Committee:	**Cabinet**	**Agenda Item**
Date:	**23 February 2012**	**13i**
Title:	**Housing Revenue Account 2012/13 Budget and 30 year Business Plan**	
Portfolio holders:	**Councillor Robert Chambers** **Councillor Julie Redfern**	Item for Decision

Summary

1 This report sets out the following:

- A proposed Housing Revenue Account budget for 2012/13
- A proposed funding strategy for the self financing payment of £88.4 million that the Council is required to make on 28 March 2012.
- A proposed Business Plan for the 30 year period 2012/13 to 2041/42

2 The report builds upon earlier discussions held by the Tenants Forum and Housing Board, including rent setting decisions in November and interim business planning discussions in January.

3 The report, budget and Business Plan was endorsed by the Housing Board on 31 January. The Scrutiny Committee reviewed the documents on 7 February and endorsed the proposals.

4 The key theme for this process is the HRA self financing reform, the most significant change to council housing finance in decades. The housing subsidy system is to be abolished, enabled by councils in negative subsidy such as UDC effectively buying themselves out of the system by making one substantial up front payment, funded by borrowing. The annual interest payable on the loans will be significantly lower than the amount of funds paid over in negative subsidy, creating substantial revenue headroom within the HRA and thus opportunities to make large new investment in council housing on a scale that is unprecedented in many years.

Recommendations

5 The Cabinet is requested to approve, for recommendation to Full Council on 23 February:

a) The Self Financing Funding Strategy as set out in paragraphs 13-19

b) The HRA Business Plan as summarised in paragraphs 20-29 and attached to the report

c) The HRA budget for 2012/13 as set out in paragraphs 30-32 and Appendix A

d) Increases in rents and service charges for 2012/13 as set out in paragraphs 33-40

e) With effect from 1 April 2012, the ringfencing of HRA capital receipts (such as Right to Buy receipts) for use by the HRA Business Plan.

Financial Implications

6 Detailed in the report.

Background Papers

Rent setting report to Housing Board November 2011
Draft business plan to Housing Board January 2012
DCLG self financing reform documents
DCLG subsidy determination documents
CIH Consult Business Plan

Impact

Communication/Consultation	The proposals in this report have been discussed with the Tenants Forum and informed by the professional advisers CIH Consult and Arlingclose
Community Safety	None
Equalities	An Equalities Impact Assessment forms part of the HRA Business Plan and is attached
Health & Safety	None
Legal implications	HRA self financing is a legal requirement under the Localities Act.
Sustainability	The Business Plan is designed to ensure the sustainability of council housing in Uttlesford for a 30 year period.
Ward-specific impacts	None
Workforce/Workplace	None

Self Financing Reform

7 On 28 March the Council will be required to make a payment of £88.407m to DCLG as part of the abolition of negative housing subsidy and creation of the self financing regime. £88.407m is the Government's calculation of 30 years' worth of negative housing subsidy payments, including inflation, with the total discounted to present day prices.

8 The objectives of the reform are as follows.

- To end the unfair housing subsidy system
- To create opportunities for local authorities to invest in new social housing
- To reduce levels of historic local authority housing debt

9 The Council needs to be mindful of these objectives when setting its business plan. Commentators have observed that if councils do not make appreciable progress in the areas of housing investment and debt reduction, there is a higher risk that the Government will alter the new system.

10 The Council will be required to take out loans to fund the self financing payment. The Council has obtained specialist advice on the borrowing strategy to employ from its treasury management advisers, Arlingclose.

11 The reform will benefit UDC, its tenants and the district generally. In 2011/12, the amount payable to the Government under negative housing subsidy is £5.2 million. The estimated amount of interest payable on the loans is £2.645 million in 2012/13. From the first year, there is substantial revenue headroom available for investment.

12 The Government has discounted the rates usually available from the Public Works Loans Board (PWLB), an agency of Government that lends money to local authorities at an already competitive cost. Given the discount, applied to interest rates currently at a low point, there is a once-only opportunity to borrow at low cost. Arlingclose advice is that the only sensible course of action is to borrow from PWLB. Private money market alternatives might be available, but at higher cost, with large arrangement fees, a requirement for the Council to invest time and expense in obtaining and maintaining a credit rating, and without the flexibility and ease of dealing with PWLB.

13 Based on earlier discussions with the Tenants Forum, Housing Board and Portfolio Holders for Housing and Finance, the following were the key parameters used by officers and Arlingclose to develop funding strategy.

- The full amount of debt be repaid within 30 years business plan
- No debt repayment within the first 5 years in order to maximise revenue headroom to invest in housing projects
- Reasonable certainty and predictability of cost, avoiding imprudent exposure to variations in interest rates.

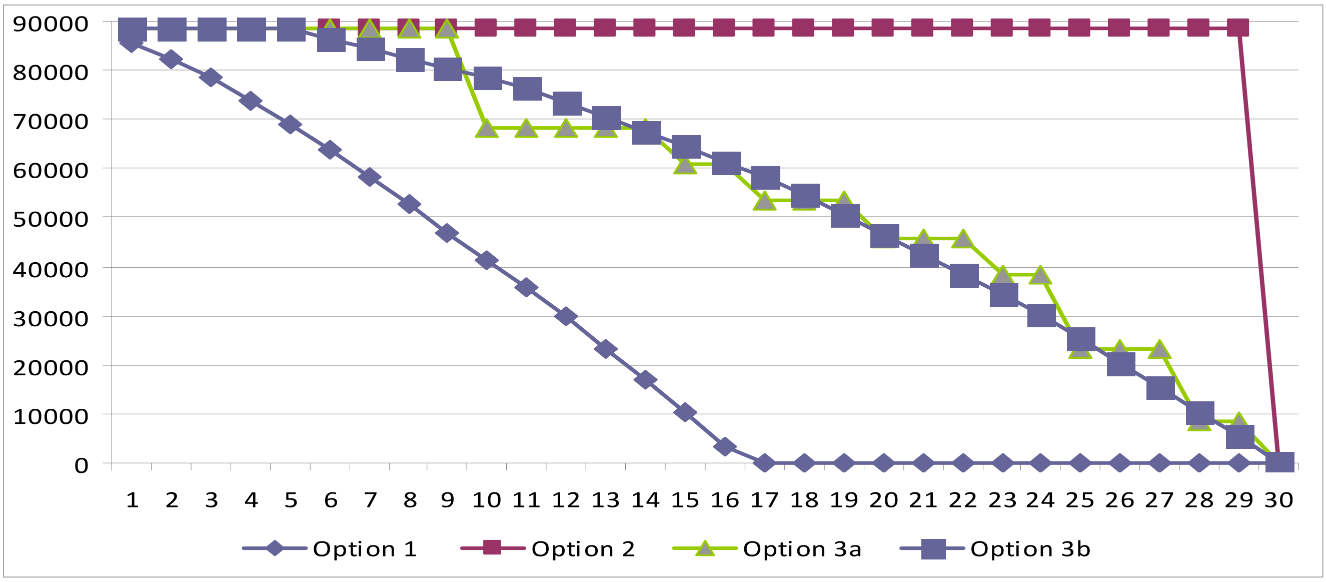
14 Borrowing options that meet these objectives have been modelled by Arlingclose in consultation with the Assistant Chief Executive – Finance. Aware that some local authorities are considering very different scenarios, including trying to pay off debt as soon as possible, and others deferring debt repayment to year 30, Arlingclose have modelled these too.

15 A summary of the Arlingclose advice is below. Options 1 and 2 are not compatible with the objectives Members have set, but are included for comparison purposes. The Arlingclose recommendation is to adopt a balanced portfolio (Option 3), with the variant Option 3b emerging as the strategy best suited to the Council's needs.

	Option	Advantages	Disadvantages	Average interest rate	Gross interest cost over 30 years	Net interest cost over 30 years	Revenue saving in first five years
1	Maximum Debt Repayment	Lowest cost option Debt repaid within 17 years	No capacity to invest in new projects until year 18	2.71%	£23.3m	£23.3m	Nil
2	Fixed Debt	Predictability and certainty of cost Some revenue headroom	Highest cost option, (offset by capacity to earn investment income) No debt repayment until year 30 Little flexibility to adapt to changed circumstances Monies tied up in reserve pending debt repayment Investment income subject to interest rate fluctuations	3.45%	£91.5m	£38.7m	£4.0m
3a	Balanced Portfolio, higher variability	High level of flexibility to adapt to changing circumstances Some revenue headroom Some capacity to earn investment income	High level of exposure to variable interest rates No debt repayment until year 10 Debt repayment in large instalments	3.34%	£59.6m	£49.0m	£6.6m
3b	Balanced Portfolio, lower variability	Maximises revenue headroom in the first 5 years Some flexibility to adapt to changing circumstances Debt repayments more evenly spread	Moderate level of exposure to variable interest rates No significant opportunities to earn investment income	3.30%	£58.6m	£58.6m	£12.5m

16 Further details on options are in the Arlingclose report which is available from Assistant Chief Executive – Finance on request.

17 The following chart shows the debt repayment profile of each option. The recommended option, 3b, is the curved mauve line in the chart.



18 The following table, taken from the Arlingclose report, shows the debt portfolio structure of the recommended option 3b.

Loan type	Principal (£m)	Loan period (years)	Estimated interest rate
Variable	2.000	6	0.70%
Variable	2.000	7	0.70%
Variable	2.000	8	0.70%
Variable	2.000	9	0.70%
Variable	2.000	10	0.70%
Fixed	2.000	11	2.78%
Fixed	3.000	12	2.88%
Fixed	3.000	13	2.96%
Fixed	3.000	14	3.03%
Fixed	3.000	15	3.09%
Fixed	3.000	16	3.14%
Fixed	3.000	17	3.18%
Fixed	4.000	18	3.22%
Fixed	4.000	19	3.25%
Fixed	4.000	20	3.29%
Fixed	4.000	21	3.32%
Fixed	4.000	22	3.34%
Fixed	4.000	23	3.37%
Fixed	4.000	24	3.39%
Fixed	5.000	25	3.40%
Fixed	5.000	26	3.42%
Fixed	5.000	27	3.43%
Fixed	5.000	28	3.44%
Fixed	5.000	29	3.45%
Fixed	5.407	30	3.45%
Total/Average	**88.407**	**20.3**	**3.30%**

19 Arlingclose's options appraisal includes a risk analysis which shows that the Balanced Portfolio option is the lowest risk overall with no individual risks deemed "high".

Risk	**Comment**	**Option 1 Fast Repayment**	**Option 2 30 year debt**	**Option 3 Balanced Portfolio**
Credit & counterparty	Holding debt and corresponding investment simultaneously	Medium 2	High 3	Medium 2
Liquidity	Shortfall of cash	High 3	Low 1	Low 1
Refinancing	Potential problem regarding replacing debt at appropriate rates either due to anticipated refinancing or as a result of an unexpected budgetary shortfall	High 3	Low 1	Medium 2
Interest Rate – Borrowing the Settlement	The nature of the HRA PWLB funding window concentrates risk on 26 March 2012 when funding rates will be agreed	High 3	High 3	Medium 2
Interest Rate – ongoing borrowing	Exposure to an adverse movement in interest rates (upwards)	Medium 2	Low 1	Medium 2
Interest Rate – investments	Exposure to an adverse movement in interest rates (downwards)	Low 1	High3	Medium 2
Political / Policy	Adverse change in PWLB lending / repayment / interest rate policy	High 3	Medium 2	Medium 2
Inflation	HRA income is explicitly linked to inflation. Risk that lower inflation results in lower income, particularly if debt costs are fixed	Medium 2	High 3	Medium 2
Market	Relating to premature repayment of debt / adverse premium levels	Low 1	High 3	Medium 2
Legal & Regulatory	Compliance with relevant statutes, Codes of Practice and treasury management strategy	Low 1	Low 1	Low 1
Operational fraud, error & corruption	The size of the settlement sum and transacting on one day increase risk	Low 1	Low 1	Low 1
	Sum of risk scores	**22**	**22**	**20**

HRA 30 Year Business Plan

20 A new 30 year business plan has been prepared and is attached. It is based upon funding strategy Option 3b set out above.

21 The objectives of the business plan are to achieve the following:

- Ability to fund interest costs and debt repayment within 30 years.
- Ensure that the Council's existing council housing stock continues to meet or exceed the decent homes standard
- Capital works and maintenance programmes are funded and required improvements take place when due
- Redevelopment of existing sites no longer fit for purpose or with high void levels e.g. Mead Court Stansted.
- Investment in new council housing build.
- Continued implementation of rent convergence policy.

22 A detailed action plan has been developed to address the priorities of the Business Plan. The Action Plan is an appendix to the Business Plan document attached to this report. The actions have been structured around the themes of:

- Resident involvement and empowerment
- Home
- Tenancy
- Neighbourhood and community
- Value for money.

23 The business plan has been modelled with specialist support from the housing finance experts CIH Consult. It is based on the draft HRA revenue budget for 2012/13 set out in this report, which is year 1 of the plan, and is extrapolated to estimate cost and income in years 2 to 30.

24 The model prepared confirms the sustainability of the business plan including ability to repay debt, meet the needs of existing tenants and invest in new projects. Necessarily however the plan includes a set of assumptions and there are risks that actual experience will differ. In particular, assumptions about cost inflation, rent increases and the levels of Right to Buy sales create risk of variability in the plan.

25 As a result the plan will require careful monitoring and a formal annual refresh to ensure its ongoing sustainability. “Self financing” means exactly that – there is no safety net and the HRA will have to be managed in a business like way to ensure that there is sufficient income to meet financial obligations and cost pressures. The element of variable debt within the funding strategy provides some flexibility to reprofile debt repayment and interest costs.

26 To be genuinely self-financing, it is important that all council housing-related financial resources are ringfenced; tighter rules and stronger of auditing of the ringfence are likely. The Council has operated a strong ringfence around revenue resources but its practice in the past has not been to ringfence RTB capital receipts for housing purposes. To ensure affordability of the business plan and compatibility with self financing principles, it is now necessary to adopt a policy of ringfencing RTB capital receipts to the HRA. This can be accomplished without detriment to the General Fund forecast budgets since the balance of usable receipts has diminished and only modest levels of new receipts had been assumed.

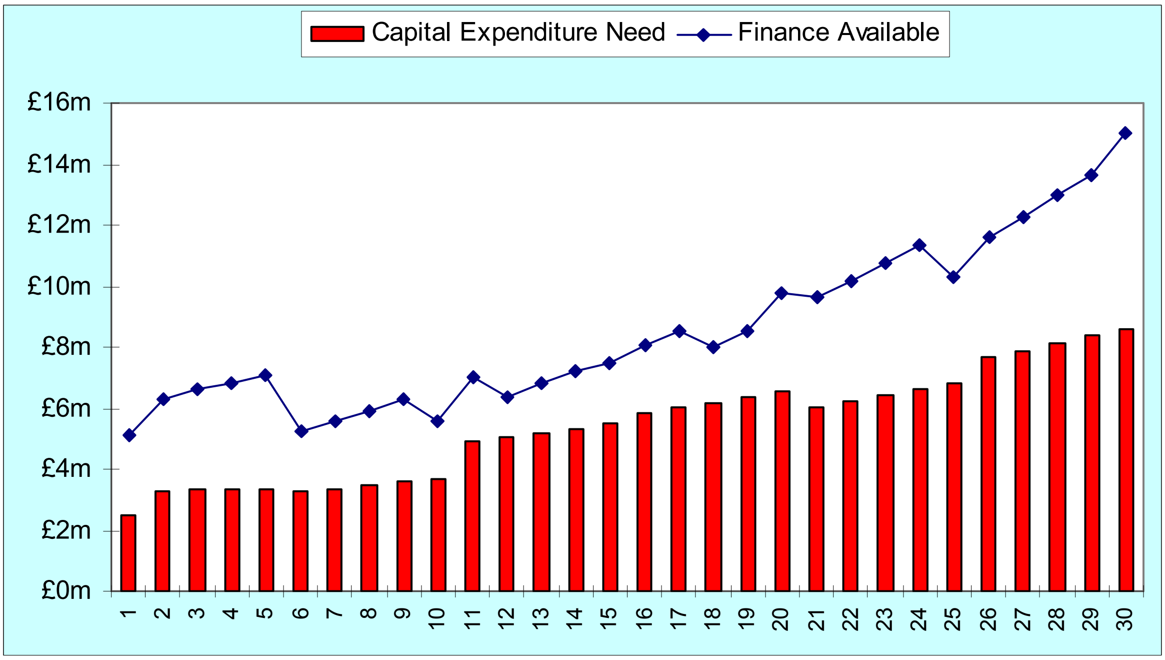
27 There are risks inherent in all council business plans, the most significant of which are felt to be the following.

- Further reform of council housing finances by a future Government. Obviously it is impossible to predict what successive Governments will do during a 30 year period but reform in the earlier years is considered unlikely provided that Councils make good progress on debt repayment and achieving new housing build.
- Right to Buy sales increasing, reducing income available to the business plan. Mitigated by achieving new build and minimising void properties in existing stock portfolio.
- Cost inflation, and inflation factors used to inform rent setting calculations, varying from assumed levels.

28 The Business Plan is summarised in the table below. It shows that revenue headroom in the first year is £2.7 million, and in the first five years, £16.3 million. Total headroom over the 30 year period is some £93 million.

£000	Year 1	Year 2	Year 3	Year 4	Year 5	**Total Years 1 to 5**	Years 6 to 30	**Total Years 1 to 30**
Income	-13,756	-14,292	-14,845	-15,485	-15,915	**-74,293**	-582,907	**-657,200**
Expenditure	11,042	11,238	11,608	11,944	12,189	**58,021**	505,232	**563,253**
In year revenue surplus	-2,715	-3,054	-3,237	-3,541	-3,725	**-16,272**	-77,675	**-93,947**
Transfer to/from(-) Working Balance	15	0	-48	0	0	**-33**	416	**383**
Total revenue headroom	**-2,700**	**-3,054**	**-3,285**	**-3,541**	**-3,725**	**-16,305**	**-77,259**	**-93,564**

29 One of the Business Plan's key outputs is the demonstrable ability to meet the capital needs of existing dwelling stock with revenue headroom available to invest in new projects. This is illustrated by the chart below.



Housing Revenue Account budget 2012/13

30 A budget has been prepared based upon the following:

- Rent increases approved by the Tenants Forum and Housing Board in November 2011. The average increase is 7.7%.
- Increases in garage rents and service charges approved by the Housing Board on 10 January.
- No negative housing subsidy
- interest payable on loans in accordance with the funding strategy option 3b
- Staffing costs in accordance with a proposed new management and staffing structure that at time of writing under staff consultation pending implementation beginning in February.
- Further reductions in Supporting People grant
- Repairs and maintenance programme.

31 The budget is set out in Appendix A. It is consistent with the figures used for year 1 of the Business Plan, which in turn are extrapolated to inform years 2 to 30. A summary is below.

£000	2010/11 Actual	2011/12 Budget	2011/12 Forecast	2012/13 Budget
Rent income	-11,378	-12,067	-12,073	-12,942
Other income	-753	-807	-788	-814
Expenditure	7,158	7,692	7,497	8,397
Negative housing subsidy	4,898	5,199	5,199	0
Interest on loans	0	0	0	2,645
Action Plan	0	0	0	1,268
Transfer to reserves	0	85	235	1,432
(Surplus) / Deficit	**-76**	**101**	**70**	**-14**

32 The key point to highlight is the availability of £2.7 million of revenue headroom to invest in new housing projects. This is shown as a transfer to a reserve pending determination of the priorities for investment.

Rents & Service Charges

33 The following summarises the rent increases agreed with the Tenants Forum and Housing Board.

34 The Government's policy is to bring about a converging pattern of rents for all similar social housing properties. The original intention was to achieve convergence to a "Formula Rent" level by 2011/12. This target date changes according to economic conditions; the current target date is 2015/16 i.e. within 4 years. All things being equal, properties with rents below the Formula Rent level would have their rent increased in 2012/13 at such a rate that they would reach the Formula Rent level in 4 years.

35 However, Government specified caps and limits restrict the amount of any individual increase to a maximum of RPI+ ½% + £2. (The RPI is the value in September of the preceding year. In this case, RPI in September 2011 was at 5.6%). This is to protect tenants from excessive annual increases.

36 The effect of the caps and limits is that for many properties the increase in 2012/13 is smaller than that required to reach the Formula Rent level within 4 years.

37 Currently when a property is re-let to a new tenant the rent is set at current rent levels. Officers recommend that as at 1 April 2012 the rents for all new tenancies, not including transfers, are set at target formula rents.

38 Detailed calculations shows that the average weekly increase will be 7.70%. This will increase the calculated average rent by £6.39 from £82.71 to £89.15 per week. Individual rent increases range between 6.28% and 9.46%.

2012/13 Rent increase	Average rent increase	Smallest rent increase	Largest rent increase	Average weekly rent
Rent formula using RPI @ 5.6% + 0.5%	**7.70%** **£6.39**	**6.28%** **£3.94**	**9.46%** **£8.55**	**£89.15**

Households Affected

Increase under £5.00	Increase between £5.00 - £7.50	Increase over £7.50
369 or 13%	2,285 or 80%	199 or 7%

39 For other rents and services, on 10 January the Housing Board agreed that charges should be increased by the September inflation rate, as used for dwelling rents, but to use the lower CPI measure of 5.2% rather than the higher RPI of 5.6%. The increase of 5.2% applies to garage rents and charges for heating, water, sewage, warden and Lifeline services.

40 The Housing Board also agreed to:

a. The introduction of service charges for common services in general needs flats.
b. The introduction of service charges for common services in sheltered accommodation and to fully subsidise these charges for existing sheltered tenants not in receipt of housing benefit.

Housing Revenue Account Working Balance

41 The Council's policy is to maintain a Working Balance at a level sufficient to provide a safe contingency level, equivalent to the total of 2% of expenditure and 2% of income. Applying this calculation to the draft 2012/13 budget produces a target balance of £0.495 million.

42 The forecast Working Balance as at 31 March 2012 is £0.726 million, with a further in-year surplus of £14,000 in the 2012/13 budget, giving total projected balance of £0.740 million.

43 It is considered prudent for the Working Balance to exceed to the targeted level given the introduction of self financing and new business plan and the potential for variability this brings.

Risk Analysis

Risk	Likelihood	Impact	Mitigating actions
Actual experience differs from the assumptions in the budget and business plan	3 some variation is inevitable	3 sums involved are potentially significant	Ensure funding strategy has element of flexibility Robust monitoring Annual refresh of business plan
A risk assessment of the recommended funding option is shown above			Adopt a balanced debt portfolio in line with Option 3b Proactive treasury management

1 = Little or no risk or impact
2 = Some risk or impact – action may be necessary.
3 = Significant risk or impact – action required
4 = Near certainty of risk occurring, catastrophic effect or failure of project.

Appendices

Appendix A Draft Housing Revenue Account Budget 2012/13

Housing Revenue Account Business Plan 2012/13 – 2041/42

APPENDIX A

HOUSING REVENUE ACCOUNT BUDGET 2012/13

HRA Budget Summary	**2010/11 Actual**	**2011/12 Current Budget**	**2011/12 Forecast Outturn**	**2012/13 Draft budget**
INCOME				
Dwellling Rents	(11,378,440)	(12,067,260)	(12,072,500)	(12,942,250)
Garage Rents	(191,204)	(220,760)	(202,580)	(190,760)
Other Rents etc	(2,288)	(3,710)	(3,334)	(3,210)
Charges for Services & Facilities	(556,929)	(578,776)	(578,349)	(614,570)
Investment Income	(2,643)	(4,000)	(4,000)	(5,000)
Total Income	**(12,131,503)**	**(12,874,506)**	**(12,860,763)**	**(13,755,790)**
EXPENDITURE				
HRA finance system				
Negative Housing Subsidy	4,898,000	5,198,710	5,199,000	
Interest on HRA Loan				2,644,742
Sub total	**4,898,000**	**5,198,710**	**5,199,000**	**2,644,742**
Operating Expenditure				
Housing Repairs	1,787,645	1,803,200	1,848,401	1,995,190
Housing Services / Assistant Director Hsg	288,267	264,220	274,570	370,650
Property Services	370,254	416,800	366,900	300,960
Business & Performance Management	193,849	250,830	233,222	264,010
Sheltered Housing Services	460,679	416,598	378,207	440,090
Common Service Flats	319,382	365,366	362,400	444,830
Housing Sewerage	16,485	52,460	59,000	52,010
Estate Maintenance	120,982	145,550	145,550	147,640
Rents, Rates & Other Property Charges	42,751	46,190	43,868	44,580
Depreciation - Dwellings	1,934,664	2,205,320	2,056,714	2,872,710
Depreciation - Other Assets	26,680	20,680	19,286	21,410
Pay Award	0	0	0	6,000
Bad Debt Provision	28,626	65,000	65,000	65,000
Capitalised Salaries/Supervision Charges	(265,407)	(249,870)	(249,870)	(250,000)
Contribution to Capital Programme	400,000	500,000	500,000	250,000
Total Operating Expenditure	**5,724,858**	**6,302,344**	**6,103,248**	**7,025,080**
Recharge from General Fund	1,116,005	1,090,598	1,078,830	1,120,870
HRA Share of Corporate Core	232,000	248,000	236,000	200,000
Pension Costs	84,906	51,000	79,000	51,000
Transfer to Major Repairs Reserve	0	85,000	235,000	0
Total Expenditure	**12,055,769**	**12,975,652**	**12,931,078**	**11,041,692**
Operating (Surplus) / Deficit	**(75,735)**	**101,146**	**70,315**	**(2,714,098)**
Use of self financing headroom				
Funding of Action Plan revenue items				248,000
Funding of Action Plan capital items				1,020,000
Transfer to Change Management Reserve				200,000
Transfer to Potential Projects Reserve				732,000
Transfer to Major Repairs Reserve				500,000
Sub total				**2,700,000**
(Surplus) / Deficit	**(75,735)**	**101,146**	**70,315**	**(14,098)**