Cabinet 14 February 2012

Report of the Cabinet Member for Health, Housing and Adult Social Services and the Cabinet Member for Corporate Services

Housing Revenue Account Reform and Business Planning

Purpose of report

1. This report provides an overview of the new Housing Revenue Account (HRA) self financing system and the impact of this reform on the Housing Business Plan. It asks members to agree the outline summary business plan attached at Annex 1, with a view to receiving a further more detailed report later in 2012. It also asks members to make key decisions required to maintain the financial stability of the HRA, namely the 2012/13 average rent increase and the proposed level of overall capital expenditure.

Background

2. April 2012 will mark a significant change to the way that council housing is financed. The Localism Bill will dismantle the current system of HRA subsidy and replace it with a new system of self financing. This results in a number of changes to the current financing system which has a significant impact on the Council's HRA business plan and its stock retention strategy.

3. The current HRA is a national housing finance account and HRA subsidy is the system for redistributing resources between councils based on a desk top assessment of each council's notional deficit or surplus. York is in negative subsidy in that its notional income exceeds its notional expenditure. As a result we pay the difference to the Government (expected to be £7.7m in 2011/12) which then redistributes this to those authorities who are in positive subsidy. Under this system, York's negative subsidy is forecast to increase year on year and we have no method of influencing or reducing the amount that must be paid over to Government.

4. The new system involves a reallocation of housing debt based on whether the valuation of each council's housing business is higher than their existing debt. For York, the government estimates that the value of our housing business is £145m, which is some £122m higher than our

existing level of housing debt. Therefore, the council will need to borrow in order to pay this difference of £122m to central government. This is a one off payment and in return the council gets greater independence and responsibility for the management of its housing stock as in future it will have the ability to actively manage the debt and its financial impact on the HRA.

5. The statutory ring fence that prevents councils from subsidising the housing account with contributions from the general fund and vice versa remains in place with no changes proposed. Taken in the round, this settlement represents a good outcome for the council and this report goes on to explain the impact on the housing business plan.

Rent restructuring

6. In 2000 the Government announced that from April 2002 all councils and housing associations had to set their rents on a new, fair and consistent basis. This involved a phased change in rents over 10 years beginning in April 2002 based on a formula for rent setting created by Central Government. This is known as rent restructuring and will mean that rents charged will move towards a Government set target rent. By 2012 similar properties should be charged similar rents regardless of who owns the property, other than the new "affordable" rents that are set at up to 80% of market rent. This deadline has been extended and rents will now converge by 2015/16. This Government formula rent takes account of various factors including the number of bedrooms a property has, property valuation, average earnings and the date at which all rents are expected to converge.

7. Current Government rents' policy assumes that through the process of rent restructuring there will be eventual convergence between the rents in the local authority and registered social landlord (RSL) sectors. At this point actual and guideline rents for a single authority should all have the same value. The actual rent is the rent charged to the tenant. The guideline rent is a notional rent and a feature of the outgoing HRA subsidy system. However, this is the level of rent the Government has assumed when calculating the settlement of £122m.

8. Taking into account the rent calculations on individual properties and the impact of moving all rents towards the target rent results in an actual average rent increase for York of 7.4%. The rent increase will apply to all council properties including hostels and travellers sites. It is necessary to serve notices on tenants to vary their current rent and a minimum of four weeks notice is required.

9. The Government expectation is that councils will continue to follow national rent setting policy, and the settlement is based on future income levels assuming the current national rent policies are implemented as planned. Should the council decide to set a lower rent increase this will have a direct financial impact because the debt level will remain the same but with less rental income available to service that debt. The result being that either savings will need to be made in the housing service or the debt will need to be taken over a longer time period which is, in the longer term, more expensive.

10. The recommended option is therefore to increase rents in line with Government guidance of RPI at September 2011 of 5.6% plus 0.5% plus the move towards convergence. If the council chooses not to follow the government guidance, every 1% reduction equates to a recurring reduction in income of £277k. Following the guidance results in an average increase of 7.4%. This is in line with the recommendation from Government and matches the assumed level of income in the HRA settlement calculations. The average weekly rent will be £72.02 and average weekly increase £4.98.

Options

11. Option 1 (recommended option) – Agree the outline 5 year business plan as set out in Annex 1, including
    a. The average rent increase of 7.4% for 2012/13
    b. Continuing to follow national social rent policy
    c. Capital investment of £43m over the 5 years

Analysis

12. The outline business plan is based on a number of key strategic assumptions, including;
    - That the council will continue to follow national social rent policy in determining the rents payable by tenants
    - That the capital programme will be set at a level that allows the council to continue to deliver the York Standard for all homes (i.e. decent homes plus)
    - That the council will repay the self financing debt by 2030/31.

13. The main areas that need to be considered are examined in more detail in the following paragraphs. They are linked in that the income from rents will fund the capital programme and the repayment of the debt, along with all the other services for tenants in the HRA such as disabled adaptations, tenancy services, etc.

Debt strategy and treasury management

14. The new system will limit the level of borrowing that the council can undertake for housing by setting a limit of indebtedness. Nationally, the Government appreciates that this reform represents a major transaction with significant levels of debt being transferred between central and local government and have made some changes to assist this process. The key change occurred when the Government announced at the end of September 2011 that Public Works Loans Board Loan interest rates, solely for the purpose of discharging a council's obligation under self financing, are to be reduced by 1%. This makes these PWLB loans more attractive than alternative sources of funding e.g. bonds and therefore effectively makes this the best option for councils that need to borrow in order to pay central government.

15. The reform of the HRA subsidy arrangements is expected to take place on 28th March 2012 and will require the council to pay a fixed amount (£122m) to Government to remove the council from the subsidy system. The amount that the council is required to pay to government has changed from the initial consultation, increasing from £89m to £122m. The amount increased due to a reduction in the discount rate used to value the HRA from 7% to 6.5% along with changes to inflation, property numbers and the assumed average rent increase for 2012/13. Due to the changes to PWLB loans outlined in paragraph 10 above, this is financially the most advantageous way to finance the borrowing required. Assuming the recommended option is agreed, the loans will be repaid in accordance with the HRA borrowing strategy which is outlined in the separate Treasury Management Strategy report also on the agenda.

16. Alternative methods of financing the housing debt have been considered by officers, including bonds and other market loans, however the PWLB loans offer the best value for the council due to their flexibility and low interest rates.

Capital Investment

17. The council has already achieved the Governments Decent Homes Standard and the outline business plan is based on achievement of a higher "York Standard" for all properties. The proposed level of capital expenditure stands at £43m over the 5 year period from 2012/13 to 2016/17.

18. There is a difference between the level of borrowing the council needs to take on in order to make the payment to Government and the cap on the maximum amount the council is allowed to borrow for self financing.

This is commonly referred to as "headroom" within the self financing settlement and could be used to deliver new council housing or other investment in the housing stock.

19. At this stage, it is proposed that no additional borrowing is undertaken as it is recognised that this headroom is not immediately required to meet the York Standard on all homes. The need for any additional investment funded from headroom borrowing will be kept under review and further detail around the options available will be provided in the more detailed report due to Cabinet in June 2012. It is prudent to retain this option to allow additional work that tenants and members may wish to bring forward to improve the quality of the housing stock.

Sensitivity Analysis

20. A series of prudent assumptions have been made in order to construct the baseline HRA business plan, which are as follows;
    a. RPI at 2.5%
    b. Financing costs at 6.0%
    c. 10 RTB sales per year, generating a useable capital receipt of £187k
    d. Void rate at 1.2%
    e. Bad Debts at 0.4%

21. The assumed rent Increases are set out in the table below

Year	Estimated Average Rent Increase (assuming 2.5% RPI)	Average rent per week	Average increase per week
2012/13	7.4%	£72.02	£4.98
2013/14	4.3%	£75.09	£3.07
2014/15	4.3%	£78.28	£3.19
2015/16	4.2%	£81.59	£3.31
2016/17	3%	£84.05	£2.46

22. When broken down by size / type of accommodation, the above estimated rent increases for 2012/13 results in an average rent for a 2 bed property of £73.70 and a 3 bed property £80.52

23. There are a number of alternative assumptions and scenarios that can be applied to the baseline model to test the impact of a range of actions on planning for the housing stock over a 30 year business plan. The most significant factors that make a difference to the plan are the level of investment carried out, the number of Right To Buys and the assumed rent levels. The HRA business plan will be formally monitored on a

regular basis and any variations reported to members in the usual finance monitoring reports.

Consultation

24. The Tenants Federation have been briefed on the changes being made and the impact they have on the housing business plan.

Corporate Priorities

25. The information and issues included in this report demonstrate progress on achieving the priorities set out in the Council Plan (2011-15).

Implications

26. The implications are:
    - Financial - the financial implications are dealt with in the body of the report.
    - Human Resources - there are no specific human resource implications to this report.
    - Equalities – the outline business plan maintains the current level of provision for disabled adaptations to council properties. There are no changes to services as a result of this report. However, should members not agree the recommended option then savings may need to be identified and a full Equalities Impact Assessment will be completed for any reductions or changes in service delivery.
    - Legal - there are no legal implications to this report.
    - Crime and Disorder - there are no specific crime and disorder implications to this report.
    - Information Technology - there are no information technology implications to this report.
    - Property - there are no property implications to this report.
    - Other - there are no other implications to this report.

Risk Management

27. While the settlement can be viewed as positive there are a number of areas of risk that will need to be closely monitored and suitable mitigation identified.

28. Interest rates could rise above the levels used in the plan. Given the current low rates this is clearly a high risk and the mitigation proposed is to adopt a range of borrowing tactics including using some long term fixed rate borrowing to give more certainty in the business plan figures. In future the council will be adopting real business planning for the HRA

and in doing so will be proactively managing these risks and making real decisions about rents, investment, borrowing and repayment of debt.

29. The proposals contained in the Welfare Reform Bill could reduce income to some families and may increase the level of bad debts. The progress of the bill and the impact on lower income households needs to be closely monitored with emphasis placed on preventative work, such as financial inclusion, financial capacity building and measures to prevent households from falling into poverty.

30. Inflation could be higher than the current assumptions however the impact of this on the plan is minimal. If this should occur then the capital programme would need to be reduced for a period to compensate.

31. Right to Buy Sales could be higher, reducing the overall level of rental income received. If this should occur then the capital programme would need to be reduced for a period to compensate. Currently 75% of RTB receipts are pooled back to central government. In December, Government issued a consultation paper entitled "Reinvigorating the Right to Buy and one for one replacement" with a deadline for responses of 2nd February 2012. The consultation focuses on proposals to increase caps on RTB discounts to make the scheme more attractive to tenants and considers how any RTB receipts are to be shared between local and central Government. As they have not revised the assumptions on the number of RTBs, and they have allowed for repayment of the debt on a property before pooling, this does not have any impact on the debt settlement. However, if the proposed changes do make the scheme more attractive to tenants there could be an increase in the number of RTBs which will have an adverse impact on the ongoing business plan due to the loss of rental income whilst also reducing the capital receipts available to reinvest in the capital programme. The situation will be kept under review and any material impact reported to members.

32. The Government will continue to set national social rent setting policy and maintaining the rental income stream is essential for the viability of the business plan. Any variation from the national policy is likely to result in a negative financial impact on the business plan and could result in reductions in services to tenants.

33. Under the current system depreciation is essentially an accounting entry which is reversed out of the HRA "below the line" and as such has no impact on the overall bottom line. However, the move to self financing will mean that in future depreciation is a real charge to the HRA. This reinforces the importance of maintaining the stock to a good standard. The Chartered Institute of Public Finance & Accountancy will be issuing further guidance and officers will continue to monitor the situation.

Recommendations

34. Members are asked to:

a. Approve the average rent increase for 2012/13 as set out in paragraphs 6 to 10
Reason: to ensure the ongoing financial stability of the HRA and allow work on improving the quality of the council's affordable housing to continue.

b. Note the HRA revenue plan as set out in Annex 1, that will be recommended to Council within the Financial Strategy report elsewhere on this agenda
Reason: to ensure the ongoing financial stability of the HRA

c. Note the HRA capital investment plan as set out in Annex 1, that will be recommended to Council within the Capital Budget report elsewhere on this agenda
Reason: to ensure the ongoing financial stability of the HRA and allow work on improving the quality of the council's affordable housing to continue.

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<tr><td colspan="3">Wards Affected: All</td><td colspan="2"></td></tr>
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Annex 1 – HRA financial plan

Background Papers:
Council Housing: A Real Future - CLG Consultation Paper & Opportunities / Implications for CYC, Executive, 22nd June 2010