

London Borough of Sutton

Housing Advisory Group – 23 February 2012

The Executive – 26 March 2012

3

Report of the Executive Head of Community Living and Strategic Commissioning**HOUSING REVENUE ACCOUNT BUSINESS PLAN**

Ward Location:	Not applicable	Author(s) and Contact Phone Number(s):
		Trevor Hart, Housing Strategy and Performance Manager (x5844)
Area Served:	Borough-wide	Executive Member:
		Cllr Jayne McCoy

Report for Information**Summary**

This report provides for Members an update of the current Housing Revenue Account (HRA) Business Plan, taking into account the Council's HRA self-financing settlement, and discusses some of the potential resource issues to be considered when a new Business Plan is developed and published in early 2012/13. The HRA Business Plan sets out the Council's plans for managing and maintaining its housing stock in the medium to long term, covering a period of 30 years.

Recommendations

I recommend that the report be noted.

1. Background

- 1.1 Although the day-to-day management of the housing service, including the delivery of major works programmes, was transferred to Sutton Housing Partnership (SHP) in 2006, the Council has retained responsibility for publishing the HRA Business Plan, which is produced to ensure effective planning and management of the Authority's housing assets in the longer term. Sutton published its latest HRA Business Plan in July 2011, covering the 30 year period 2011/12 to 2040/41. This can be found at: <http://www.sutton.gov.uk/CHttpHandler.ashx?id=16058&p=0>
- 1.2 The financial modelling within the Business Plan was based on the resources and stock investment needs identified or anticipated at the time, taking into account the introduction of HRA self-financing from 2012/13 and the amounts of decent homes backlog funding likely to be forthcoming over the 2010 Spending Review period. The modelling within the Plan has now been updated to reflect the self-financing determination and the need to reconsider the range of possible resource scenarios and the implications of these for both capital investment and revenue services.
- 1.3 This report advises The Executive of the updated modelling and potential resourcing issues to be considered. It also invites Members to begin to consider key choices to be made that will inform a new Housing Revenue Account (HRA) Business Plan, to be published in early 2012/13. The next section discusses the implications of self-

financing for Sutton and our HRA Business Plan. Section 3 goes on to look at the updated financial modelling and considers some of the issues that will need to be addressed as the new Business Plan is developed.

2. HRA Self-financing

2.1 Under the Government’s reforms to council housing finance the HRA subsidy system is being replaced by a new ‘self-financing’ regime in which authorities like Sutton that have paid ‘negative subsidy’ to the Exchequer will in future keep all of their rental income in exchange for taking on a proportion of the national HRA debt (self-financing settlement payment). Authorities that are currently in receipt of subsidy will have their debt reduced.

2.2 In January the DCLG issued its final self-financing determination in which each local authority’s opening debt settlement has been calculated. The paper also set out allowances for management, maintenance and major repairs, guideline rental income for 2012/13 and assumed HRA debt (known as Subsidy Capital Finance Requirement or ‘SCFR’) at 1 April 2012, these all forming part of the self-financing calculation.

2.3 Sutton’s opening debt calculation is as follows:

	Stock valuation	£173.870m
less	Subsidy Capital Finance Requirement	£32.744m
equals	Self-financing settlement payment	£141.126m

2.4 The stock valuation is calculated by deducting from the projected rental stream over 30 years assumed costs of management and maintenance and then converting this to a ‘net present value’. Local authority rents, which will continue to be controlled by central Government under self-financing, remain set to be uplifted to converge with equivalent housing association rents by 2015/16, after which they are expected to rise by inflation plus ½% p.a. As part of the self-financing ‘deal’ with local government management and maintenance allowances and the major repairs allowance (MRA) have all been uplifted significantly to ensure that councils have enough revenue in the HRA to properly maintain their stock assets. Additional sums have also been included in the calculation to reflect the cost of carrying out adaptations for disabled tenants.

2.5 In order to maintain its control over public expenditure the Government has determined that authorities’ HRA borrowing into the future will be limited to their stock valuation. However, where a council’s actual debt (known as Housing Capital Finance Requirement or ‘HCFR’) is less than its assumed debt (SCFR) the difference becomes borrowing ‘headroom’. In Sutton’s case, because our HCFR is £14.9m less than our SCFR we will begin self-financing with this amount of borrowing headroom. The amount is calculated as follows:

	Stock valuation	£173.9m
less	Settlement payment	£141.1m
less	Housing Capital Finance Requirement	£17.9m
equals	Borrowing headroom	£14.9m

2.6 As explained in February’s budget report, the proposal is to take out a 30 year loan (or multiple loans) to cover the £141.1m settlement payment from the Public Works Loans Board (PWLB). The Government has agreed a special one off reduced rate

for this purpose for those councils that are required to make a payment. This is expected to be at or very close to 3.5%. Settlement day is 28th March 2012 when all transactions across the country will take place.

- 2.7 Based on a loan rate of 3.5% the estimated interest and debt management expenses for this loan are around £5m p.a. This raises the costs to the HRA of estimated interest and debt management expenses to £5.9m p.a. However, an increase in the loan rate, for example of just 1/3% by settlement day, would increase the interest paid by around £0.5m p.a. for the life of the loan. The cost of repaying the capital over the period of the borrowing needs to be added to these expenses when the work to analyse the best loan option is completed. This will not impact on the Business Plan until about year 10.
- 2.8 With its current HCFR of £17.9m and the additional self-financing debt settlement payment of £141.1m, the total HRA debt will increase to £159m. Officers have completed analysing debt pooling options between the HRA and the General Fund, and a two pool approach will be adopted. *[To be updated in final report to The Executive]*

3. Updated Financial Modelling and key issues to be addressed

- 3.1 Using the figures provided in the draft self-financing determination, officers have updated the financial modelling contained within the current HRA Business Plan. These comprise a 'base' model and a number of variations to this, referred to as sensitivities. The final determination figures, subsequently issued, differ only very slightly from the draft ones; however, these will be used for the new Business Plan, which will also take into account the actual loan interest rate.

Revised base model

- 3.2 The base model has been updated to take into account the latest calculation of the negative subsidy payment for 2011/12, the projected 2011/12 year end balance, the guideline rent increase for next year, a revised calculation of stock asset depreciation and revised debt management and interest costs. The revised base model maintains 2011/12 as 'Year 1', and was used to calculate the 2012/13 HRA estimates that were included in the budget report.
- 3.3 The capital and revenue summaries from the revised base model are set out at Appendices 1(i) and 1(ii). These are the updated equivalents of Appendices F(i) and F(ii) in the current HRA Business Plan. Also, set out at Appendix 2, is a schedule of assumptions upon which the revised base model is calculated, this being the updated equivalent of Appendix G in the current Business Plan.
- 3.3 The original base model took into account the position in relation to the investment requirement in the stock calculated as at 1 April 2011. This is set out in summary at Appendix 3. Since the revised base model continues to use 2011/12 as Year 1, the stock investment requirement position also remains as at 1 April 2011 for the purpose of the remodelling at this stage. However, when the new Business Plan is produced in early 2012/13 it will be possible, and necessary, to update this to the position as at 1 April 2012; Year 1 of the model will also move on by one year to become 2012/13.
- 3.4 In terms of financial assumptions, the original base model had assumed an interest rate of 5%, which was the best estimate that could be made at the time. The revised base model applies the indicative PWLB reduced rate of interest (3.5%) to the self-financing settlement debt and 5% to other borrowing. Other key assumptions within the revised base model remain largely as before and are as follows:

- The full amount of the last three years of decent homes backlog funding is received (£12m in 2012/13, £14m in 2013/14 and £26.420m in 2014/15, all paid by way of capital grant)
- The full amount of the available borrowing headroom is taken up in Year 5, once the decent homes backlog funding has come to an end (NB: this comprises the £14.9m available as at 1 April 2012 and also some additional headroom generated as a result of the paying down of pre-existing loans in the early years.)
- RTB sales are assumed at a rate on average of four p.a. but no capital funding from Right-to-Buy (RTB) sales is assumed
- Interest only is paid on the self-financing debt; various payments are, however, made to clear other historic debts as they become due (shown in the Debt Repayments column)
- Inflation is assumed as 5.6% for Year 2 (2012/13) and at an average of 2.5% over the remaining 28 years of the Business Plan period
- Building cost inflation is assumed to be 2.5% over the 30 year period
- Rents rise according to Government formula until convergence with target rents is achieved by 2015/6 and then rise at inflation plus ½% p.a. thereafter
- Depreciation of assets (from Year 2) is calculated according to the Government's (uplifted) figure set within the self-financing determination
- The SHP management fee is set to increase by inflation plus ½% year on year
- The costs of tenant heating and hot water and Council HRA costs increase by inflation only

3.5 In terms of key outputs from the revised base model, the revenue summary (Appendix 1 (i)) shows that:

- I. Total income (all rents and service charges) rises from £34.1m to £84.7m over the 30 year period.
- II. SHP's management costs rise from £13.6m in 2011/12 to just over £30m in 2040/41; the Council's management costs increase from £2.1m to £4.9m over the period.
- III. Depreciation is uplifted from the MRA figure of £4.9m in Year 1 to just over £7m in Year 2 with the introduction of self-financing; thereafter this increases to £13.4m by year 30. The depreciation figures relate closely to the Major Repairs Reserve (MRR) in the capital summary (see below).
- IV. Debt management costs and interest payments on the debt reach £6.7m by Year 5. Since the self-financing settlement debt is not paid off, they remain broadly at this level throughout the rest of the business plan period.
- V. Additional revenue funding for capital works (termed revenue contributions to capital outlay or 'RCCO') is applied from Year 2 through to Year 8, prioritising available funding for investment.
- VI. From Year 9, by which time all backlog investment in the stock has been addressed, an 'investment reserve' starts to build up, reaching £456.4m at the end of Year 30. This would be available for improving revenue (day to day) services or, combined with the capital surplus (see below), for further

investment in the existing stock or for other housing purposes such as regeneration or new build.

3.6 The capital summary (Appendix 1(ii)) shows:

- I. The investment requirement in the third column reflects the amounts as set out in Appendix 3 (albeit that the latter are aggregated into five year periods).
- II. The fourth column only shows the borrowing to be used for stock investment, not the self-financing borrowing settlement amount (the associated costs of which are included in the revenue summary).
- III. Per the base model assumptions, no funding is assumed from RTB receipts, while the remaining (Years 2, 3 and 4) amounts of decent homes backlog funding are included in the following column.
- IV. The 'MRR' and 'RCCO' amounts are shown in the next two columns.
- V. The difference between the investment requirement and resources ('Total Financing') is reflected in the 'Shortfall/(Surplus)' column, and subsequently in the 'Cumulative Shortfall/(Surplus)' column. The latter shows that although a significant shortfall (nearly £27.4m) builds up over the first three years, this is almost completely made up over the following five years, reducing to just £768k by the end of Year 8. Thereafter a surplus on the capital account begins to build up, reaching £24.3m by year 30.

Although shown in a separate column for the purposes of how the model operates, in reality this surplus constitutes the Major Repairs Reserve (MRR) and would be available for further investment in the stock or for other housing purposes such as regeneration or new build.

3.7 In summary, the revised base model incorporates a real terms increase in revenue funded housing management services (via SHP's management fee). It reflects the Government's uplifted assumptions around the sums needed to maintain the stock as an asset by way of the amount of depreciation built in and provides for significant revenue contributions to capital works.

3.8 When taken with borrowing and the decent homes backlog funding, there are sufficient resources to undertake all required / identified investment over the 30 year life of the Business Plan, albeit that it would take eight years to effectively address the existing backlog. This is, however, a reduction of two years on what the original base model had predicted. Thereafter very significant 'Investment Reserve' derived from both revenue and capital resources builds up, totalling £480.7m by Year 30.

Updated sensitivity modelling

3.9 As mentioned above, the current HRA Business Plan also contains additional modelling around a number of scenarios or 'sensitivities' (i.e. variations to the revised base model). These have been reviewed and a revised set of modelled sensitivities, also based on the draft self-financing determination, has been produced, these being:

1. None of the Years 3 and 4 decent homes backlog funding is forthcoming
2. Only 50% of the Years 3 and 4 decent homes backlog funding is forthcoming
3. HRA debt is repaid from Year 9 (once the investment backlog has been addressed)
4. Building costs increase by inflation plus 1% each year [*To be included in the report to The Executive*]

5. Provision for bad debt is doubled due to increases in arrears resulting from the impact of welfare reform and other factors
 6. Removal of the Chaucer estate from the HRA in Year 6 (see below)
 7. A 'worse case' position (combination of 1, 3, 4, 5 and 6 above) *[To be included in the report to The Executive]*
- 3.10 The first and second of these reflect the uncertainty around future public spending and the possibility that as a result of spending pressures at the national level this funding may be cut back. Regarding the paying off of the HRA debt (sensitivity 3), there is no legal requirement to do this but in order to provide for new borrowing headroom later on during the Business Plan period one option would be to pay off the debt principal once the capital investment backlog has been addressed.
- 3.11 Historically building cost inflation has been higher than general inflation and so sensitivity 4 allows for this. A further variation (sensitivity 5) looks at the possibility that rent arrears might increase significantly, principally as a result of the proposed welfare reforms in which underoccupying council tenants could have their housing benefit reduced.
- 3.12 Under sensitivity 6 an assumption is made that the Chaucer estate is redeveloped and removed from the HRA in Year 6. In light of disproportionate investment needs and other issues, the possibility of considering alternative approaches to the estate have been discussed in previous business plans although no decision has been taken as to what its future should be – for example, whether it should be redeveloped and transferred to a housing association as per the Durand scheme, whether it might be redeveloped 'in-house' or whether it might be retained in its present form and refurbished. This will be revisited and a proposed way forward recommended in due course. It should be noted that in modelling this sensitivity only revenue income has been adjusted (downwards), with no attempt at this stage to calculate the effects of removing the estate from the HRA in terms of any reduced management and/or maintenance expenditure.
- 3.13 Finally, in terms of the amount of resources for investment available, sensitivity 7 represents a 'worse case' position by combining sensitivities 1, 3, 4, 5 and 6. *[To be provided in report to Executive]* A further sensitivity taking account of the impact locally of the proposals to reinvigorate the Right-to-Buy in terms of assumed additional council house sales may be considered for the new Business Plan depending on the outcome of the Government consultation on the proposal.
- 3.14 For each sensitivity the key outcomes in terms of addressing the investment backlog and the amount of money available for future investment, set against the revised base model, are shown in the table below.

Sensitivity	Cumulative capital shortfall at Year 5 (£m)	Year capital shortfall effectively eliminated	Capital surplus at Year 30 (£m)	Investment Reserve from revenue at Year 30 (£m)	Total Investment Reserve at Year 30 (£m)
Base model	24.3	8	24.3	456.4	480.7
1 – No Years 3 or 4 decent homes backlog funding award received	64.7	12	16.5	423.9	440.4
2 – Only 50% of Years 3 and 4 decent homes backlog funding award received	38.4	10	22.5	437.8	460.3
3 - Debt repaid after Year 9	24.3	8	24.3	373.6	397.9
4 – Building costs rise by inflation plus 1%	TBA	TBA	TBA	TBA	TBA
5 - Provision for bad debt doubled	25.2	9	23.8	445.7	469.5
6 – Removal from the HRA of the Chaucer estate in Year 6	24.3	9	23.9	424.0	447.9
7 – Combination of sensitivities 1, 3, 4, 5 and 6	TBA	TBA	TBA	TBA	TBA

3.15 As can be seen, under sensitivity 1 the effect of receiving no Years 3 or 4 decent homes backlog funding is that it would take until Year 12 (an extra four years) before the investment backlog is fully addressed, while the total investment reserve at Year 30 reduces from £480.7m to £440.4m. Only receiving 50% of the funding also results in an extension of the time to address the backlog and a reduced total investment reserve but to a lesser extent.

3.16 The impact of repaying the self-financing debt from Year 9 is to reduce the total investment reserve at Year 30 by over £80m, albeit the sum is still very significant at just under £400m. Under scenario 5 the effects of assuming a higher level of bad debt are to slightly increase the time taken to address the investment backlog while also reducing the Year 30 total investment reserve by around £10m.

3.17 Removing the Chaucer estate from the HRA in year 6 also results in a slight increase in the time taken to address the investment backlog and a reduction in the Year 30 total investment reserve of some £33m. However, the impact may be mitigated to a small extent were the modelling to calculate and deduct associated repair costs over the 30 year period.

Commentary on sensitivities 4 and 7 will be included in the report to The Executive

4. Financial Implications

4.1 Section 2 above sets out the financial issues. The HRA Business Plan will need updating once 28th March (settlement day) has happened with the actual interest rate and repayment options for the loan(s) taken out.

4.2 It is likely that the Council will adopt a two pool approach i.e. splitting the HRA and General Fund debt into separate pools. The Council is currently looking at loan options that will benefit the HRA over the 30 Business Plan period. These include taking out one 30 year loan or taking out multiple loans (splitting amounts and length of loans over a 30 year period)

5. Influence of the Council's Core Values

- 5.1 The direction, strategic aims and supporting objectives of the new HRA Business Plan will reflect the Council's vision and core values in terms of working in partnership, making services open and accessible, seeking innovative approaches to delivering better, more cost-effective services and promoting diversity.

6. Equality Impact Assessment

- 6.1 An equalities impact assessment will be published alongside the new HRA business plan.

7. Background Papers

Draft HRA Self-financing Determination (DCLG, November 2011)

HRA Self-financing Determination (DCLG, January 2012)