
REPORT TO:	OVERVIEW AND SCRUTINY COMMITTEE	AGENDA ITEM: 6
DATE OF MEETING:	11th FEBRUARY 2009	CATEGORY: RECOMMENDED
REPORT FROM:	DIRECTOR OF CORPORATE SERVICES	OPEN
MEMBERS' CONTACT POINT:	KEVIN STACKHOUSE (595811)	DOC: u/ks/budget round 0910/policycommitteereports/hra
SUBJECT:	HOUSING REVENUE ACCOUNT BUDGET, FINANCIAL PROJECTION and PROPOSED RENT INCREASE 2009/10	REF:
WARD(S) AFFECTED:	ALL	TERMS OF REFERENCE: HCS 01

1.0 Recommendations

- 1.1 That an average rent increase of 6.28% for 2009/10 in accordance with Government guidelines be approved and is adjusted for individual tenants in accordance with the Rent Restructuring Formula.
- 1.2 That the proposed estimates of income and expenditure for 2009/10 for the Housing Revenue Account are considered and referred to the Finance and Management Committee for approval.
- 1.3 That the updated financial projection, including the associated assumptions and risks for the Housing Revenue Account to 2018 is considered and noted.

2.0 Purpose of Report

- 2.1 To detail the Housing Revenue Account's (HRA) base budget for 2009/10 and an updated financial forecast to 2018. It also sets out details of the proposed rent increase for 2009/10.
- 2.2 In addition, the report provides details of the Government's subsidy settlement for 2009/10.

3.0 Executive Summary

- 3.1 The overall financial forecast for the HRA is improved compared to that previously reported in September 2008, although there remains an on-going budget deficit in the longer term of approximately £656,000 by 2018, compared to £850,000 last September. In addition, the first year that the HRA

falls into deficit is now projected to be in 2011/12, compared to 2010/11 previously.

- 3.2 This slightly better position is mainly due to changes in rent levels brought about by the Government's updated rent restructuring policy, together with a further reduction in projected council house sales.
- 3.3 The latest projection shows that the HRA can now maintain an adequate level of reserves as required by the Council's Financial Strategy over the 10-year planning period. The forecasted balance is £937,000 (surplus) compared to a projected deficit balance of £335,000 in September 2008.
- 3.4 However, this all depends to a large extent on the inflation index applied to formula rents over this period, caps/limits and whether any other changes are made to the timing of rent convergence.
- 3.5 Consequently, the continuing uncertainty around the national subsidy system remains and, as in previous years, changes made on an annual basis have a major impact on the 10-year financial projection. In turn, this makes business planning much more difficult.

Rent Convergence

- 3.6 Effectively, there is no longer a definitive date set for completing rent restructuring. Twelve months ago, the Government delayed full rent convergence to 2016/17, a further 5 years than originally planned. The principle was to avoid hefty rent rises for tenants.
- 3.7 This was the case for South Derbyshire as generally, actual rents were below formula rents. Whilst this would help to smooth increases for individual tenants over a longer period, overall, the financial position on the HRA worsened as this reduced the amount of rent compared to previous projections.
- 3.8 The Government calculates the formula rent based on the rate of inflation in the previous September. As this stood at 5% in September 2008, this would have increased rents nationally by up to 9%, after adding the uplift required to actual rents in order to catch up the formula rent.
- 3.9 Therefore, the Government has capped overall increases to 7%. This is higher than the previous 5% limit applied in 2006/07 and 2007/08. However, to complicate matters further, on this model, full rent convergence will not be completed until 2024.
- 3.10 This is because the rate of inflation was historically high in September 2008 (5%) compared to previous years since the introduction of rent restructuring.
- 3.11 Therefore, the model pushes back further, rent convergence to compensate. In addition, there is no longer a fixed date to work towards for convergence. It will be determined each year depending upon future inflation rates – it is now a moveable date.

Rental Income and Rent Increases

- 3.12 On the Council's rent restructuring journey, it is the increase in inflation on formula rents (from 5%) that has had a big impact on future rental income for the Council. The previous projection assumed inflation of 3.5% in 09/10 and 2.75% per year thereafter, broadly in line with national indices.
- 3.13 This has increased the ability to raise current base rents higher overall than in previous models, including a catching up element when rents were capped in 2006/07 and 2007/08.
- 3.14 Increases for individual tenants will continue an upward trend in 2009/10 based on the Government's model. The average increase for South Derbyshire if these proposals are approved will be 6.28% (5.9% in 2008/09).

Council House Sales

- 3.15 Previous projections since 2005/06 have been reducing the estimated sales, as first rising house prices and more recently the economic downturn, have significantly reduced "right to buys." This had helped to maintain rent income in the HRA.
- 3.16 The previous projection assumed 130 between 2008/09 and 2017/18. This has now been reduced to 90 (effectively an average of 9 per year) including no sales being forecast for 2009/10, with subsequent years being reduced accordingly.

The Overall Projection

- 3.17 Clearly, in undertaking a longer-term projection, assumptions regarding costs and other external factors need to be made. In particular, on housing subsidy and the Council's increasing payment to the National Pool (negative subsidy).
- 3.18 As explained above, future rent income is perhaps now as uncertain as it ever was. If inflation is relatively high over a few years, then under the current model, this benefits the HRA further and conversely, lower inflation will worsen any future forecast. Clearly at present, inflation is falling and this trend is expected to continue over the coming months, but the key indicator will be the level as at September.
- 3.19 In addition, there is the interplay of caps/limits and final rent convergence. This updated forecast assumes average inflation for rent rises (before any uplift) of 2.5% per year from 2011/12, with a limit of 7% overall and rent convergence by 2023/24. The detailed report shows the sensitivity of these assumptions.
- 3.20 However, unless inflation becomes historically high over a sustained period of years, it is still likely that at some stage the HRA will fall into yearly deficit that can quickly accelerate.

- 3.21 Therefore, although the short-term position continues to remain fairly sound, the longer-term viability of the HRA is still very much questionable. This is compounded by the uncertainties within the current funding system.
- 3.22 Previous reports to this Committee have highlighted a low cost base compared to other housing authorities, but with limited scope for additional investment. Infact, this current budget assumes a “standstill” position.
- 3.23 The effect of this on maintenance and improvement budgets is covered by the Head of Housing Services within the detail of the report. In addition, there are growing service pressures in some areas particularly the Housing Options Team (Allocations, Homelessness and Advice).
- 3.24 Finally, the Committee will be aware of the current review commissioned by Central Government of the subsidy system and the wider HRA. This is due to report later in 2009 and clearly the outcomes and how this will affect the Council remains to be seen.

4.0 **Detail**

4.1 The detailed figures are set out in 2 appendices, as follows:

- **Appendix 1** - a summary of each main income and expenditure head within the HRA for 2008/09 to 2017/18, together with the yearly surplus/deficit and balance on the HRA's general reserve.
- **Appendix 2** – an analysis of how housing subsidy has been calculated.

Changes to the Compilation of the 2009/10 Base Budget

- 4.2 In accordance with proposals to change local accounting practice, the cost of the main departmental housing account will now be charged direct to the HRA rather than being reallocated from Finance Committee.
- 4.3 From 2009/10, the costs of employees and the associated overheads associated with council housing will be charged straight to the cost of the service in the HRA that they directly support. It is considered that this will provide an easier analysis of direct service costs in the future.
- 4.4 However, unlike previous years, the base figures exclude the costs of all other internal support service charges. These will still be considered by the Finance and Management Committee in detail and will be allocated across services (including the HRA) in accordance with accounting practice, when approved through the budget process.
- 4.5 However, to calculate a full cost base for the HRA, the cost of internal support has been added in and is shown separately at this stage in Appendix 1.

Formulating the 2008/09 Base Budget

- 4.6 The estimates are also based on service levels in 2008/09 continuing, and include any full year effects of previous year's growth and capital expenditure. However, any non-recurring and one-off items have been removed.

Inflation

- 4.7 Allowances for inflation based on various assumptions regarding price increases, etc. have been calculated across the main spending heads. The indices used are summarised below.
- Employee Costs – 2.75%
 - Responsive Repairs and Maintenance – 4.5%
 - Planned Maintenance – 2.75%
 - Utilities – various, as per contracts
(These range from a 5% for gas and electricity to 6.5% for water).
 - Business Rates – 5%
 - Fuel – 5%
 - Insurance Premiums – 1.5%

- General Materials, Supplies & Services (including grants) – 2.5%
- Office Expenses (equipment, stationery, etc.) – 0% (cash limited)
- Income from Fees and Charges (excluding rents) - 2.75%

HOUSING SUBSIDY (Appendix 2)

4.8 The main points arising from the Government's National Housing Subsidy settlement for 2009/10 are summarised below:

- A net reduction in national subsidy (after allowing for the Major Repairs Allowance) of £120m.
- This is due to a 4.26% increase in assumed rents with lower increases of 2.85% and 3.46% in Maintenance and Management Allowances respectively.
- A 3.32% increase in the Major Repairs Allowance.

4.9 The amount of subsidy due to housing authorities is determined through a notional (assumed) HRA based on a number of factors and formulae, determined nationally.

4.10 These are designed to assess the need to spend on repairs and management of the housing stock. However, they can only do this to the degree that the overall national amount allocated for subsidy is limited. An analysis of each component is detailed below.

Major Repairs Allowance (MRA)

4.11 Although this is calculated in the subsidy mechanism, it does not form part of the Council's HRA as it is funding provided by the Government for capital investment in the housing stock.

4.12 The Council's allowance per property has been increased from £599.43 in 2008/09 to £611.36 in 2009/10 (2%). This is below the average increase nationally of 3.32% and that for the East Midlands of 2.14%.

4.13 In cash terms (after allowing for a reduction in properties) this equates to an increase of approximately £20,000. Consequently, the total capital allowance for council housing in 2009/10 is estimated at £1.895m.

Management and Maintenance (M&M) Allowances

4.14 The average increase nationally is 2.85% for maintenance and 3.46% for management (3.1% combined). The Council's increases are shown in the following table.

	MANAGEMENT	MAINTENANCE
Allowance 2008/09	£406.72	£865.24
Allowance 2009/10	£428.12	£902.62
Percentage Increase	5.23%	4.32%

4.15 The increases are above the national average. Based on the number of council properties, this increases resources in 2009/10 by approximately £148,000 compared to 2008/09.

Guideline Rents

4.16 Based on this, the subsidy system assumes the amount of money an authority collects in rent. This amount is deducted from M&M allowances and if it is greater (which it is for the Council) this produces the negative subsidy position and the net amount is paid to the national pool.

4.17 Guideline rents will increase nationally by 6.2% in 2009/10. The effect on the Council is shown in the following table – i.e. the Council's guideline rent as set by the subsidy system.

2008/09	£58.68 per week
2009/10	£61.20 per week
Increase	£2.52 per week (4.3%)

4.18 Based on the number of council properties, this reduces resources in the notional account in 2009/10 by approximately £318,000 compared to 2008/09.

Overall Position

4.19 After allowing for changes in the other (smaller) components, overall, the Council's base contribution to the national pool will increase by approximately £160,000 in 2009/10 to just under £3.0m (net of the Major Repairs Allowance).

RENT RESTRUCTURING AND PROPOSED RENT INCREASE 2009/10

4.20 Rent restructuring was introduced in 2001/02, with the aim of basing rents on property values, local wages and the number of bedrooms in a property. In addition, it is also intended to eliminate differences between rents set by local councils and those set by other housing providers.

- 4.21 Rents for individual properties are now calculated in accordance with a formula based on the above factors.
- 4.22 In recognition that the new system could substantially change individual rents over-night, the Government's policy was to phase in changes between actual rents being paid at that time and those calculated under the national formula. Full convergence was originally planned by 2011/12 (i.e. over a 10-year period).
- 4.23 In 2004, the Government undertook a review of their policy, in particular to change parts of the formula in order to update it for:
- Larger properties (to increase the weighting for properties with 3 or more bedrooms).
 - To reflect increases in property values since 2000.
- 4.24 These proposals were implemented for 2006/07. Consequently, all authorities were required to recalculate formula rents for each tenant back to 2001/02 and update it to 2006/07 in accordance with the changes highlighted above. Changes at this time also introduced a cap on overall rent increases of 5% for 2006/07 and 2007/08.
- 4.25 Rent restructuring has generally increased average rents in the local authority sector as they are brought into parity with other housing providers. Therefore last year, the Government decided to extend the current convergence period by a further 5 years to 2016/17, but removed any overall cap on increases.
- 4.26 This was designed to spread the effects of future increases to avoid hefty rent rises for tenants. This was the case for South Derbyshire as generally, actual rents were below formula rents.

Changes for 2009/10

- 4.27 The Government calculates the formula rent based on the rate of inflation in the previous September. As this stood at 5% in September 2008, this would have increased rents nationally by up to 9%, after adding the uplift required to actual rents in order to catch up the formula rent.
- 4.28 Therefore, the Government has capped overall increases to 7%. This is higher than the previous 5% limit applied in 2006/07 and 2007/08. However, to complicate matters further, on this model, full rent convergence will not be completed until 2024.
- 4.29 This is because the rate of inflation was historically high in September 2008 (5%) compared to previous years since the introduction of rent restructuring.
- 4.30 Therefore, the model pushes back further, rent convergence to compensate. In addition, there is no longer a fixed date to work towards for convergence. It will

be determined each year depending upon future inflation rates – it is now a moveable date.

Rental Increases and Overall Income

- 4.31 On the Council's rent restructuring journey, it is the increase in inflation on formula rents (from 5%) that has had a big impact on future rental income for the Council. The previous projection assumed inflation of 3.5% in 09/10 and 2.75% per year thereafter, broadly in line with national indices.
- 4.32 This has increased the ability to raise current base rents higher overall than in previous models, including a catching up element when rents were capped in 2006/07 and 2007/08.
- 4.33 For 2009/10, the Government has set a national average increase in formula rents of 5.5%, i.e. 5% inflation as measured by the retail prices index at September 2008 + 0.5% real terms increase.
- 4.34 All tenants will again see an increase in rent for next year. However, individual tenants will see their rent change depending on how their current rent compares to their formula – the formula having been increased as above.
- 4.35 The average increase for tenants in South Derbyshire if these proposals are approved will be 6.28% (5.9% in 2008/09), the average rent increasing from £58.11 per week in 2008/09, to £61.76 per week in 2009/10.
- 4.36 However, within this average increase, there is a range of changes and these are summarised in the following table.

LEVEL OF INCREASE (IN POUNDS)		LEVEL OF INCREASE (IN PERCENTAGE TERMS)	
Less than £2 per week	0	Less than 5%	0
Between £2 and £3	294	Between 5% and 6%	943
Between £3 and £4	2,445	Between 6% and 7%	2,064
Between £4 and £5 (Largest increase £4.83)	355	Between 7% and 8% (Largest increase 7.4%)	87
Total Properties	3,094		3,094

- 4.37 The average rent proposed for 2009/10 of £61.76 per week is below the Formula of £68.13 (a difference of over 10%).

Flexibility?

- 4.38 Although the Council does not have to follow the Government guideline for rents, the HRA would be penalised through the subsidy system by not following the Government's policy. For example, where rents are set higher,

the subsidy mechanism would withdraw grant for Rent Rebates. This would become an additional cost on the HRA.

- 4.39 Setting lower rents would not in itself directly reduce subsidy. However, the mechanism assumes that rent restructuring is being applied and builds this into assumed rent levels in the notional account. Setting a lower level will therefore reduce overall rent to the HRA.
- 4.40 On this point, a 1% reduction in average rents would “cost” the HRA approximately £100,000 in 2009/10. However, under rent restructuring, this would need to be made up in subsequent years, as actual rents on average, would fall further behind the Formula Rent.

HRA FINANCIAL FORECAST TO 2018 – OVERVIEW (APPENDIX 1)

- 4.41 Following the Housing Stock Options Review in 2004, the Council is directed by the Government to plan and monitor its longer-term financial position over 10 years on the HRA (on a rolling basis) and to maintain at least its minimum balance. The Council’s financial strategy sets this minimum contingency at £1/2m.
- 4.42 The overall financial forecast for the HRA shows a slight improvement compared to that previously reported in September 2008, although there remains an on-going budget deficit in the longer term of approximately £656,000 by 2018, compared to £850,000 last September.
- 4.43 In addition, the first year that the HRA falls into deficit is now projected to be in 2011/12 compared to 2010/11 previously.
- 4.44 This slightly better position is mainly due to changes in rent levels brought about by the Government’s updated rent restructuring policy (as explained earlier), together with a further reduction in projected council house sales.

Council House Sales

- 4.45 Previous projections since 2005/06 have been reducing the estimated sales, as first rising house prices and more recently the economic downturn, have significantly reduced “right to buys.” This had helped to maintain rent income in the HRA.
- 4.46 The previous projection assumed 130 between 2008/09 and 2017/18. This has now been reduced to 90 (effectively an average of 9 per year) including no sales being forecast for 2009/10, with subsequent years being reduced accordingly.

Overall Implications

- 4.47 The overall effect of rent restructuring and lower council house sales means that the HRA can maintain an adequate level of reserves as required by the

Council's Financial Strategy over the 10-year planning period. The forecasted balance is approximately 937,00 (surplus) compared to a projected deficit balance of £335,000 in September 2008.

4.48 However, this all depends to a large extent on the inflation index applied to formula rents over this period, caps/limits and whether any other changes are made to the timing of rent convergence.

4.49 Consequently, the continuing uncertainty around the national subsidy system remains and, as in previous years, changes made on an annual basis have a major impact on the 10-year financial projection. In turn, this makes business planning much more difficult.

Summary of Main Assumptions and Risks

4.50 Clearly a forecast of this length does need to be treated with a certain degree of caution, and assumptions need to be made that could in the future change. Factors such as housing subsidy and council house sales are outside the Council's control.

4.51 The current assumptions beyond the current base budget from 2009/10 are set out below for the major categories of income and expenditure in the HRA.

Housing Repairs

4.52 An increase of 4.5% in overall spending, to reflect the traditionally higher than average inflation increases in the building sector. This is unchanged from the previous projection. Clearly, the current economic downturn could change this in the short-term and it will need to be kept under review.

Management Costs

4.53 These are largely staffing costs, increasing by 3% per year assuming current service provision. This is also unchanged from the previous projection.

Housing Rents

4.54 The projection is built on an average increase of approximately 4% per year from 2010/11. This is based on an inflation rate of 2.5%, plus a ½% real terms increase (3% in total) as indicated by the Government. The remaining increase of 1% is due to the annual uplift required to bring actual rents into line with the Formula.

4.55 On this model, which projects forward the effect of the changes for 2009/10, full rent convergence will be completed by 2024. This also assumes a continuing maximum overall limit on rents of 7% per year.

4.56 As highlighted earlier however, this model will depend on the rate of inflation in September each year. The projection assumes average inflation of 2.5%, this

being a broad measure of long-term inflation currently used. The sensitivity of this factor (all other items unchanged) is shown in the following table.

Inflation Factor	Reserve Balance @ 2018	Budget Deficit in 2017/18
Average 2.5% per year	£937k (Surplus)	£656k
Average 4% per year	£3.1m (Surplus)	£45k (Surplus)
Average 1.5% per year	£1/2m (Deficit)	£1m

4.57 Future rent income is perhaps now as uncertain as it ever was. If inflation is relatively high over a few years, then under the current model, this benefits the HRA further and conversely, lower inflation will worsen any future forecast.

Changes to the Rent Convergence Date

4.58 In addition, if any changes are made to the cap or a fixed date for rent convergence is again made, this will also affect overall income. The current model pushes back full convergence to 2023/24.

4.59 As the Council's average rent is approximately 10% below the Formula Rent, extending convergence penalises the overall HRA as it reduces the amount of rent income per year compared to previous forecasts.

4.60 If the convergence date were again pulled forward, then this would benefit the overall HRA. For example, if the date was again set at 2016/17, then (assuming other factors remained unchanged), this would increase the surplus amount to £1m in 2017/18 and the HRA would not start operating in deficit until 2012/13.

4.61 However, the longer-term budget deficit would still be approximately £600,000 per year by 2018, i.e. on this basis the timing of rent convergence does not change the uncertainty around the longer-term viability of the HRA.

Increases for Individual Tenants

4.62 It should be noted that within all of this, rents on average for individual tenants, will continue to increase, whatever the inflation rate or timing of convergence.

4.63 This is due to the Governments intention to continue with at least a 1/2% rise above inflation and from the fact that overall rents are still 10% below the Formula. Uplift will be required each year under the current policy.

Council House Sales

- 4.64 As previously highlighted, the projection assumes no sales in 2009/10 and a reduction in future years compared to previous forecasts. This will ultimately depend on the future economic situation, financial markets and house prices.
- 4.65 It is not inconceivable that higher rents could increase future right to buys when the economic situation is better. Based on an average rent of £61.72 per week, each “right to buy” reduces rental income by approximately £3,200 per year (£32,000 over 10-years).

Payment to the National Pool (Negative Subsidy)

- 4.66 Overall, this is another risk factor for the HRA especially as it is outside the Council's control. Although the factors this year have not changed as significantly as recent years for the Council, it can be volatile. The Council's payment to the Pool is expected to rise year on year as previous projections have assumed.

National Funding

- 4.67 In addition, national subsidy for housing authorities is expected to keep on reducing as housing stock nationally continues to fall. Therefore, on this basis, it is also assumed that the Council's negative subsidy position will continue to rise.

Reviewing the Subsidy System

- 4.68 In December 2007, the Government announced a review of the HRA subsidy system. Its purpose is to ensure a sustainable, long-term system for financing council housing. The review includes:
- The scope for authorities operating outside national subsidy
 - The need to spend on repairs and management
 - Rent policy
 - Financing the HRA
 - Accounting within the HRA
- 4.69 The review is expected to produce a final report later in 2009. This will then be subject to a period of consultation, with proposals feeding into the next Comprehensive Spending Review in 2010. It is considered therefore, that any substantial changes will not be implemented until 2011/12 at the earliest.

Overall Summary

- 4.70 Clearly, all of this together continues to provide challenges for managing the HRA. However, unless inflation becomes historically high over a sustained period of years, it is still likely that at some stage the HRA will fall into yearly deficit that can quickly accelerate. If council house sales at anytime in the future increase back to previous levels, this will also reduce projected income.

- 4.71 Although the short-term position continues to remain fairly sound, the longer-term viability of the HRA is still very much questionable. This is compounded by the uncertainties within the current funding system.
- 4.72 Previous reports to this Committee have highlighted a low cost base compared to other housing authorities, but with limited scope for additional investment. Infact, this current budget assumes a “standstill” position.
- 4.73 On this point, the Head of Housing Services comments as follows:

Demands upon maintenance and improvement budgets.

The projection assumes that expenditure on major items of property maintenance and improvement at current levels over the next ten years will suffice. This is unlikely to be the case.

The experience of the national Decent Homes standard is that there is a subjective element to it and that landlords have interpreted it in different ways. Whilst there is great merit in the Decent Homes standard, in that it has fundamentally led to a national improvement in the living conditions of millions of tenants, it can mean different things in different areas. For instance some landlords have replaced far larger numbers of high cost items (pro-rata) than this Council. For those landlords it will mean that maintaining the Decent Homes standard in the future will be a lower cost process (pro-rata) than our own.

Other cost pressures relate to the fact that our investment has primarily been about the internal fabric of the stock and that we have not had major renewal of expensive items most notably roofs and rewires. There is only so long that major programmes of renewal can be delayed for. An example of the issue that we may be 'losing pace' on the external fabric of dwellings is that we recently fell out of the upper quartile SAP rating (a measure of the thermal efficiency of homes) which is a direct reflection of the fact that other landlords are investing more in this area.

The budget projection also does not take account of tenant aspirations. The recent STATUS survey highlighted the top two priorities for tenants to be gardening and decorating help for the elderly. Another example of headroom for aspirations not being built into the budget would be showers. Very few of our properties have showers. For most now in the private sector use of an over bath shower or walk in shower is an everyday activity. This does not apply to our tenants.

In terms of the environment and improving the fabric of the estates we have only made a minimal start on this issue in the last year or so. Much more could be done.

- 4.74 Finally, the current review commissioned by Central Government of the subsidy system and the wider HRA is due to report later in 2009. Clearly the outcomes and how this will affect the Council remains to be seen.

5.0 Financial Implications

5.1 As detailed in the report

6.0 Corporate Implications

6.1 None Directly

7.0 Community Implications

7.1 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 housing to be delivered to the local community.

8.0 Background Papers

8.1 Department for Communities and Local Government - Housing Subsidy Determination (and associated papers) 2009/10.