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| REPORT TO: | HOUSING AND COMMUNITY SERVICES COMMITTEE | AGENDA ITEM: 7. |
| DATE OF MEETING: | 2nd FEBRUARY 2012 | CATEGORY: RECOMMENDED |
| REPORT FROM: | CHIEF EXECUTIVE OFFICER | OPEN |
| MEMBERS' CONTACT POINT: | CHIEF FINANCE OFFICER KEVIN STACKHOUSE (01283 595811) Kevin.stackhouse@south-derbys.gov.uk | DOC: u/ks/budget round 1213/policy reports/hra1213 |
| SUBJECT: | HOUSING REVENUE ACCOUNT BUDGET 2012/13 Including Proposed Rent Increase and Longer Term Financial Projection | REF: |
| WARD(S) AFFECTED: | ALL | TERMS OF REFERENCE: HC 01 |

1.0 Recommendations

- 1.1 That an average rent increase of 8.5% (£5.49 per week) is considered and approved for 2012/13 in accordance with Government guidelines for tenanted properties.
- 1.2 That the average rent increase is adjusted for individual tenants in accordance with the Rent Restructuring Formula.
- 1.3 That the proposed estimates of income and expenditure for 2012/13 for the Housing Revenue Account are considered and referred to the Finance and Management Committee for approval.
- 1.4 That the updated financial projection, including the associated assumptions and analysis for the Housing Revenue Account to 2023 is considered and approved.

2.0 Introduction and Purpose of the Report

- 2.1 As part of the annual financial planning cycle, the report details the Housing Revenue Account's (HRA) base budget for 2012/13 together with an updated financial forecast to 2023. The report also sets out details of the proposed rent increase for 2012/13 under the Government's National Rent Setting Policy.

Self Financing

- 2.2 As previously reported, the current subsidy system for financing council housing nationally will be abolished on 31st March 2012. Under the Localism Act 2011, the Council will no longer pay a “negative subsidy” payment to the Government but will take-on a share of the national housing debt based on a valuation of its local housing stock / business.
- 2.3 Previous reports over the last 12 months have detailed the framework and estimated effects on the Council’s HRA / 30-year Business Plan. Treasury Management and other issues such as capital investment and rent income have also been considered.
- 2.4 The Council’s debt take-on has been confirmed at approximately £58m. The Finance and Management Committee considered the treasury management implications and options for repaying this debt at their meeting on 23rd January 2012.
- 2.5 The base budget for 2012/13 and 10-year financial projection is the first financial plan constructed under “self-financing.” This includes the recommended debt repayment profile and associated interest costs, together with previously approved stock investment needs.
- 2.6 In addition, the base budget for repairs and management costs, together with all other day to day income and expenditure has been reviewed.

3.0 Detail

- 3.1 The detailed figures are set out in the following appendices as follows:
 - **Appendix 1** - a summary of each main income and expenditure head within the HRA for 2011/12 to 2022/23, together with the yearly surplus/deficit and balance on the HRA’s general reserve. This also shows how future surpluses will be built up to repay debt.
 - **Appendix 2** – an analysis of interest costs based on the debt repayment profile approved by Finance and Management Committee on 23rd January 2012.
 - **Appendix 3** – an analysis of how resources will be generated to finance the debt repayment schedule over 30-years.

Formulating the 2012/13 Base Budget

- 3.2 The estimates are generally based on service levels in 2011/12 continuing and include any full year effects of previous year’s growth and service restructures. Non-recurring and one-off items associated with IT development and early termination costs have been removed.

Planning Period

- 3.3 A rolling 10-year projection is still considered to be a relevant planning period as it accords with the approved debt maturity profile and ensures focus is maintained on the longer-term.
- 3.4 An overall 30-year Business Plan will continue to focus on stock investment in line with available finance and tenant aspirations. This is also considered to be good practice and a good tool in the self-financing regime to demonstrate to all stakeholders that the housing business is sustainable.

Summary

- 3.5 **Appendix 1** shows the fully costed base budget and financial projection for the first 10 years of self-financing. This shows that the HRA is sustainable, can deliver the required capital investment in the stock and make the necessary surpluses in future years to repay debt.
- 3.6 This is a much improved position compared to previous estimates. Additional resources are now available within the Business Plan due to lower interest rates. Based on the approved debt profile, the average rate is forecast to be around 3% compared to 5.75% in the previous Plan.
- 3.7 At this stage, the projection assumes no further borrowing above the initial debt take-on. Including existing debt, headroom of around £7m remains before the HRA would exceed its borrowing limit which will be set and fixed by the Government on 1st April 2012 under self-financing.
- 3.8 It is important to note that the base budget and projected figures are based on annual rent increases in line with Government guidelines and in particular that for 2012/13. This is detailed later in the report from **section 3.49 onwards**.
- 3.9 In addition, it assumes that there are no significant increases in interest rates prior to 28th March 2012 (the date of debt-take-on) from that currently projected and included in the base budget.
- 3.10 An analysis of the main assumptions and risks is detailed in the following sections.

General Inflation

- 3.11 Where applicable, a rate of 2.5% has been included year on year for items of income and expenditure (excluding rents). This is based on a general index of longer-term inflation rates.
- 3.12 Inflation in the very early years of the Plan could be lower due to the Government's proposals for public sector pay restraint.

Income (excluding Housing Rents)

- 3.13 Current income streams from garage rents, shops and other recharges will continue and have been based on current levels. Under self-financing, the HRA will continue to receive interest from the General Fund based on investment of surplus cash. This is estimated at £20,000 per year.
- 3.14 It is projected that Supporting People Grant will reduce from 2012/13 by £100,000 per year. An amount of £270,000 has been included on a flat line basis across the 10-year projection.

Housing Repairs

- 3.15 Besides servicing the debt take-on, the day to day budgets for repairs and planned maintenance spend remains the biggest cost in the HRA. It has been assumed that the current level will remain and increases only for inflation.
- 3.16 This is an area that has been marginally under spent in recent years. However, under self-financing and as a demand led budget, it is considered prudent that the current level is maintained at this stage to cover any risk or contingency sums during the early years. This can be kept under review.

Management Costs and Sheltered Services

- 3.17 Due to service restructures during the last year, the base cost level has been reduced by £134,000 per year.

Allocation of Current Debt

- 3.18 When considering the final treasury management implications, the Finance and Management Committee approved a "two pool" approach to future debt management at the Council. This is the preferred solution under accounting regulations associated with self-financing and allows a clean separation of General Fund and HRA debt in the new system.
- 3.19 Effectively, the remaining debt at the Council (pre self-financing) will continue to be allocated to the HRA at broadly the same level as currently charged. This is based on the HRA's underlying borrowing requirement. The current debt outstanding amounts to approximately £1.3m and this will be repaid over 20-years. The associated costs have been built into the projections.

Interest and Repayment of the Debt Settlement

- 3.20 The Council will need to pay the Government £57,733,000 on 28th March 2012. After considering various options during the year, the Finance and Management Committee approved that this amount will be borrowed from the Public Works Loans Board (PWLB) utilising a "balanced" portfolio structure as shown below.

LOANS

| Interest Calculation | Repayment Method | Principal (£) | Period (Years) | Rate (%) |
|----------------------|------------------|-------------------|----------------|--------------|
| Variable | Maturity | 10,000,000 | 10 | 0.70% |
| Fixed | Maturity | 10,000,000 | 12 | 2.88% |
| Fixed | Maturity | 10,000,000 | 15 | 3.09% |
| Fixed | Maturity | 10,000,000 | 20 | 3.29% |
| Fixed | Maturity | 10,000,000 | 25 | 3.40% |
| Fixed | Maturity | 7,733,000 | 30 | 3.45% |
| TOTAL | | 57,733,000 | 18.7 | 2.78% |

3.21 **Appendices 2 and 3** detail the profile of interest and loan repayments over the 30-year business planning period. This shows how surpluses will be built-up at different stages to repay each tranche of the debt as it periodically falls due (Appendix 3). The first 10-years are reflected in the HRA projection at **Appendix 1**.

3.22 In principle, each authority should be in a better financial position under self-financing compared to the out-going subsidy system. The extent of this will vary from authority to authority. This position was strengthened by the Government's decision to offer lower than normal interest rates via the PWLB for self-financing transactions.

The Council's Position

3.23 In accordance with the Council's approved Business Plan, no resources are available for debt repayment in the short term as they are invested in capital works to the stock to meet a backlog and to maintain at least "decent standards." In year 6, surpluses start to accrue on the HRA as the on-going capital need reduces and the full implementation of rent restructuring takes effect.

3.24 Costs associated with arranging the initial PWLB borrowing and on-going treasury management support are also included in the financial projection.

Capital Investment

3.25 Although the Council will no longer receive a Major Repairs Allowance, the additional resources generated from self-financing will allow for capital investment.

3.26 Nationally, self-financing should provide additional resources for capital investment to meet backlog works and maintain decent standards, together with improvements and enhancements. In addition, the Government anticipate an increase in the supply of housing accommodation through New Build.

3.27 Capital works will continue to be funded from a Major Repairs Reserve. This will be topped up each year from revenue contributions which will include an

amount for depreciation. These amounts are shown separately as the Capital Expenditure Requirement (CER) in **Appendix 1**.

- 3.28 The CER will substantially allow for all identified capital investment contained in the Stock Condition Survey to be delivered. This is a much better position than anticipated in the previous Business Plan. It arises due to the additional resources anticipated through lower interest rates to finance the debt take-on.
- 3.29 A detailed report on the full investment programme is subject to a separate report on this Committee's Agenda.

Future Borrowing

- 3.30 To control the overall amount of borrowing, the Government have set a debt limit (or cap) for each authority. This will apply from 1st April 2012 and will be fixed. It is based on the underlying borrowing requirement used by the Government for the outgoing subsidy system.
- 3.31 The Council's debt cap is £67.1m. After allowing for the debt take-on of £57.8m and current debt of £1.3m, this leaves borrowing "headroom" of around £8m.
- 3.32 To conform to the National Prudential Capital Financing System, any future borrowings will need to be affordable within the overall Business Plan. However, this "headroom" does provide flexibility for future capital investment decisions.

Right to Buy Receipts (RTBs)

- 3.33 Under self-financing, pooling of capital receipts from the sale of council houses will continue to apply. This means that 75% of proceeds (minus allowable administration costs) will be continue to be paid to the Government.
- 3.34 The remaining 25% will be available to the Council. The Council has previously approved that this will be for the sole benefit of the HRA from 1st April 2012.
- 3.35 The Government's debt settlement figure includes a provision for the loss of rental income from RTBs post 1st April 2012. This has been assumed at an average of 8 per year for South Derbyshire - a reduction of 268 properties over the 30-year planning period.

Reinvigorating the Right to Buy and One to One Replacement

- 3.36 The Government issued a consultation paper in December 2011, with proposals to increase RTBs. The main proposal is to increase the discount available on the purchase price to tenants who qualify/retain the right to buy their council property. The aim is to make it more attractive for tenants to purchase their homes.

- 3.37 The proposals are also designed to provide additional resources for councils to repay debt and build new homes to increase the housing supply. In principle, the proceeds from sales over and above the level assumed in the self-financing settlement (i.e. five) will be allocated to debt repayment and to build up a provision for new build.
- 3.38 The exact apportionment is still to be determined. It is recognised that the income generated from each sale (after allowing a proportion for debt repayment) will not be sufficient to directly replace the property sold.
- 3.39 The Government's proposals envisage that the ring-fenced proportion will be supplemented from other housing providers (working in partnership) or cross subsidised from HRA resources.
- 3.40 The financial plan in Appendix 1 does not at this stage include any capital receipts from RTBs. This will be kept under review pending the detailed mechanics of the Government's proposals and actual income generated.
- 3.41 Actual sales for the Council continue to be historically low with only 3 so far in 2011/12, the lowest ever recorded in one year.

Other Provisions

- 3.42 The financial plan for the HRA continues to make provision for future costs arising from the pay and grading review and pension liabilities. In addition, provision has been made for additional capital salaries to support an increased investment programme compared to that currently delivered.
- 3.43 Capital spend in the early years of self-financing will more than double compared to current levels, peaking at around £5.5m.

HRA General Reserve

- 3.44 It is estimated that the HRA will enter self-financing with a general reserve of around £1.9m. This is above the current minimum contingency level of £1/2m approved in the Council's Financial Strategy.
- 3.45 This will be used over the first 5 years of the Plan to meet the estimated deficit on the overall HRA. Around 2016/2017, it is projected that the reserve will have fallen to around £950,000.
- 3.46 After this date, the Plan moves into surplus and as highlighted previously, this is set-aside to repay debt. Therefore from 2016/17, the general reserve will remain flat at this level.

Risk Strategy

- 3.47 The principle of self-financing will allow greater freedom and scope for local HRAs and for councils to deliver additional investment in their stock. However, this comes with a transfer of greater responsibilities and hence risk.

3.48 Therefore, it is recommended that a level of £1m is maintained as the minimum general reserve balance on the HRA from April 2012.

Rent Restructuring and Proposed Rent Increase 2012/13 and Beyond

3.49 Previous reports to the Committee have indicated that rent income (from tenanted properties) is a fundamental part of the self-financing proposals. It will continue to be the most significant source of income, accounting for around 95% of all income generated in the HRA.

3.50 Under self-financing, councils will be expected to follow the national rent setting framework and continue towards rent convergence. The self-financing settlement is based on real terms increases in rent each year of inflation + 0.5%. For 2012/13, the national average rent increase has been set at:

- **RPI as at September 2011 – 5.6%, plus 0.5% = 6.1%**

3.51 As reported to the Committee in much detail during recent years, the Council's average formula rent is substantially behind the national average.

3.52 The situation has been exacerbated over the last 3 to 4 years by the national formula capping increases for individual tenants in any one year, together with the Council setting rents lower than the national average formula. Both cases have been designed to protect tenants from large increases but this has resulted in lower income into the overall HRA.

Overall Increase 2012/13

3.53 Consequently for 2011/12, the Council's average rent is around 9% lower than the national formula. In order to catch up by 2015/16 (4 years) the average rent for tenants in South Derbyshire will need to increase by a further 2.4% in 2012/13.

3.54 This makes the overall average rent increase of 8.5% (6.1% + 2.4%) for 2012/13 – an average of **£5.49p per week**.

3.55 However, within this, a cap of RPI (5.6%) + 1/2% + £2 per week will apply to individual tenants. This will affect 1,297 of the 3,043 South Derbyshire tenants (42%). Without this constraint, the average increase would be 9.1%.

3.56 These tenants will be pushed back further from their Formula Rent meaning that they will take longer to converge. Consequently, it is projected that full rent convergence at South Derbyshire will not take place now until **2018/19**, three years after the Government target. Overall, this reduces rent within the HRA by approximately £30,000 per year.

3.57 In accordance with the Council's Financial Strategy, the Financial Plan assumes that future rent increases will continue in line with the National Rent Setting Formula. The actual level of increases will depend on the annual rate of inflation.

Analysis of Increases

- 3.58 Based on the National Formula, all tenants will see an increase in their rents for 2012/13. Within the average of 8.5%, the lowest increase is 6.4% (£3.32 per week) with the highest being 9.3% (£6.92 per week).
- 3.59 The Council's average rent will increase from £64.51 per week to **£70.00 per week**. The average Formula Rent for 2012/13 is now **£75.44**, still around 7% higher than the actual of £70.00 per week. Actual rents will range from £51 per week for a one bedroom property to £87 per week for 4 bedroom detached property.

Effect on the Base Budget

- 3.60 The Base Budget for 2012/13 and the financial projection are based on the average increase of 8.5% for 2012/13. Assuming inflation of 3.5% in 2013/14 and 2.5% per year thereafter, the projection anticipates full rent convergence by 2018/19.
- 3.61 The increase for 2012/13 is fundamental to self-financing. Effectively, it provides the resources to enable the HRA to enter the new system with sufficient base income to manage the debt-take-on and to meet the on-going capital investment needs of the stock.
- 3.62 As highlighted, rent convergence will in any case come after the Government's target; whilst this protects individual tenants, this has, and will continue, to constrain overall resources in the HRA.

Effect of Lower Increases

- 3.63 Clearly therefore, any reduction in the proposed rent increase compared to the National Formula for 2012/13 will have an effect on the Financial Plan detailed in **Appendix 1**. Lower resources will mean that the risk of managing the debt-take on is increased or planned expenditure / capital investment would need to be curtailed.
- 3.64 For every 1% reduction in the average increase of 8.5% for 2012/13, this reduces overall resources in the HRA by approximately £110,000 per year or £1.1m over 10 years. It also pushes back full rent convergence.
- 3.65 In the longer-term it would not affect the resources available to repay debt as this is based on future surpluses generated after initial capital investment and rent convergence has taken place.
- 3.66 However, the problem is created in the meantime with the level of HRA Balances. They are not sufficient to contain a reduction and would fall below £1m by 2015/16, eventually falling to around £300,000 by 2017/18.
- 3.67 A 2% reduction would produce a negative balance by 2016/17 and clearly this is not sustainable, nor indeed legal. As highlighted, the increase in 2012/13 is

fundamental to the Financial Plan as it provides the base income to sustain the HRA both in the short and longer term.

Additional Risks and Flexibility

- 3.68 The added risks of setting a lower average increase are two-fold. Firstly, in future years, lower inflation constrains income further and /or the Government changes national rent setting policy and delays convergence.
- 3.69 Secondly, interest rates may increase over and above those currently projected on debt take-on, and with lower base resources, this could increase the risk of servicing the debt in the longer-term.
- 3.70 However, it should be noted that the Plan now includes a greater level of capital investment than originally anticipated due to the lower interest rate likely to be secured on self-financing.
- 3.71 In addition, longer-term, there is additional scope for prudential borrowing within the overall debt cap as was anticipated in the original Plan.

Other Options

- 3.72 There may be several ways to set rents which would generate the overall level of actual income included in the Financial Plan (at 8.5%) without adhering strictly to the national rent setting policy. Indeed, in setting the rent for 2011/12, the Committee agreed that reletting void properties should be straight at Formula Rent.
- 3.73 Increases could be targeted at particular properties or in relation to where current rents compare to Formula for particular properties. In addition, a maximum increase could be applied across the board.
- 3.74 However, in order to achieve the average of 8.5%, and to limit increases for particular tenants, this would impact even greater on other tenants to compensate. To a certain extent, the Government Cap is set to achieve this.
- 3.75 The effect of the Cap for South Derbyshire tenants is that some of the largest increases are for tenants where their rent is not constrained. These generally relate to smaller type properties where increases are in excess of 8% or £5 per week.
- 3.76 The issue for the Council is that with a high inflationary increase together with a further 2.4% to catch up to the Formula, all tenants are already facing large increases. Some properties are less than £1 per week behind their Formula, whilst at the other extreme several properties are still up to £16 per week behind Formula.
- 3.77 The smaller properties are generally closer to the Formula. These are one bedroom properties including bedsits. For 2012/13, the actual rent for these properties will increase by over £3 per week (6%). Taking them straight to

Formula for 2012/13, would generate around £10,000 per year in additional rent for the HRA.

- 3.78 If the Cap was not applied, this would generate approximately £30,000 per year in additional rent for the HRA. If convergence was brought forward a year, this would generate an additional £75,000 per year, net of benefit subsidy loss for breaking the cap. In this case, some rents increase by over 10%.
- 3.79 These additional amounts could be used to lessen the impact on other tenants. However, this means that increases would be greater in future years to catch up if the National Guideline is followed.
- 3.80 It should be noted that the National Rent Setting Policy is attempting to bring equity and fairness to social rents by setting levels with recognition to size and location of property.
- 3.81 The Financial Plan is based on the National Framework and tenants may continue to face relatively large increases over the next 3 to 4 years to “catch up.” This will depend on the level of inflation.

4.0 Financial Implications

- 4.1 As detailed in the report

5.0 Corporate Implications

- 5.1 There are no other legal, HR or other corporate implications apart from that considered in the report.

6.0 Community Implications

- 6.1 The proposed budgets and spending within the HRA provides the financial resources to enable many of the on-going services and Council priorities associated with council housing to be delivered to the local community.

7.0 Background Papers

- 7.1 Department for Communities and Local Government – The Housing Revenue Account Self-financing Determinations available at:

<http://www.communities.gov.uk/publications/housing/draftdeterminationsselffinancing>

