of depreciation for both of the components with a 15-year life and all four components with a 30-year life.
4. Calculate amount of depreciation for each separate component and sum to a total of componentised depreciation.
5. Authorities will also need to consider the treatment of backlog and improvement works required to dwellings.

6. The methodology relies upon authorities having an appropriate asset management database system in place to record and estimate long term life cycle and replacement costs for asset elements. A key objective is to ensure that the charge to the HRA for depreciation reflects the long term life cycle costs identified within the database.
7. A similar process should be undertaken for all non-dwelling assets held within the HRA. Many authorities have included non-dwelling assets within their stock condition surveys. Financing for these depreciation charges should ideally be covered by the income generated from these assets; it should be noted that the draft guidance note does result in the generation of a bottom-line cost to the HRA additional to that borne within the current system.

We are seeking both general comments on the proposals as set out and comments on the specific issues highlighted by Thursday 31 March 2011. Comments should be sent by email to julian.smith@cipfa.org.uk