SOUTH DERBYSHIRE DISTRICT COUNCIL

HOUSING REVENUE ACCOUNT BUSINESS PLAN

POST-SELF FINANCING IMPLEMENTATION UPDATE AND SUMMARY

Introduction

In the run up to the implementation of self financing for the Housing Revenue Account (HRA) and based on the stock condition survey undertaken in late 2009, the council approved a fully updated HRA business plan in June 2011. At that time, the council was working with indicative figures from government as to what the final HRA settlement would be.

Subsequently, the council approved the HRA budget (with an indicative 10 year medium term planning horizon) and 5 year HRA capital programme in February 2012. Whilst the final settlement figures were at that time available, the final basis for the take-on of additional debt remained outstanding pending treasury and market conditions in the run up to the actual transaction (26th/28th March).

Now that the settlement has been implemented and the council has taken on the new debt, this update and summary of the HRA business plan sets out the latest position for the stock and housing landlord services from 2012 onwards and traces the move from the last approved version (June 2011). This summary sets out:

- The key assumptions for the HRA business plan
- Updates information from the stock condition survey
- Identifies the short, medium and long term prospects for the HRA, for revenue, for capital and for debt coverage/repayment
- Highlights the potential opportunities there are for investment in the existing stock and new homes within the business plan.

Members and all stakeholders will be engaged in a series of discussions during the summer of 2012 aimed at developing a sense of the priorities for investment in housing through the business plan. These discussions will also consider the possible impacts of the ‘refreshed’ Right to Buy arrangements on the plan. The objective is therefore to develop a long term sustainable, investing business plan in the autumn of 2012 so that the council can deliver more of its housing priorities in the coming years.

The main objectives and service/stock background are set out in detail in the full June 2011 plan which focuses on the management and maintenance of the council’s own housing asset base – this summary update should therefore be read very much in conjunction with the substantive business plan.

The business plan documentation, and this summary, has been externally and independently reviewed and verified by Steve Partridge from the Chartered Institute of Housing (CIH). In addition, CIH have developed, updated and externally verified the business plan model and we will use this as the basis for our modelling moving forward.

HRA self financing settlement

The final valuation of the council's housing stock according to the government's formula was £66.852m. This figure was arrived at by assuming:

- Rents converge with housing association formula rents in 2015/16 following a 6.1% increase in formula rents in 2012 driven by RPI inflation
- Management and maintenance allowances totalling £1,901 per property, an increase of 0.7% above the previous subsidy level
- Major repairs allowance totalling £849 per property, an increase of 32.2% on the previous subsidy level
- An allowance (for the first time) for disabled facilities in the HRA of £181k.

The government's previous assumption of housing debt for South Derbyshire was £9.429m and the council paid the difference between two in a one off settlement to government on 28th March: £57.423m.

The government put in place special arrangements for the settlement payments in which borrowing from the PWLB was undertaken at preferential rates. Officers considered the options for sourcing funding and determined that the PWLB route would be the most cost-effective.

Work undertaken on the potential business planning expenditure profiles examined options for single loans and mixes of short/long length and compared these to the possible expenditure profiles for the stock. This identified that a mix of funding was the most appropriate way to borrow the funds. The mix of funds is shown in the table below.

Table 1: Mix of funds for settlement payment

Loan	Interest Calculation	Repayment Method[1]	Principal (m)	Period (Years)	Actual Rate (%)
1	Variable	Maturity	10.0	10	0.70%
2	Fixed	Maturity	10.0	12	2.70%
3	Fixed	Maturity	10.0	15	3.01%
4	Fixed	Maturity	10.0	20	3.30%
5	Fixed	Maturity	10.0	25	3.44%
6	Fixed	Maturity	7.423	30	3.50%
			57.423		2.78%

The table highlights the very low average effective interest rate on the borrowing in the HRA which has provided more headroom in the plan than envisaged in the June 2011 business plan.

The new self financing system includes the imposition of a borrowing cap by government at the level of the stock valuation: for South Derbyshire the cap is £66.852m. The council had repaid housing debt so that it was below the level that the government provided for in the former subsidy system calculation: the day before

[1] The loans are all 'Maturity' loans meaning that interest is paid on the principal sum until repayment is due. The council will consider options for redemption and/or refinancing on all of these loans as they fall due.

the settlement, the housing debt was actually £1.300m, resulting in an opening actual debt level on 1st April 2012 of £58.723m.

The council therefore retains headroom beneath the borrowing cap of £8.129m and this is available to draw down for future investment as the business plan develops.

There are no imminent prospects of the borrowing cap being raised as such a decision will be subject to successive spending reviews by government. The council will therefore need to work within the debt cap that it has, identifying and using the resources and headroom available as necessary to deliver objectives.

Key assumptions

The council has had to make some assumptions around future behaviour of key variables in order to forecast the business plan over 30 years. The business model must identify the resources necessary to ensure that the council's debts are able to be repaid within this period.

The overall assumptions are scheduled below:

- Property numbers are 3,038 on 1st April 2012
- Right to Buy sales every year at a net value of £50,000 reflecting the updated discounts and the number included within the HRA debt settlement (6 in 2012.13 rising to 7 then 8 after year 4); this is therefore before the potential impact of the new RTB rules on volumes of sales; the position will be kept under review and any material changes within 2012.13 reported in the autumn.
- General inflation (RPI) is 2.5% per year over the long term.
- Interest rates remain at the low opening level of 2.7% in the first 10 years then the average rises slowly to 3.6% over the following 20 years to reflect the potential impact of successive refinancing of loans (if put in place). In the original plan we said the average interest rate would be 3.5%.

The main revenue assumptions are scheduled below:

- Rents inflation for target/formula rents is RPI+0.5% for all years as this was the basis for the settlement.
- Rent increases have been assumed to increase gradually to converge with formula rents across the stock by 2021.22 – during this period, increases average around RPI+1-1.5% annually in order to achieve convergence.
- Officers are concerned about the impact of housing benefit reform on the ability of tenants to pay their rent and have therefore trebled the amount of HRA resources placed into the bad debt provision; trends in arrears will continue to be closely monitored over the next 2 years as the impact of reductions and the introduction of Universal Credit take effect.
- Cost inflation is also 2.5% across all budget headings, meaning that future management and maintenance costs will need to be contained to inflation-only increases (subject to planned budget changes in the next few years which are limited).
- Maintenance and repairs costs are adjusted to reflect the loss of properties through right to buy.

- All other income (service charges and non-dwelling rents) is also assumed to rise with inflation, except for Supporting People grant which is cash frozen for every year of the plan.
- Minimum balances are set to £760k annually representing £250 per property in line with audit commission guidelines.

The main capital assumptions are as scheduled below:

- The stock condition survey total outputs have been rolled on one year, adjusted for inflation and stock changes, and total £119.7m over 30 years at today's prices for the opening stock; this represents £39,400 per property over 30 years (including substantial investment into disabled adaptations of £400k per year into the long term) and therefore a very strong commitment to investment in maintaining and improving the existing stock for tenants.
- The capital profile provides for the completion of an 'up front' programme of renewals to enable the stock to reach a modern standard by 2017.
- Capital management fees are included at 4% of total expenditure.
- Inflation on all capital expenditure is 2.5% per year.
- Funding for capital investment will continue to be primarily through the operation of the Major Repairs Reserve (MRR); the assumption is that the HRA will move £4.5m in 2012.13 and £5.5m per year between 2013 and 2017 into the MRR to help finance the capital programme.
- Capital financing is also planned to be supplemented through additional revenue contributions from the HRA totalling £4.08m across the first 5 years (2012-2017).
- Around £394k of RTB receipts are assumed to be available to commit to the HRA capital programme in the plan in the first 5 years.
- Beyond 2017, the stock survey needs are potentially reduced and therefore the resources required from the HRA reduce (to £3.5m pa then £3m pa for the long term).
- There is no draw down on any borrowing headroom.

Summary of assumptions

Taken together, the assumptions contained within the business plan represent the continuation of the landlord service in its current format and with current levels of spending increased for inflation, with the exception of supporting people grant. The underlying rationale is that the existing stock will continue to be maintained and improved according to the outputs from the 2009 stock condition survey. The plan therefore sets a baseline which demonstrates the ability of the council to honour its commitments to tenants and to secure the long term future of its assets.

There is the potential to enhance investment in key areas, for services, for the existing stock or in new stock. Some scenarios are set out in this document subject to more discussion with members and tenants around the priorities for investment.

The summary outputs set out below are in two parts:

- The five year plan for revenue and capital investment – in line with the approved budgets.
- A long term forecast of the 30 year position to demonstrate long term sustainability.

Five year revenue and capital programme

A detailed 30 year forecast for revenue and capital is enclosed at appendix 1. The tables below summarise the revenue, capital and reserves position for the business plan.

Table 2: HRA 5 year forecast 2012-2017 *All figures in £'000*

Year	2012.13	2013.14	2014.15	2015.16	2016.17
Rents	10,970	11,694	11,843	12,223	12,609
Other income	677	689	701	712	723
Total Income	**11,647**	**12,383**	**12,544**	**12,935**	**13,332**
Management	-2,238	-2,294	-2,351	-2,410	-2,470
Repairs	-2,402	-2,510	-2,591	-2,637	-2,696
Bad Debt Provision	-20	-43	-65	-67	-69
Debt charges	-1,662	-1,664	-1,660	-1,768	-1,890
Depreciation	-4,500	-5,500	-5,500	-5,500	-5,500
Operating expenditure	**-10,822**	**-12,011**	**-12,167**	**-12,382**	**-12,625**
Debt repayment	0	0	0	0	0
Revenue contribution to capital	-800	-786	-809	-831	-854
Total Appropriations	**-800**	**-786**	**-809**	**-831**	**-854**
Surplus/deficit	**25**	**-414**	**-432**	**-278**	**-147**
Opening Balance	2,002	2,027	1,613	1,181	903
Closing Balance	**2,027**	**1,613**	**1,181**	**903**	**756**

Table 3: HRA 5 years capital programme 2012-2017

Year	2012.13	2013.14	2014.15	2015.16	2016.17
	1	**2**	**3**	**4**	**5**
Capital Programme	**5,328**	**6,286**	**6,309**	**6,331**	**6,354**
Major Repairs Reserve	4,453	5,411	5,408	5,383	5,390
Right to Buy Receipts	75	90	92	117	110
Revenue Contributions	800	786	809	831	854
Capital Finance	**5,328**	**6,287**	**6,309**	**6,331**	**6,353**
Memo: Major Repairs Reserve	75	164	257	374	484

The key elements of the business plan can be summarised as follows:

1. Total service related expenditure of £4.6m per annum is rolled forward with inflation over 5 years.
2. Total capital spending is £30.608m over 5 years, representing an increase over and above existing programmes and targeted at completing the works necessary to improve our homes.
3. In order to meet these spending needs, we will draw on £1.2m of revenue balances over the period with a varied forward HRA balance of c£760k at 2017.
4. Major repairs reserve balances are planned to be almost £500k at 2017.

30 year business planning forecast

The charts below show the capital and debt profiles for a 30 year time horizon taking into account all the assumptions set out above and linking the generation of additional resources to the set aside for debt repayment.

Chart 4: long term capital needs against resources available. All figures in £'000

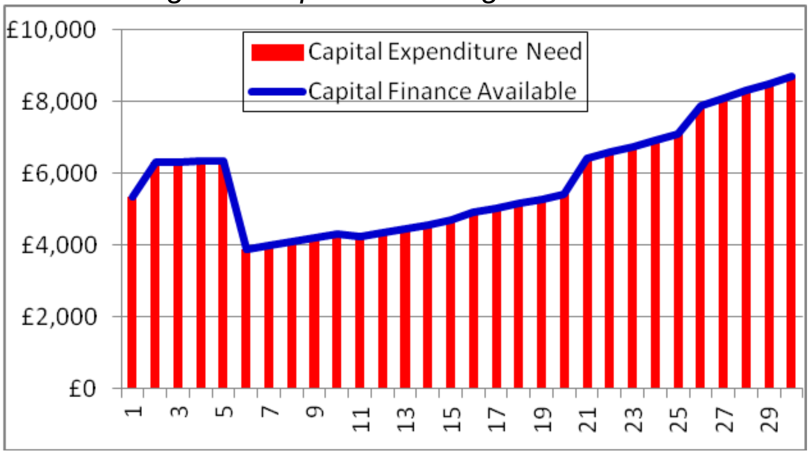
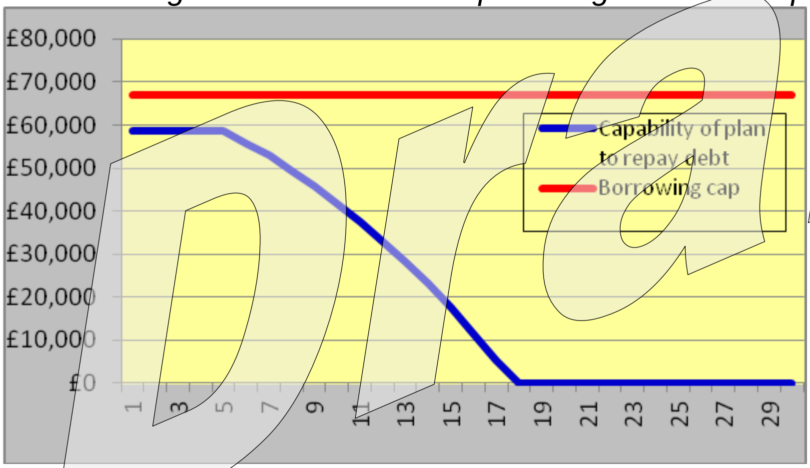


Chart 5: long term debt reduction profile against debt cap. All figures in £'000



Taken together, the charts exemplify how:

- The plan is sustainable and viable over the long term.
- Revenue surpluses rise throughout the 30 years.
- All capital expenditure needs for the existing stock can be comfortably covered for the lifetime of the plan.
- Debt can be covered down by around year 18 (2030); as this is earlier than the actual loan redemptions required, this could lead to the capacity for further investment during the lifetime.

The charts below compare the capability of the plan to generate debt repayment with the actual required debt profile. The difference between the two profiles represents the potential additional capability for investment.

As resources are generated, and as debt repayment is not actually required until loans reach redemption, surpluses build in the HRA representing this potential additional capacity for investment.

Chart 6: capability of the plan to repay debt against actual redemption profile.
All figures in £'000

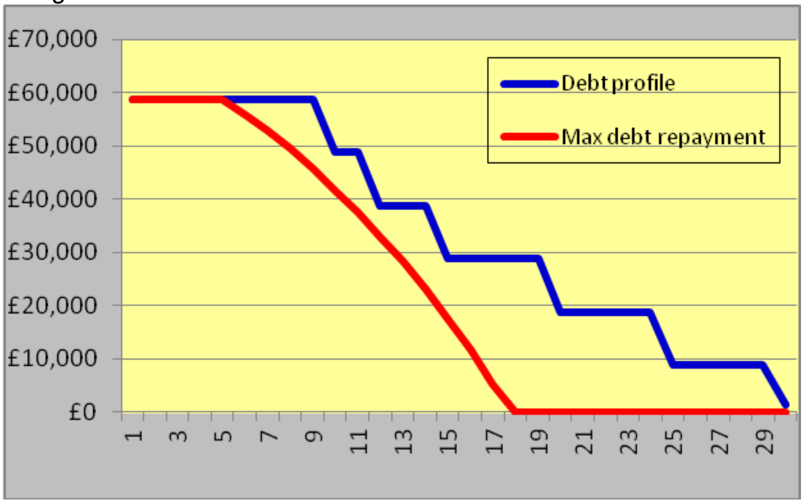
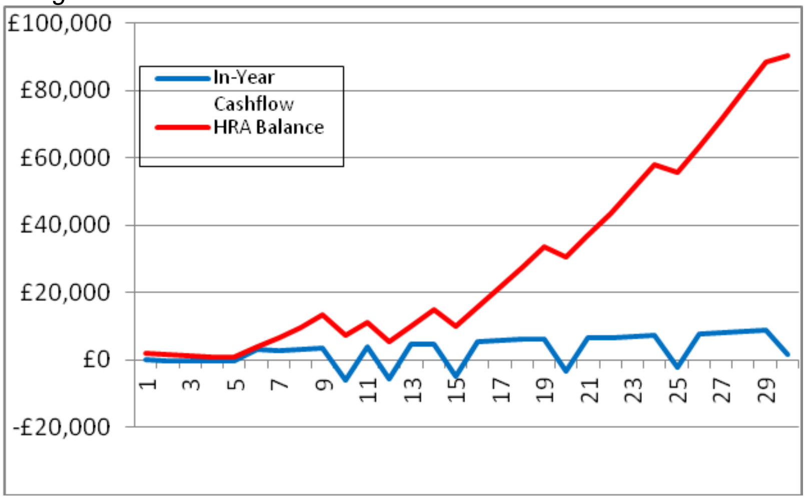


Chart 7: forecast revenue surpluses over plan lifetime
All figures in £'000



Taken together, the charts show that there is additional headroom over and above the profile to repay the actual loans that have been taken on to fund the settlement payment and, if unspent, that these total might reach £80m after 30 years.

There is therefore ample scope for risk mitigation as well as additional investment over the lifetime of the plan.

The plan profiles shown above rely upon the council continuing to take sensible and sustainable decisions around investment in services, the asset base and in generating income. They also reply upon the ability of the council to continue to collect all revenues related to the stock within the plan.

The final section of this summary sets out some general sensitivities of the plan to changes in economic conditions and to changes in financial policy, either on the part of the government or the council. Given these sensitivities and the opportunities the council has to secure long term sustainability of the stock, there are likely to be additional resources for investment to be the subject of work throughout the summer of 2012.

Sensitivities and risk management

The table below sets out a summary of the main risks and sensitivities that have been identified towards the delivery of the HRA business plan. This analysis shows the sensitivity of the business plan to changes in economic assumptions, income assumptions, cost policies and debt/treasury management and expresses the difference as either a) the changes in the earliest potential year of debt repayment (18 in the baseline model) or b) the built-up surplus in 30 years after actual loan redemption (£88m in the baseline plan).

The general message is that whilst there is comfort in the plan to address risks as identified, the council must focus on ensuring rents are increased over time in line with the expectations within the plan so that the benefits of a sustainable future are realised.

Table 8: sensitivities in the business plan

Sensitivities	30 year revenue surplus £m *	Year of earliest debt repayment *
Baseline plan	83.4	19
Inflation 3% all years	105.1	17
Interest rates 1% higher all years	73.3	20
Rent convergence year 30	10.5	29
Bad debts rise 3% (up sixfold)	69.9	20
Cost inflation 1% higher all years	25.7	21

** These are either/or – mutually exclusive depending upon debt treasury management policy*

Officers will develop and update the corporate risk strategy to reflect the change in risk profile arising from the introduction of self financing. In overall terms, a risk profile which was previously primarily around the policy and government-led intervention issues associated with being part of an unpredictable national financing system have been replaced with economic, debt financing and local-policy risks (for example income raising in the future).

Summary

Since the substantive business plan document was approved last year, in general terms the financial move has been positive towards the South Derbyshire HRA. An increase in income inflation which drove both a higher rent increase and therefore a higher debt settlement has been offset by a significant reduction in the cost of debt. This will allow the council to deliver long term sustainability for the HRA with the prospect for increased investment in the future.

Officers will bring back proposals for increased investment in new homes and redevelopment where additional homes may be deliverable. The main sources of finance for additional investment include:

- Drawing down on headroom of £8m borrowing – using future rental streams to the repay additional borrowing
- Deploying revenue surpluses towards new homes (via the possible operation of a new homes replacement reserve)
- Retention of RTB receipts as part of the proposed new local-agreement arrangements which are to be signed with government.