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# Somerset West and Taunton Council

## Tenants Strategic Board 15th January 2020
## Scrutiny Committee 20th January

## Housing Revenue Account (HRA) - Business Plan Review

**This matter is the responsibility of Executive Councillor Member Francesca Smith**

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**1 Executive Summary / Purpose of the Report**

**1.1** The Housing Revenue Account (HRA) Business Plan contains the financial model of the service for the next 30 years. A number of largely external changes has meant that a full refresh of the Business Plan is necessary. This report identifies the changes and the impact of these. The report also sets out a new vision for the Housing Service and plans for growth in the number of new homes we plan to build. Lastly the report also proposes a new rent policy following the end of a period of four years of imposed rent reduction, this will provide a refreshed income position on which to build future plans set out in this report.

**1.2** Officers have worked with external housing and business planning advisers Savills to create a new structure and approach to modelling future financial planning. The proposed Business Plan represents the current established position, it also incorporates assumptions concerning future projected substantial growth and gearing primarily to invest in new homes, that have been accommodated within the plan. This substantially increased level of investment is possible due to the imposed debt cap on the business having been removed, and so represents higher levels of investment and borrowing than the service has previously undertaken. This creates substantial opportunity to do more, but also will increase risk, factors which will need to be balanced carefully by the Council in the coming years.

**1.3** In summary, the assumptions made within the business plan are prudent without being excessively restrictive; they provide for inflation on income and costs at prevailing rates which are aligned, allow a considerable investment in existing stock, a substantial investment in new homes leading to a net increase in properties, whilst debt forecast at elevated levels to today at the end of 30 years. The peak debt of the plan is £164.4 million in year 11, which would not have been possible under the previous HRA regime with a debt cap of £115.8million.

## 2 Recommendations

**For the Tenants Strategic Board and Scrutiny Committee to comment on the report. (It is envisaged that the recommendation for the Executive will be:)**

**Executive recommends to Council to**:

**2.1** Approve the revised 30 year Housing Revenue Account (HRA) Business Plan as set out in this report.

**2.2** Approve the proposed vision for the Housing service along with three new service Objectives.

**2.3** Approve the proposed Housing Revenue Account Rent Setting policy 2020.

## 3 Risk Assessment

**3.1** A review of key sensitivities and stress testing of the proposed plan is contained in section 16 of this report.

## 4 Background and Full details of the Report

**4.1** Somerset West and Taunton Council owns and manages affordable housing of over 5700 homes mostly at social rent levels. This “business” within the Council has a turnover of £26M. Income is derived mostly from rents from our tenants but also from service charges and other fees. Expenditure is made up of Council staff delivering services to tenants along with repairs and maintenance and other improvements to existing homes and investment in new much needed homes, and the repayment of borrowing.

**4.2** The finances of our Housing Service is held within a ringfenced account called the Housing Revenue Account (HRA) which is separate from all other Council finances in that the money is only to be used for providing services to tenants.

**4.3** In 2012 the Council moved away from a national subsidy system, which meant an annual payment from the HRA to central government, to be ‘self-financing’. As part of the self-financing agreement, a mandatory one-off payment of £85.12m was made to government, in return for being able to retain all income locally to manage and maintain the housing stock. The total debt in the HRA at the start of self-financing was £99.7m. Financially this was a positive step for the Council and it released more resources to be invested locally on additional services and new homes.

**4.4** In order to manage the freedoms gained by the HRA through self-financing, a new 30 year Business Plan (2012-2042) was introduced. This set out the Council’s overall aims and objectives for Housing Services, as well as laying out plans to manage the increased risks and opportunities. The HRA Business Plan has been reviewed and updated regularly since 2012, but recently there have been many changes in national policies and local aspiration that means a full update of the Business Plan is once again required.

## 5 Changes in our operating environment.

**5.1** **Debt Cap removal.** Since 2012 the HRA has been subject to an imposed notional debt cap, essentially setting a limit on the borrowing the service could undertake which provided a constraint on growth of the service in terms of investment in new homes. The HRA debt cap was £116M. Following many years of lobbying by the sector, the debt cap has now been removed, which heralds a new era of growth opportunity, as the business can afford to prudently borrow significantly more to allow more investment in existing and new homes.

**5.2** **Rent Reduction.** The Council along with all Registered Providers (RPs) of social housing was subject to a four year period of enforced rent reduction. This step imposed in 2016 essentially removed £185M from the 30 year business plan at this time. Measures were taken at this stage to reduce costs and manage this reduction in revenue whilst continuing to invest in our properties and in services for tenants. The period of rent reduction is now at an end and this gives the opportunity to once again apply appropriate and modest rent increases to ensure the business keeps track of increases in its operating costs. This issue is addressed in more detail later in the report.

**5.3** **Post Grenfell issues**. The Grenfell tragedy continues to rightly have a profound impact on the housing sector ensuring that improvements to how housing stock is maintained and managed are implemented. Key themes around investment in landlord compliance issues, scrutiny and regulation of social landlords and ensuring that resident’s voices are heard and acted on are key drivers. These issues feature in the thinking behind some of the changes proposed in this report, particularly around roles and responsibilities in a new Housing Structure.

**5.4** **Climate Change and Fuel Poverty.** The Council has declared a climate emergency, we also know that many of our tenants struggle to be able to afford to heat their homes, particularly as many of our homes are hard to heat due to poor thermal performance. The ability of the HRA to invest in communities especially with regard to the built infrastructure creates an opportunity for funding to be targeted at these issues.

## 6 Housing Vision and Objectives

**6.1** We have created a new vision statement for the housing service to amplify the ambition of the Councils new Corporate Plan, which gives Housing a greater corporate focus. We are also proposing new service objectives and supporting customer commitments to describe how we will deliver these priorities. This will be supported by a new Comprehensive Service Action Plan. A summary of the new vision and objectives is set out below, the full document is attached at Appendix 1.

**6.2 SWT Housing – "Great Homes for Local Communities"**

**6.3 Corporate Strategy**:

*"A district that offers a choice of good quality homes for our residents whatever their age and income, in communities where support is available for those who need it."*

**6.4 SWT Housing:**

*"Our homes will be safe and secure and we will build many more in which our tenants will thrive. To do this we will develop a great team to provide excellent and modern services. We will compare ourselves with the best and match their performance, and seek to win awards to recognise our progress and give assurance we are doing a good job. We will work hard to deliver the following objectives….."*

**6.5 SWT Housing - Our Objectives** Our work and resources will be directed to help people to lead healthy and fulfilling lives and even more people to access better homes in Somerset West and Taunton by:

1. **Delivering more new homes**
   Our purpose is to run a highly efficient business to enable us to build more new homes.
2. **Providing great customer service**
   Our purpose is to ensure our customers consistently experience great service and community support.
3. **Improving our existing homes and neighbourhoods**
   Our purpose is to invest in homes and the places where people want to live.

## 7 Rental Income

**7.1** A new Somerset West and Taunton rent setting policy from April 2020.

In 2016 Government required councils to reduce rents by 1% against the 2015 levels annually for 4 years (part of the Welfare Reform and Work Act 2016). This, time limited, rent reduction meant significantly less money with which to manage and maintain properties and provide services to tenants. In the Summer Budget 2015 the Government's Impact Assessment of this policy change estimated that by the end of the 4 year reduction period average rents will be 12% lower than they would have been had the existing rent formula of Consumer Price Index (CPI) plus 1% continued to apply throughout the period.

Table 1 below sets out the impact on our rental levels of the rent reduction period and a comparison with rents that are now proposes.

Table1

| | Baseline | 1% reduction each year for 4 years | | | | CPI+1% for 5 years | | | | |
|---|---|---|---|---|---|---|---|---|---|---|
| | 2015/16 | 2016/17 | 2017/18 | 2018/19 | 2019/20 | 2020/21 | 2020/22 | 2020/23 | 2020/24 | 2020/25 |
| Actual / Proposed | 84.15 | 83.32 | 82.50 | 81.68 | 80.87 | 83.05 | 85.30 | 87.60 | 89.96 | 92.39 |
| | | | | | | | | | | |
| If increased by 1% | 84.15 | 85.00 | 85.85 | 86.70 | 87.57 | 88.45 | 89.33 | 90.22 | 91.13 | 92.04 |
| If increased by CPI at 2% | 84.15 | 85.84 | 87.55 | 89.30 | 91.09 | 92.91 | 94.77 | 96.67 | 98.60 | 100.57 |

From 2020 Government has restored the rent policy and regulatory arrangements that were in place before the 2016 rent reduction came into effect.

**7.2** The Regulator of Social Housing's new Rent Standard from April 2020 reverts back to the original social formula rate with increases not exceeding the limit CPI plus 1% for a period of 5 years. All affordable rate rents are to be reviewed annually with any increases set so as not to exceed a limit of CPI plus 1%. The Rent Standard also includes the continued ability for landlords to apply rent flexibility, which as set out below the Council now intends to implement.

**7.3** In addition to applying the above inflationary plus 1% increase the Council's own new rent setting policy is proposing to apply an upward tolerance (rent flexibility), on an individual basis, to new social formula rents (new tenants only) of 5% on general needs and 10% on sheltered/supported housing. In the past the Council has not applied such tolerances, however, the Council has an increasingly important role to play in housing and having the necessary rental income with which to maintain and manage existing homes, support the delivery of new homes and invest in a range of enabling activities will be a great benefit to the council, its tenants and local communities.

**7.4** Note: 3265 (58%) of our tenants are in receipt of Housing Benefit and Universal Credit (where available) this will help mitigate the impact of rent increases on households. (For Sheltered Housing resident and Extra Care residents this percentage increases to 75% and 83% respectively).

**7.5** The Council's use of rental income is subject to the Housing Revenue Account (HRA) ring fence which prevents council rents from subsidising council tax and the General Fund. The rental income generated through the Council's new rent setting policy is to be used to deliver its future plan:

**7.6** Invest in building more desperately needed new homes:

- We will deliver over a 1000 new homes over the next 30 years, the life of the plan, through a range of housing options to support our vision.

Within the Somerset West and Taunton area 4,408 (at 07/11/19) households have applied and are waiting for housing on the council's register for accommodation (Homefinder Somerset). Between 1 January and 30 October 2019 a total of 119,112 bids for accommodation were placed by 7,801 households on homes across Somerset. For the Somerset West and Taunton area, of the 141 homes advertised during July to September 2019, the average number of bids received per property was 82. The highest number of bids received 296 was for a 1 bed bungalow in central Taunton.

**7.7** Make significant investment into carrying out major repairs and improvements to existing homes:

- Recognising the importance of decent accessible homes for people with support needs we will enhance our current sheltered housing stock so that people living in their homes are safe and well. We will invest in disabled adaptions to support people to remain living in their home. Such works will aid the viability of our existing sheltered housing schemes.

- Help disabled customers with adaptations or to find a more suitable property.

**7.8** Invest in activities that support tenants and communities:

- To help tenants sustain their tenancies we will continue to invest in improving access to debt and welfare benefit advice, skills development and training.

- We are committed to tackling anti-social behaviour in the neighbourhoods for which we are responsible and will make investment in services that will support our tenants and communities where these incidents occur.

- To prevent tenancy breakdown and promote independent living we will continue to invest in mental health and well-being support services.

- Where we have council housing we will invest in a range of local projects and groups that have a positive impact, enabling our tenants and communities to thrive.

The Council has the power and duty to set its own rent. Dwelling rents for more than 5,700 properties provide annual income of over £24m for the HRA .The tables below show the various rents for 2020/21 calculated from the formula. The tables also show the effect of the proposed increases.

<u>Table 2: Social Rents - General Needs</u>

| **Social Rents - General Needs** | | | | | | | | |
|---|---|---|---|---|---|---|---|---|
| | **FY 2019/20** | **FY 2020/21** | | | | | | |
| Property Bedroom Size | Social Rent Rate (GN) | Social Rent Rate (GN) | **Difference:** Social rent 2019/20 (GN) **verses** Social rent 2020/21 (GN) - £'s | Social rent including flexibility level 2020/21 (GN) – **relets only** | **Difference:** Social rent 2020/21 (GN) **verses** Social rent 2020/21 including flexibility level (GN) | | Rent Cap 2019/20 | LHA Rate 2019/20 |
| | | Sept CPI+1% | | General Needs (GN) @ 5% | | | | |
| 1 and bedsits | 73.23 | 75.20 | 1.98 | 78.96 | 3.76 | | 141.43 | 92.05 |
| 2 | 79.98 | 82.14 | 2.16 | 86.24 | 4.11 | | 149.74 | 120.82 |
| 3 | 88.91 | 91.32 | 2.40 | 95.88 | 4.57 | | 158.06 | 145.67 |
| 4 | 99.34 | 102.02 | 2.68 | 107.12 | 5.10 | | 166.37 | 184.11 |
| 5 | 116.93 | 120.08 | 3.16 | 126.09 | 6.00 | | 174.69 | |
| 6 or more | 158.84 | 163.13 | 4.29 | 171.29 | 8.16 | | 183.00 | |

Table 3: Social Rents - Sheltered Housing

| Social Rents - Sheltered Housing (including Extra care) | | | | | | | | |
|---|---|---|---|---|---|---|---|---|
| | **FY 2019/20** | **FY 2020/21** | | | | | | |
| Property Bedroom Size | Social Rent Net Rate (GN) | Social Rent Net Rate (GN) | **Difference:** Social rent gross 2019/20 (GN) **verses** Social rent gross 2020/21 (GN) - £'s | Social rent gross including flexibility level 2020/21 (GN) – **relets only** | **Difference:** Social rent gross 2020/21 (GN) **verses** Social rent gross 2020/21 including flexibility level (GN) | | Rent Cap 2019/20 | LHA Rate 2019/20 |
| | | Sept CPI+1% | | Sheltered Housing (SH) @ 10% | | | | |
| 1 and bedsits | 73.23 | 75.20 | 1.98 | 82.72 | 7.52 | | 141.43 | 92.05 |
| 2 | 79.98 | 82.14 | 2.16 | 90.35 | 8.21 | | 149.74 | 120.82 |
| 3 | 88.91 | 91.32 | 2.40 | 100.45 | 9.13 | | 158.06 | 145.67 |
| 4 | 99.34 | 102.02 | 2.68 | 112.22 | 10.20 | | 166.37 | 184.11 |
| 5 | 116.93 | 120.08 | 3.16 | 132.09 | 12.01 | | 174.69 | |
| 6 or more | 158.84 | 163.13 | 4.29 | 179.44 | 16.31 | | 183.00 | |

**7.9** Even with the proposed rent increases the Council's rents are among the lowest in the Taunton Deane area. For example the Council's average rent was £80.87 in 2019/20 compared to an estimated rent of £94.19 in 2019/20 for Housing Associations based on 2017/18 data.

**7.10** Appendix 2 of this report contains a proposed rent policy for 2020-2025. It describes in more detail the how Somerset West and Taunton Council is proposing to calculate and charge rent from April 2020 for its HRA owned properties.

## 8 Management Costs

**8.1** Following the Council decision to establish a structure of four Directorates, a new Housing staff structure will be implemented. Whilst most roles will "lift and shift" from the current structure some vacancies will arise where we require a new focus to meet the housing business objectives. The new structure contains growth and new emphasis in relation to development and regeneration to meet our current and future aspirations in this regard, along with landlord safety and compliance, tenant engagement and customer experience, and performance and finance to oversee a more highly geared business.

**8.2** The Housing Directorate staff structure will incorporate direct staff costs relating to both the HRA and the General Fund (GF), the latter in relation to the Homelessness function. The HRA will also receive the benefit of central support services delivered by staff in the GF, such as procurement, accounts payable, facilities management, HR/Payroll, etc. The HRA will fund a proportion of these costs for the central support services received.

**8.3** As reported to Full Council on the 3rd December 2019, the Council's leadership team identified ongoing financial pressures in order to protect service standards and maintain capacity whilst completing the safe delivery of expected service process efficiencies and greater customer access to self-service. The HRA will need to take on a share of these transition and service resilience cost pressures in year 1, but will see a cost reduction going forwards as the Change Programme drives forward to deliver the service process efficiencies and demand management benefits anticipated.

**8.4** We have also added an efficiency target of £150k as we aspire to driving improvements in the service to realise cash benefits. We have three Lean reviews underway in the "big three" processes of income management, voids and response repairs. With more reviews planned.

## 9 Stock Capital Investment.

**9.1** As part of the business plan review we have undertaken a review of the current stock investment data. This results in a refresh of our 30 year capital investment requirements. Adjustments have been made for example for the stock that will be removed because of the North Taunton project. The stock investment of £159.1million, is an average £28,032 per property over 30 years, is in line with benchmarks for similar authorities. This data drives the planning for our Major Works capital programme.

## 10 Right to Buy (RTB) Receipts

**10.1** The RTB scheme is a government scheme that enables tenants to purchase their homes at a discount, subject to meeting qualifying criteria. The scheme saw the maximum discount increase significantly in 2012 to up to £75,000 followed by a steady increase year on year to up to £82,800 in April 2019.

**10.2** In 2012 Taunton Deane Borough Council signed up to a "1-4-1 Agreement" with the Treasury/MHCLG to retain a higher proportion of RTB the additional receipts on the proviso, and agreed that these receipts would be used to fund new social housing. This agreement continues now under SWT until such time as the Council decides to opt out. Only a small percentage of receipts from RTB sales are retained by the Council. These additional RTB receipts can only account for 30% of spend on new social housing costs, with the remaining 70% coming from other funds such as revenue funding or borrowing.

**10.3** The RTB receipts cannot be used in the same scheme as other Government funding such as grants from Homes England. They must also be spent within three years of the capital receipt, or must be returned to Government with interest at 4% over base rate from the date of the original receipt. Receipts can be returned to Government in the quarter in which they are received with no interest payable.

**10.4** Alternatively, the 30% RTB funding could be granted to and used by Housing Associations in the area, providing they meet the same match funding requirements. The new housing doesn't need to be provided by the Council.

**10.5** To date, the Council has successfully spent all of their retained 1-4-1 receipts resulting in no returns being made to the Treasury/MHCLG.

a. **RTB Receipts Year to Date**: Table 4 below shows the number of RTB sales, the total (capital) receipts received under the new RTB discount scheme, the Council retained 1-4-1 receipts to be used for new social housing, and the total amount that would need to be spent by the Council in order to fully retain them.

Table 4: Right to Buy receipts

| | Total 2012/13 | Total 2013/14 | Total 2014/15 | Total 2015/16 | Total 2016/17 | Total 2017/18 | Total 2018/19 |
|---|---|---|---|---|---|---|---|
| Sales | 37 | 47 | 35 | 38 | 44 | 53 | 34 |
| Total Receipts (£k) | 2,330 | 2,705 | 2,317 | 2,666 | 3,568 | 3,971 | 2,576 |
| 1-4-1 Receipts (£k) | 1,234 | 1,230 | 1,005 | 1,193 | 1,864 | 2,069 | 1,149 |
| 1-4-1 Receipts Spend - Per Year (£k) | | | | 1,234 | 1,230 | 1,005 | 1,193 |
| Match Funding Spend - Per Year (£k) | | | | 2,879 | 2,871 | 2,345 | 2,783 |
| **Total Spend Required - Per Year (£k)** | **-** | **-** | **-** | **4,112** | **4,102** | **3,350** | **3,976** |
| Total Spend Required - Cumulative (£k) | - | - | - | 4,112 | 8,214 | 11,563 | 15,539 |
| Average number of units per year | | | | 25 | 25 | 20 | 24 |

| | Total 2019/20 | Total 2020/21 | Total 2021/22 | Total 2022/23 |
|---|---|---|---|---|
| Sales | 35 | 32 | 32 | 32 |
| Total Receipts (£k) | 2,317 | 2,576 | 2,576 | 2,576 |
| 1-4-1 Receipts (£k) | 1,005 | 1,149 | 1,149 | 1,149 |
| 1-4-1 Receipts Spend - Per Year (£k) | 1,864 | 2,069 | 1,149 | 1,005 |
| Match Funding Spend - Per Year (£k) | 4,349 | 4,829 | 2,681 | 2,345 |
| **Total Spend Required - Per Year (£k)** | **6,213** | **6,898** | **3,830** | **3,350** |
| Total Spend Required - Cumulative (£k) | 21,752 | 28,650 | 32,480 | 35,829 |
| Average number of units per year | 38 | 42 | 23 | 20 |

[Note that the grey data is estimated.]

**Forecast Spend of RTB Receipts**: The estimated spend on approved schemes, such as Outer Circle and Laxton Road, together with additional open market buybacks, will be sufficient to meet the RTB match funding requirements to quarter 4 of 2019/20.

b. Looking forwards over the next three years, there are a number of new build and off-the-shelf buybacks being investigated that, if approved by Full Council, together with a minimal amount of open market buybacks, will see our RTB match funding requirements achieved for the next three years.

c. This will support the aspiration for an additional 1000 homes in the next 30 years, being able to achieve this with 30% match funding from RTB Receipts, whilst ensuring we do not have to return our RTB receipts (plus interest) back to the Government.

d. However this will require significant borrowing, which is now possible since the removal of the debt cap, and will have to be managed carefully within the overall 2020 Business Plan to ensure that the revenue account can fund the interest payments and principal loan repayment.

## 11 Welfare Reform

**11.1** The 2012 HRA Business Plan made a provision for Welfare Reform, as there was an expectation that the changes would lead to an increase in non-payment of rent and other charges. The Provision for Bad Debt was increased from 0.5% to 2% (c£500k) for three years.

**11.2** The 2016 HRA Business Plan extended this provision to cover the delayed roll out of Universal Credit, again with the expectation that the changes would lead to an increase in non-payment of rent and other charges. The Provision for Bad Debt was maintained at 2% (c£500k) for a further three years.

**11.3** Whilst new claimant's moved to the new Universal Credits scheme from 2016, the migration of existing claimants has experienced continued delays. It is also worth noting that the Universal Credit scheme pays claimants in arrears and not in advance, as we currently expect our rental payments to be made.

**11.4** The 2020 Business Plan includes a new two year provision at 0.75% (£180k) of dwelling rental income, dropping to 0.5% thereafter, to mitigate the financial risk associated with a possible increase in unrecoverable rental income due to the forthcoming "managed migration" to the Universal Credit scheme that is indicated to be completed by March 2023.

**11.5** Under the Council's wider Financial Strategy the Executive has agreed a new Operational Target of £2.4m for the minimum HRA general reserve balance. Remaining at or above this target provides added financial resilience to bad debt (and other) financial risk if needed.

## 12 Business Growth – Development of New Homes

**12.1** The Business Plan has previously included significant annual contributions of £1m (from 2015/16) towards the development of housing schemes. In line with the introduction of a Development Strategy, the Business Plan in 2016 instead included an average annual addition of 15 dwellings, which would include a combination of new development, redevelopment and acquisitions. This level of investment was what was affordable at this time.

**12.2** Since this time we have delivered 108 units via new build and over 50 acquisitions to date. This is an average of 20 units per year since self-financing in 2012.

**12.3** However as described above the removal of the debt cap allows for more investment in housing growth, we aspire to do more, so are proposing a target of delivering 1000 new homes over the next 30 years, the life of this plan. In order to deliver this number of new homes (an increase of 140% of our current rate of development) will require us to diversify our new homes delivery approach, seek other forms of funding for example from Homes England and to cultivate an extensive new scheme pipeline.

**12.4** This growth will require a significant increase in borrowing, which will place greater stress on the business, this is discussed in later sections of this report. The need for the business to drive efficiency, achieve consistent levels of strong performance across key processes and closely monitor new metrics will be vital to safely manage this higher level of gearing.

**12.5** With this increased provision, but due to losses through RTB and regeneration of defective stock, the total stock numbers are set out in the table below:-

**Table 5:** Forecast General Needs Stock Numbers

| Financial Year | 2020/21 | 2021/22 | 2022/23 | 2023/24 | 2024/25 | 2025-2050 |
|---|---|---|---|---|---|---|
| **Opening Stock** | 5,750 | 5,747 | 5,730 | 5,724 | 5,755 | 5,761 |
| **RTB Sales** | -32 | -28 | -24 | -20 | -19 | -364 |
| **Demolition** | -13 | -12 | -22 | -11 | -25 | -79 |
| **Development Gains** | 42 | 23 | 40 | 62 | 50 | 832 |
| **Closing Stock** | 5,747 | 5,730 | 5,724 | 5,755 | 5,761 | 6,150 |
| **Net Gain Over 30 Years** | | | | | | 400 |
| **Total Development Gains Over 30 Years** | | | | | | 1,049 |

## 13 Treasury Management and Repayment of Borrowing

**13.1** The Business Plan incorporates significant capital expenditure which is to be funded from capital receipts, the Major Repairs Allowance (depreciation charges reinvested in assets), revenue contributions to capital, capital grants and borrowing.

**13.2** The funding and cash flow implications will be managed in line with the Council's Capital, Investment and Treasury Strategies which is approved alongside the annual budget each year.

**13.3** Although the Government abolished the HRA Debt Cap established in 2012 (£115m) it is proposed to set a prudent debt cap for the HRA.

**13.4** In the first 5 years of the business plan the Provisional Debt Cap is at £135m in Year 1 rising to £148m by Year 5 of the Plan. Then rising further in future years to a peak of £266m in Year 30. The cap will need to be kept under review and be adjusted to reflect performance against plan. It is proposed to use the Debt Cap as the Operational Boundary for Debt within the Capital Strategy. Allowing for some temporary refinancing or financing in advance of need (where it is prudent to do so for treasury purposes), it is proposed to set the Authorised Limit based on the Debt Cap + £20m.

Table 6 –HRA Borrowing Limits

| Borrowing Limits for the HRA | 2020/21 Estimate £k | 2021/22 Estimate £k | 2022/23 Estimate £k | 2023/24 Estimate £k | 2024/25 Estimate £k |
|---|---|---|---|---|---|
| Debt Cap / Operational Boundary | 135 | 135 | 135 | 139 | 148 |
| Authorised Limit | 155 | 155 | 155 | 159 | 168 |

**13.5** The capital investment proposed within the plan forecasts a borrowing requirement rising year on year from £110m in 2020/21 (Yr1) to a peak of £164m in 2030/31 (Yr11), before reducing back to £129m by 2048/49 (Year 29). This forecast incorporates borrowing for projected capital investment spending and amounts set aside from revenue resources to repay debt based on affordable MRP costs, whilst maintaining reserves at the operational target.

**13.6** Existing maturity loans undertaken in March 2012, as part of the transition to the HRA operating on a self-financing basis, are due to be redeemed each year between 2020 and 2030. In order to meet the capital financing requirement in the plan these loans will need to be refinanced. The business plan forecasts assume a degree of internal borrowing from HRA reserves and working capital cash balances. It will be necessary to utilise external borrowing facilities and the business plan is modelled on a basket of fixed term maturity loans only where needed to meet cash flow requirements, at an average interest rate of 3.5%. This is currently considered to be a prudent assumption for the business plan.

**13.7** The Section 151 Officer will work with Arlingclose, the Council’s treasury advisor, to explore appropriate sources of finance which may include PWLB but other options such as banks and other capital markets will be explored to optimise debt costs and risk.

## 14 New Capacity Indicator

**14.1** The proposition within this analysis is that, whilst there is theoretically now no limit to borrowing within the HRA, the existing asset and operating base generates a net income stream that does offer a logical limit on sustainable borrowing levels. In other words future operating surpluses created within the HRA can be used to fund the interest on additional borrowing.

We have utilised the Interest Cover Ratio (ICR) as the main metric for assessing capacity and is used to derive the provisional debt cap figure 3 below.

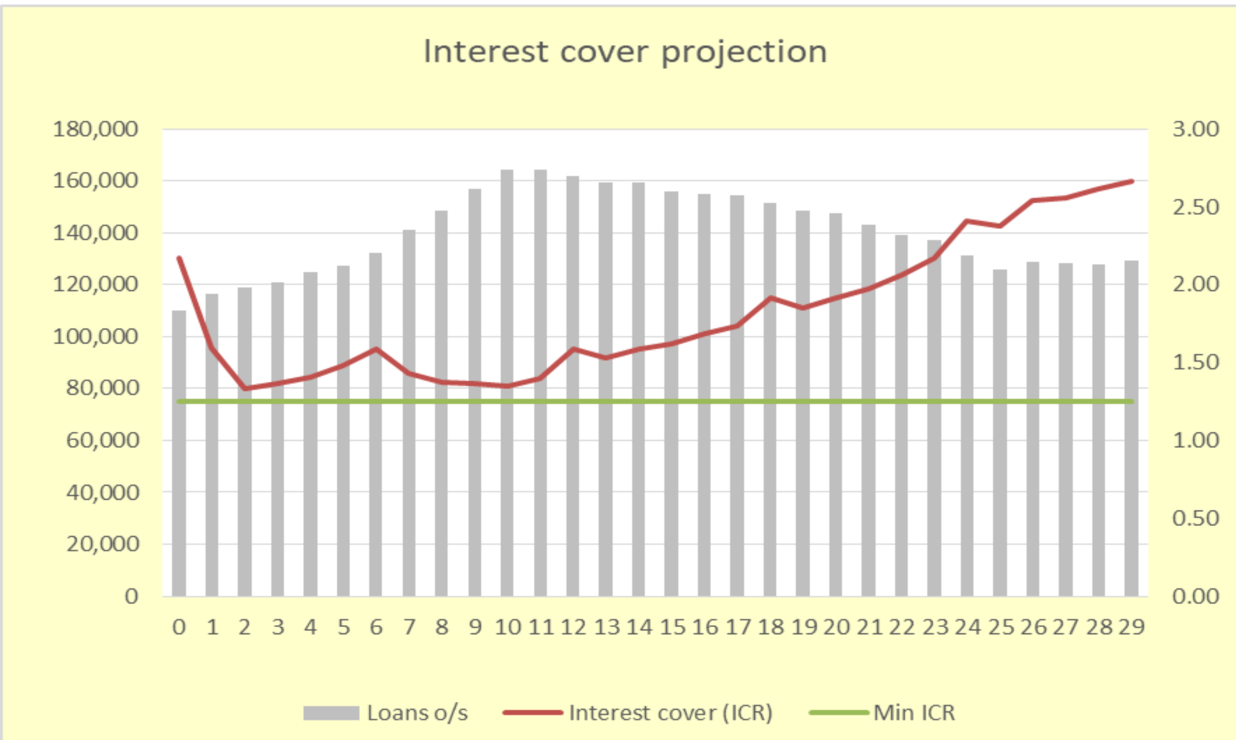
**14.2** This is the ratio of operating surplus divided by interest costs, and represents the cover that the HRA has against its interest cost liabilities in any year; the ICR is set to a minimum which provides comfort that if there were a sudden drop in income or increase in operating costs, there would be sufficient headroom to continue to cover debt interest. For housing associations (HA), the usual definition of operating surplus is EBITDA (Earnings before Interest, Tax, Depreciation and Appropriations). Typical lending covenants vary between 1.10 and 1.50 depending on the size and nature of the HA, with 1.25 being a typical expectation.

**14.3** Using the budgets for 2020.21 the ICR is forecast at 1.60 meaning that the HRA can cover the current interest charges with headroom for a further 60% of the value of interest charges (subject to other cost/income variances). By setting the minimum ICR at 1.25 the available headroom for additional interest is 28% of current interest charges or £0.762million. This translates to additional borrowing capacity of £32million.

**14.4** As the plan does in fact increase the need to borrow in the short to medium term it utilises the borrowing capacity to the point where the ICR falls to 1.33 in 2021.22 but with the benefit of projected rent increases it rises to 1.37 and then gradually increases after year 10 to a ratio of 2.66 at the conclusion of the plan.

**14.5** Therefore the borrowing projected in this plan is below the level of borrowing where the ICR is at the 1.25 minimum level set and is therefore forecast to remain within affordable limits. The chart below shows the annual ICR set against the minimum 1.25 and the actual borrowing forecast in the plan.

*Figure 1: Interest Cover Projection*




## 15 Financial Review and Appraisal

**15.1** As described above there are a number of changes, driven by both internal and external factors, which have substantially impacted on the financial position of the Business Plan. Overall indications are that planned service and capital investment is affordable in the medium and long term providing actual performance remains similar to the assumptions made.

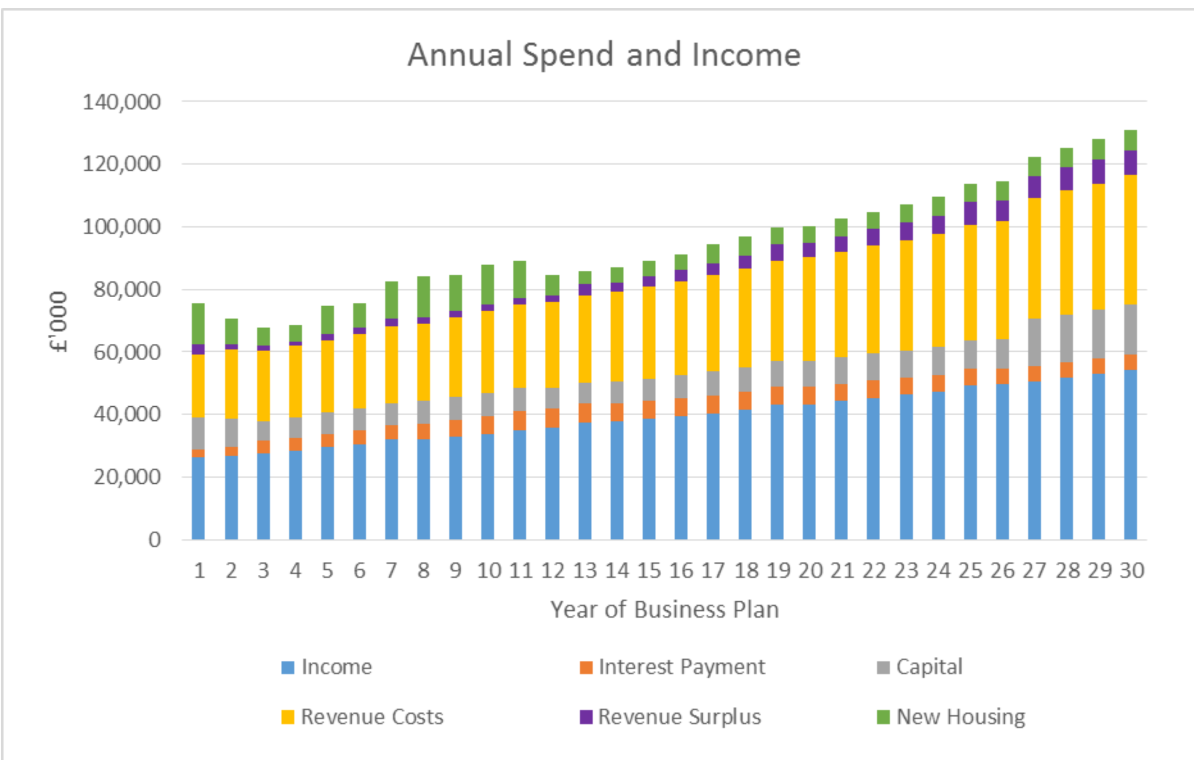
15.2 The increased ambitions for capital investment require a significant increase in borrowing over the next 10 years, taking advantage of the increased flexibility through the abolition of the debt cap. There is a clearly a related impact on overall debt costs which must be managed throughout the life of the business plan.

15.3 The strategy applied in the financial model is that HRA general balances will be maintained at the operation target level, with all available operating surpluses applied to meeting interest costs, protecting reserves balances, reducing capital financing requirements and debt repayment. This works on the principle that debt will be repaid at the earliest opportunity, which is a change to the current approach of a fixed annual debt repayment charge based on borrowing over 60 years. This approach should reduce total debt costs in the long run, benefiting the business plan.

15.3 The key underlying assumptions within the Business Plan are that rents and service charges will increase by CPI + 1% for the first five years (20/21 to 24/25) then reducing down to CPI (estimated at 2%) only thereafter, with expenditure inflating in line with government forecasts by 2% (management costs at 2.5%) and borrowing costs at 3.5%. These rates are only estimated and risk changing due to the global economic environment.

15.4 A summary of the projected annual expenditure and income is shown in graph below.

**Figure 2 -Annual Expenditure and Income within the Business Plan**



**15.5 Income**

The HRA is self-contained from the General Fund and fully funded in the main by rental and service charge income from tenants. Members need to consider the cumulative financial impact of their decisions surrounding the change in rental and service charge income year on year.

15.6 The new Rent Policy provides the option to make a one-off 5% or 10% increase in rents for new tenants which would provide an estimated additional income of £100k in year 1 assuming 450 new tenancies. Where options are presented to increase rents within the boundaries of national policies these should be considered in order to optimise income to meet the costs of operating the service and capital investment.

15.7 Rental income forecasts are based on prudent assumptions for rental growth and changes in housing stock both through RTB sales and additions through investment. There is not a direct like for like relationship between income and costs therefore material changes in income levels cannot necessarily be offset by managed changes in costs without affecting service standards.

15.8 Experience shows that housing income estimates can be susceptible to national policy changes, which can have a material impact on long term cash flows. The current business plan forecasts assume the current policy will be fully applied with rent increases returning to CPI only from April 2025.

15.9 Members are advised to carefully consider long term impact on the affordability of the business plan when making decisions regarding local rent policy and budgetary decisions, and also to note the inherent risk of interest rate volatility on income assumptions and related impact of affordability of planned spending and investment, and meeting debt repayment obligations.

15.10 It is good to see changes within the debt recovery team seeing immediate effects on recovering debts due from tenants thus reducing the financial risk and enabling a lower allowance for bad debt risk within income forecasts. This will clearly need to be carefully monitored to ensure prudent provisions are made each year.

**15.11 Expenditure**

15.12 The borrowing cap has been removed enabling the HRA to increase borrowing to fund the national and local ambitions to increase the provision of affordable homes. The overall 30-year Business Plan projects a total capital investment of c£159m on Major Works, £16m on exceptional and extensive works which primarily relate to asbestos removal and works to non-traditional properties, £9m on Disabled Adaptations, £6.5m on improvements and fire safety works, £3m on related assets and £3.6m on vehicles.

15.13 The Business Plan model suggests that this is viable and affordable, and that the HRA maintains a level of interest cover above 1.25% over the 30 years. To put this into context, the average interest cover for the Housing Association (HA) sector in 2018/19 typical lending covenants varying between 1.10 and 1.50 depending on the size and nature of the HA, with 1.25 being a typical expectation.

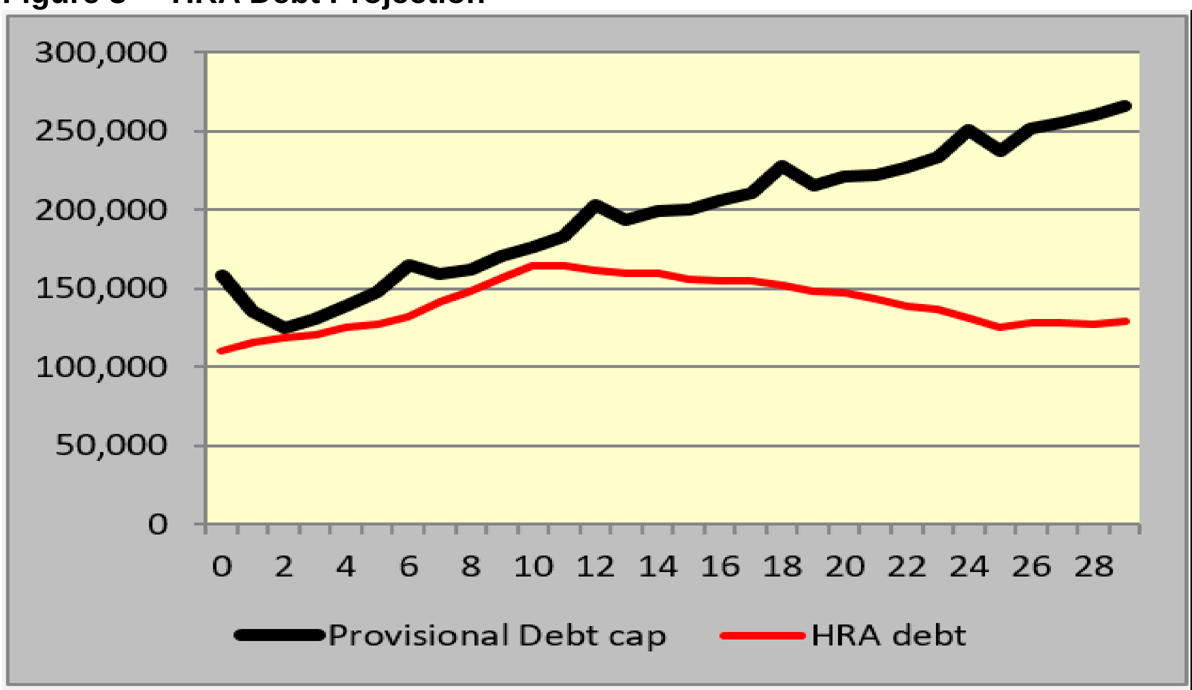
15.14 These ambitions will need to be managed closely to ensure that the interest cover is not breached and that the HRA revenue account can cope with the impact of financing debt, as current levels of surplus funds in earmarked reserves and general balances (minimum balances now at £2.4m to mitigate financial risk) are minimal.

15.15 The business plan assumes that there will be no net reduction in debt during the first 10 years (between 2020 and 2030) as capital investment grows and debt is increased, with the overall debt balance starting to reduce in 2030/31. However, revenue contributions to capital will still be made during the period reducing the requirement for additional borrowing.

15.16 Those loans maturing within the next 10 years total of £77.5m with an average interest rate of 2.49% (ranging from 0.92% to 3.21%). The current cost to finance these loans is approximately £2.122m, when refinanced at an assumed 3.5% this will create an additional cost pressure of c£589k. The Business Plan assumes that new borrowing will be at 3.5%, therefore for every £10m borrowed this creates an interest payable cost pressure of £350k. Options to reduce the capital financing costs / interest burden will be explored through the Council's treasury management arrangements.

15.17 After the peak in capital investment in 2029/30 (year 9), the Business Plan prioritises the repayment of debt at earliest opportunity, as seen by the reducing debt shown in graph below.

**Figure 3 – HRA Debt Projection**




15.18 The HRA is seeing increased demands from the increased costs of direct and shared support service staff, to fund a share of future corporate change programmes, increased interest costs and risk, and the increase in depreciation costs from the additional 1,000 homes over the next 30 years. The revenue account will need to realise cost efficiency savings (currently at £150k ongoing within the first 2 years) to redirect into other cost pressures. This ambition to find efficiency savings may have to be increased where possible to provide further headroom in order to deliver future ambitions such as carbon retrofit.

**15.19 Reserves**
The HRA 2020 Business Plan has, under the Council's wider Financial Strategy, agreed a new Operational Target of £2.4m for the minimum HRA general reserve balance to mitigate financial risk are minimal. The current levels (19/20) of general balances are in excess of £2.4m, though surpluses above this are minimal.

15.20 Earmarked reserves surpluses are also minimal with 50% of the 19/20 opening balances committed to be spent by 2021/22 and the other 50% committed to social housing development feasibility studies as part of the aspiration to build new homes. Whereas previous business plans projected large increases in reserves in the long term, the increased capital investment and related borrowing, and the priority to repay debt at the earliest opportunity means that reserves are projected to remain 'only' at the operational target throughout the life of the Plan.

## 16 Key Sensitivities and Stress Testing

**16.1** The baseline Business Plan has been subject to a standard range of stress testing to test the sensitivity of the outputs to changes in key assumptions. These are summarised in the table below. It is important to understand what external influences could have on the plan.

**16.2** The table below shows the key assumptions within the business plan before sensitivities are applied:

Table 7

| | |
|---|---|
| CPI (Base Inflation) | 2 throughout from 2021.22 |
| Rents Inflation | CPI +1% 4 years from 2021.22 then CPI only |
| Service Charge Income | CPI +0.5% throughout from 2021.22 |
| Non-Dwelling Income | CPI -0.5% throughout from 2021.22 |
| Other Income | CPI only |
| Management Costs | CPI+0.5% throughout from 2021.22 |
| Repairs Inflation | CPI only |
| Improvements | CPI only |
| Interest Rate | 3.5% on new borrowing |
| Right To Buys | 33 reducing to 11 gradually over a 30-year period |
| Buy-Back Values | £165,000 per unit (30% of total notional programme) |
| New Developments | £145,000 per unit (70% of total notional programme) |

The table below compares a range of scenarios against the impact and the consequent impact on our ICR level.

Table 8 Key Sensitivities

| | **30 yr Reserves** | | **Closing Debt** | | **Min/Max ICR** | |
|---|---|---|---|---|---|---|
| Baseline plan | **£4.3m** | | **£129.1m** | | **1.33 / 2.66** | |
| 1.Inflation CPI - 1% / 3% | £3.2m | £5.6m | £156.4m | £95.9m | **1.22**/2.17 | 1.36/4.46 |
| 2.Management Costs | £4.3m | | £108.2m | | 1.34/3.42 | |

| | | | |
|---|---|---|---|
| & Service Charges increase CPI+0.25% pa | | | |
| 3.Management Costs & Service Charges increase CPI+0.75% pa | £4.3m | £151.1m | 1.29/2.17 |
| 4.Repairs & Investment increase CPI+1% pa | £4.3m | £220.2m | **1.25**/2.17 |
| 5.Repairs & Investment increase CPI+1% and Management Costs & Service Charges at 0.75% pa | £4.3m | £242.4m | **1.06**/2.17 |
| 6.Rents CPI+0.5% all years from 2024 | £4.6m | £47.1m | 1.33/8.6 |
| 7.Right to Buys at 20 per Year throughout | £4.3m | £119.6m | 1.33/2.72 |
| 8.Interest Rate Increase 1% | £4.3m | £194.8m | **1.02**/2.17 |
| 9.Bad Debt Provision 1% of rents | £4.3m | £137.4m | 1.31/2.47 |
| 10. Development & Buy Back Costs +10% | £4.3m | £153.0m | 1.30/2.27 |

**16.3** The main headlines from the tables are:

- The plan is generally resilient to changes in its key inflationary and expenditure drivers.

- The plan does not rely upon the management of revenue expenditure in line with rent income.

- The plan relies upon the management of the capital programme within the inflationary drivers provided.

- If rent policy was to be extended to CPI+1% increases in **all** years from 2020, including from 2024, the outlook for the plan would be much improved.

**16.4** In sensitivity 1 where inflation is greater than the 2% factored in presents a more viable plan where forecast debt could be reduced to 74% of the projected level. Whilst a reduction in inflation has a negative impact to the plan where debt would increase by c21% and the ICR lowest point is 1.22, below the minimum 1.25. For business planning purposes it is considered appropriate at this stage to assume that long-term inflation will be in-line with Government estimates of 2%.

**16.5** In sensitivities 2&3 the plan demonstrates how reactive it is to increases above CPI for management costs, which form a major part of the overall HRA expenditure. By reducing the management increases to 0.25%+CPI the plan improves with greater comfort with the ICR well above the minimum mark and will lower residual debt. Increases the costs to 0.75%+CPI puts pressure on the plan with a higher closer debt by c17% and the lowest ICR close to the 1.25 minimum.

**16.6** An increase in repair and capital costs year on year would also impact on the plan significantly against the backdrop of CPI only rent increases in the longer-term as demonstrated in sensitivity 4. The Council would to review the delivery of the repairs service but also could reduce the level of its future development programme to compensate. It would be most likely that if such costs increase the impact would likely to be national rather than locally and therefore pressure from the housing sector would probably result in rent increases above CPI to compensate. This sensitivity does cause the lowest ICR to equal the minimum level of 1.25.

**16.7** In sensitivity 5 we have demonstrated a worst case scenario of both management costs and repairs increasing as per sensitivities 3 & 4 combined, with the ICR lowest point well below the minimum ICR.

**16.8** Obviously rent increases above will bring a huge benefit to the HRA which rather than using entirely for debt repayment could be used to facilitate further borrowing for additional house building and acquisition as demonstrated in sensitivity 6.

**16.9** The increase of right to buys does impact upon the plan in that there is a loss of rental income as shown in sensitivity 7 but also increased sales provides for more right to buy receipts to be facilitate subsidising the development programme.

**16.10** A key risk to the plan is the cost of borrowing as shown in sensitivity 8 where an increase of 1% causes the lowest ICR to go below the minimum level. It is likely that new borrowing will be at fixed rates determined at the point of drawdown to provide protection against future increases. The business plan will become an important tool in determining if the new build programme could be afforded in light of higher interest costs.

**16.11** In sensitivity 9 an increase in the level of bad debts has a negative impact to the plan but does not impact upon the minimum ICR.

**16.12** Sensitivity 10 shows that a 10% increase to the allowance for buy-backs and cost of new development will have an adverse impact on long-term borrowing.

**16.13** With regards to the above sensitivities there are mitigating factors that the Council can apply, for example reducing the level of new builds and acquisitions, in the face of adverse impacts from scenarios identified above.

## 17 Achieving Affordable Warmth & Carbon Neutrality

**17.1** The UK has committed to reduce greenhouse gas emissions and have set legally binding targets to achieve net zero emissions by 2050. Somerset West & Taunton Council (SWT) have published their draft framework “SWT Carbon Neutrality and Climate Resilience Plan”. The Housing service has drafted a strategy which sets the ambition and initial focus for the Housing service and would be intended to support the corporate framework with a strategic approach for achieving these objectives within the managed housing portfolio of SWT. In summary we would seek to provide low carbon, energy efficient housing for our tenants, that are both affordable and warm to live in and in doing so we will aim to achieve net zero emissions in our housing stock by 2050. This will also provide the platform required to eradicate fuel poverty. We would do this by delivering a package of affordable warmth retrofit works to our properties.

**17.2** However in order to achieve this alongside our ongoing Decent Homes capital programme a further investment commitment is required, to date it has not been possible to safely develop this capacity in the business plan. However officers will continue to work on this issue and investigate how we might fund such works and report back to members in due course and as a priority.

## 18 Links to Corporate Strategy

a. The Housing Revenue Account compliments the Council's Corporate Strategy 2020 - 2024 - Homes and Communities – to offer a choice of good quality homes for our residents, whatever their age and income, in communities where support is available for those in need.

b. As set out above the service will significantly increase the number of affordable homes in the District, alongside substantial investment in existing homes and providing essential support to our residents many of whom experience significant hardship.

## 19 Legal Implications

No direct implications arising from this report.

## 20 Safeguarding and/or Community Safety Implications

None directly relating to this report.

## 21 Equality and Diversity Implications

An Equality Impact Assessment (EIA) and some associated actions has been included at Appendix 3.

## 22 Social Value Implications

Social Value forms an important part of the selection criteria for the procurement of works in particular, the Housing Service will continue to seek ways in which its investment can have the widest possible reach.

## 23 Partnership Implications

The Housing service will continue to work with key partners to deliver its objectives and benefit our communities.

## 24 Health and Wellbeing Implications

The Housing service makes a substantial contribution to improving community health and wellbeing.

**25 Asset Management Implications**

A review of Asset data has been included in the main body of this report for the purposes of future investment planning. The Housing (HRA) Asset Management Strategy 2016 reflects the challenges the Council faces and improving its focus on value for money for the Council and for our residents:

- **To promote sustainable local communities** through coordinated capital investment and housing management.
- **To work closely with residents** to ensure that their homes meet their needs and aspirations.
- **To invest in stock**, to achieve good quality and environmental standards and to ensure that all statutory obligations are met.
- **To ensure that stock secures and strengthens the financial viability** of the business plan and safeguards its long term future and the income stream it generates.
- **Deliver Value for Money** through targeting investment where it will have the best financial and social return.
- **To carry out options appraisals** on stock that does not meet the above criteria, exploring the widest range of alternative options to improve outcomes for residents and for our business plan.
- **To deliver investment programmes in an effective way**, achieving agreed quality and value for money.

**26 Data Protection Implications**

None directly from this report.

**27 Consultation Implications**

No external consultation implications.

**28 Scrutiny Comments / Recommendation(s)**

Democratic Path

- **Tenants Strategic Board – 15 January 2020**
- **Scrutiny Committee – 20 January 2020**
- **Executive – 22 January 2020**
- **Full Council – 19 February 2020**

**Reporting Frequency:** ☐ **Once only** ☐ **Ad-hoc** ☐ **Quarterly**

☐ **Twice-yearly** ☐ **Annually**

**List of Appendices (delete if not applicable)**

| | |
|---|---|
| Appendix 1 | Housing Vision Statement - PPT |
| Appendix 2 | SWT Proposed Rent Policy |
| Appendix 3 | Equalities Impact Assessment |
| | |

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