REPORT TO:	**HOUSING AND COMMUNITY SERVICES COMMITTEE**	**AGENDA ITEM: 9**
DATE OF MEETING:	**7th FEBRUARY 2013**	**CATEGORY: RECOMMENDED**
REPORT FROM:	**CHIEF EXECUTIVE OFFICER**	**OPEN**
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SUBJECT:	**HOUSING REVENUE ACCOUNT BUDGET 2013/14 Including Proposed Rent Increase and Longer Term Financial Projection**	**REF:**
WARD(S) AFFECTED:	**ALL**	**TERMS OF REFERENCE: HC 01**

1.0 Recommendations

1.1 That an average rent increase of 5.6% (£3.93 per week) is considered and approved for 2013/14 in accordance with Government guidelines for tenanted properties.

1.2 That the average rent increase is adjusted for individual tenants in accordance with the Rent Restructuring Formula.

1.3 That the proposed estimates of income and expenditure for 2013/14 for the Housing Revenue Account are considered and referred to the Finance and Management Committee for approval.

1.4 That the updated financial projection, including the associated assumptions and analysis for the Housing Revenue Account to 2024 is considered and approved.

1.5 That options for utilising additional resources are considered.

2.0 Introduction and Purpose of the Report

2.1 As part of the annual financial planning cycle, the report details the Housing Revenue Account's (HRA) base budget for 2013/14 together with an updated financial forecast to 2024. The report also sets out details of the proposed rent increase and options for 2013/14 under the Government's National Rent Setting Policy.

Self Financing

2.2 As previously reported, 2012/13 is the first year under the self-financing framework. This was implemented following the take-on of debt, together with a business and financial plan which is now being progressed.

2.3 This is the first detailed review of the base budget and financial projection under the new framework. A review of the HRA Business Plan was undertaken following the final settlement and take on of debt. Although this is a 30-year plan, the increased importance of it in ensuring the financial viability and stability of the HRA, a process of full review every two years is now planned.

2.4 Reviews are also currently taking place to implement a future strategy for delivering New Build/Affordable Housing and the procurement of capital works.

3.0 <u>Detail</u>

3.1 The HRA's base budget and 10-year financial projection is detailed in **Appendix 1**. This shows a summary of each main income and expenditure head within the HRA for 2012/13 to 2023/24, together with the yearly surplus/deficit and balance on the HRA's general reserve.

3.2 This also shows how future surpluses will be built up to repay debt in accordance with the Council's Treasury Management Strategy.

Formulating the 2013/14 Base Budget

3.3 The estimates are generally based on service levels in 2012/13 continuing and include any full year effects of previous year's growth and service restructures. However, a detailed review of the base budget in day to day spending areas has also been undertaken to reflect the most up to date position.

3.4 The Committee approved a revised staff restructure in November 2012. This was subject to a consultation period, together with the outcome of the 2013/14 Budget Round for the HRA. The effects of this have not been included in the proposed budget at this stage.

3.5 The restructure will increase staffing costs in the HRA, although it has been proposed to finance these costs by a planned reduction in day to day repairs expenditure to reflect recent spending patterns in this area.

Planning Period

3.6 A rolling 10-year financial projection is considered to be a relevant planning period as it accords with the approved debt maturity profile and ensures focus is maintained on the longer-term.

3.7 An overall 30-year Business Plan will continue to focus on stock investment in line with available finance and tenant aspirations. This is also considered to be good practice and a good tool in the self-financing regime to demonstrate to all stakeholders that the housing business is sustainable.

Summary

3.8 **Appendix 1** shows the base budget 2012/13 and 2013/14, with projections for the following 10 years to 2024. **Appendix 2** shows the proposed base budget for 2013/14 compared to that projected in the previous 10-year financial projection.

3.9 **Appendix 3** then provides an overall reconciliation on the change between the previous and updated projections; this shows the effect of changes to the proposed base budget in 2013/14 over the 10-year planning period.

3.10 The figures show that the HRA continues to be sustainable and can deliver the required capital investment in the stock (as planned) and make the necessary surpluses in future years to repay debt – also as originally planned.

3.11 Compared to 2012/13, there is a much improved position over the longer term planning period (subject to future rent increases). This is mainly due to additional rental income as void properties are relet at Formula Rent, in accordance with the approved policy introduced in 2011/12.

3.12 In addition, there is a higher increase in rents in 2013/14 in accordance with national rent convergence - <u>if this is approved.</u>

3.13 This increases the base rental amount and therefore, as an on-going and cumulative effect over the financial planning period. Rents and options on future levels are considered in detail later in the report.

3.14 Interest costs are also expected to be lower due to the average interest rate on debt take-on being lower than anticipated. The effect of this was reported to Finance and Management Committee in June 2012 and has now been built into the projection.

3.15 Furthermore, the HRA starting position under self-financing was much better due to the overall under spend on the HRA in 2011/12. This increased the opening reserve balance on 1st April 2012 by approximately £458,000. Costs and the updated HRA reserve are also detailed later in the report.

The Updated Projection

3.16 **Appendix 1** shows the cumulative balances on the HRA and Debt Repayment Reserves by 2024. Compared to the previous projection (shown in <u>Appendix 4</u> for information) resources have increased overall by approximately £2.3m **<u>over 10-years</u>** as shown in the following table.

Increase in Property Rents	-£1,493,593
Decrease in Other Income	£173,508
Decrease in Interest payments	-£380,063
Decrease in Other Costs	-£167,788
Sub Total	**-£1,867,937**
Increase in Opening Reserve	-£458,047
Increase in Resources	**-£2,325,984**

3.17 This has increased the HRA Reserve which is now projected to be approximately £3m by 2024, well above the approved minimum level of £1m.

3.18 An analysis of the main assumptions, risks and changes between projections is detailed in the following sections.

General Inflation

3.19 Where applicable, a rate of 2.5% has been included year on year for items of income and expenditure (excluding rents). This is based on a general index of longer-term inflation rates.

3.20 Inflation in the early years of the Plan to 2015/16 could be lower due to the Government's proposals for capping pay increases in the public sector.

Decrease in Other Income (excluding Housing Rents) - £173,508

3.21 This includes garage and shop rents, together with rechargeable repairs. It also includes charges for Lifeline equipment and the Telecare Service, together with contributions from the County Council for Supporting People.

3.22 These income levels have been reviewed to reflect the overall increase in 2011/12 and current levels in 2012/13. Although there is an estimated reduction in rechargeable repairs, this has been offset by increases in garage and shop rents.

Supporting People, Careline and Telecare Services

3.23 These services are subject to change with a degree of uncertainty regarding income from 2013/14. Charges and contributions are currently being agreed with the County Council who are looking to streamline amounts across the Council at reduced rates.

3.24 Within this, Supporting People Contributions have been increased from £270,000 to £350,000 per year (cash limited) – this compares to an actual of £414,000 in 2011/12. Other charges between 2012/13 and 2013/14 show a gain of approximately £11,000 overall. However, the previous projection assumed inflationary increases on Lifeline and Telecare charges.

3.25 These have now been cash limited across the 10-year financial period, pending new arrangements from April 2013. Overall, this decreases income compared to the previous projection by £173k over 10-years.

Interest and Repayment of the Debt Settlement

3.26 The Council took on the following debt maturity profile on 28th March 2012, financed through the Public Works Loan Board (PWLB).

LOANS

Interest Calculation	Maturity Date	Principal (£)	Period (Years)	Rate (%)
Variable	March 2022	10,000,000	10	0.70%
Fixed	March 2024	10,000,000	12	2.70%
Fixed	March 2027	10,000,000	15	3.01%
Fixed	March 2032	10,000,000	20	3.30%
Fixed	March 2037	10,000,000	25	3.44%
Fixed	March 2042	7,423,000	30	3.50%
	TOTAL	**57,423,000**	**18.7**	**2.78%**

3.27 As reported to Finance and Management Committee in June 2012, the average interest rate payable on the portfolio of 2.78%was slightly below that estimated at 2.8%. This reduces projected interest payable over the life of the 30-year HRA Business Plan by approximately £104,000.

3.28 However, the profile of this reduction is staggered over the life of the debt as shown in **Appendix 5**; lower interest rates were obtained for the first 3 loans with earlier repayment dates, whilst slightly higher interest rates are payable on the longer dated loans.

3.29 Therefore, the main saving will be accrued in this 10-year financial period (£172k) with a “cost” in the following 20 years of £68k, in total – as shown in Appendix 6.

3.30 In addition, there has been a further reduction in interest rates in recent months and this has reduced the variable rate of interest on Loan 1 from 0.7% to 0.6%. This will save £10,000 in a full year, although this interest rate can change every 6 months.

3.31 The projections for this variable rate debt allow for an incremental increase in rates of up to 5% by 2022.

3.32 It is considered that interest rates will now remain low until 2015/16 and then may only start to increase marginally after that. Therefore, this could generate some further savings in the future the longer interest rates remain historically low; this will be kept under review as part of the Treasury Management Strategy.

3.33 For clarification, interest rate movements only affect one loan of £10m in the portfolio. All other loans are fixed and are not subject to fluctuations. However, higher interest rate levels in the future, provide opportunities for debt restructuring and this will also be monitored in the Treasury Management Strategy.

HRA Debt (excluding the Self-financing Element)

3.34 Under self-financing, the Treasury Management Strategy allows a “two pooled” approach to debt management in accordance with accounting regulations. Accordingly, HRA debt is accounted for separately from the General Fund.

3.35 As approved, Council debt (pre self-financing) was allocated to the HRA at broadly the same level as currently charged. The current debt outstanding amounts to approximately £1.25m and this will be repaid over 20-years. The associated costs have been built into the projections.

3.36 A proportion of this debt is also at variable rates. As interest rates currently remain low, this allows some reduction in interest charges over the 10-year planning period compared to the previous projection.

Decrease in Other Costs (£167,788)

3.37 The proposed base budget is estimated to reduce in 2013/14 compared to 2012/13 by approximately £15,000. This is mainly due to staffing costs in Sheltered Housing. Some additional provision has been made for IT costs together with the replacement of equipment in sheltered accommodation.

3.38 The 10-year effect overall, is estimated at approximately £167,000 (decrease).

Housing Repairs

3.39 Besides servicing the debt take-on, the day to day budgets for repairs and planned maintenance spend remains the biggest cost in the HRA. It has been assumed that the current level will remain and increases only for inflation over the financial period; this has not changed from the previous projection.

3.40 This is an area that has been under spent in recent years. The budget for responsive repairs has been reviewed alongside the staffing restructure that was reported to the Committee in November 2012. If the final proposals are approved, this will reduce the housing repairs budget.

Capital Investment

3.41 The original projection built in the approved and additional capital investment in the housing stock following self-financing. This is estimated at approximately £27m between 2012/13 and 2016/17.

3.42 The Committee has approved a programme of works. This includes enhancements to planned maintenance and replacement programmes, together with new improvements and facilities. This programme has not changed although the profile and timing of some expenditure will now be delayed.

3.43 This is due to a procurement review being undertaken by the Council's External Auditors. This is to advise the Council on the best service delivery framework for delivering this investment. The review is due to report by the end of February 2013 and the outcome will be reported to the Committee.

Other Provisions

3.44 The financial projections continue to make separate provision in the HRA for additional capital salaries to support the capital investment programme (£50,000 per year), the pay and grading review (£22,000 per year) and Bad Debts (£20,000 per year).

Future Borrowing

3.45 To control the overall amount of borrowing, the Government have set a debt limit (or cap) for each authority. This applied on 1st April 2012 and is fixed. It is based on the underlying borrowing requirement calculated by the Government for self-financing.

3.46 The Council's debt cap is £67.1m. After allowing for the debt take-on of £57.4m and current debt of £1.25m, this leaves borrowing "headroom" of around £8.5m.

3.47 To conform to the National Prudential Capital Financing System, any future borrowings will need to be affordable within the overall Business Plan. However, this "headroom" does provide flexibility for future capital investment decisions.

Right to Buy Receipts (RTBs)

3.48 Under self-financing, pooling of capital receipts from the sale of council houses continues to apply. This means that 75% of proceeds (minus allowable administration costs) are paid to the Government. In accordance with Council policy, the remaining 25% is available for investment in the HRA stock.

Changes to RTB Legislation

3.49 With the implementation of the self-financing framework, Council policy is to reinvest all receipts (after the 75% pooling payment to Government) from the sale of council houses into the housing stock.

3.50 Under the Government's model for the debt settlement, it was assumed that a certain level (or target) of council house sales would continue each year and this was reflected in the Council's debt take-on.

3.51 This was set at an average of 9 sales per year over the 30 year financing period (258 in total). Once the annual target is reached, further sales trigger a separate pooling calculation which is designed to ensure a greater proportion of capital receipts can be retained locally to be reinvested in New Build Expenditure.

Government Guarantee

3.52 As previously reported, the Council entered into an Agreement with the Government to enable it to retain receipts above the annual target. The pooling mechanism calculates, after allowing an amount for the debt associated with each unit sold, a net figure that is retained and that must be spent on New Build within 3 years of its receipt.

3.53 These receipts are known as **1-4-1 receipts**. All 1-4-1 receipts calculated in each financial quarter can only be used as a contribution to total expenditure equating to no more than 30%.

3.54 For example, if 1-4-1 receipts totaled £15,000 in the quarter ending March 2013, this would mean that the Required Amount of New Build Expenditure would be £50,000 by March 2016.

3.55 Expenditure can be greater than £50,000 in total, although clearly the difference between the allocated 1-4-1 receipts and the total expenditure will need to be funded from other resources.

3.56 However, if the Required Amount is not spent within 3 years, then the Council would need to repay the additional receipts retained back to the Treasury with interest added.

3.57 The Committee considered options for delivering New Build in October. (http://cmis.south-derbys.gov.uk/CmisWebPublic/Binary.ashx?Document=14175). As approved, work is now in progress to produce a fully detailed and costed plan which the Committee will be asked to consider later in 2013.

3.58 The Financial Plan does not at this stage include any capital receipts from RTBs, pending the outcome of the options review. In the meantime, accumulated receipts are being set-aside in a Capital Receipts Reserve which is being monitored by the Finance and Management Committee.

Rent Restructuring and Proposed Rent Increase 2013/14

3.59 Under self-financing, councils are expected to follow the national rent setting framework as applied under the previous subsidy system and continue towards rent convergence by 2015/16. The self-financing settlement was based on continuing real terms increases in rent each year of inflation + 0.5% until rent convergence.

3.60 Although the HRA projection has always been based on the rent convergence policy being followed, there is no statutory requirement to do so. Councils could deviate although there were consequences for doing so.

3.61 As regularly reported to the Committee, the Council's average formula rent is below the national average and rent convergence has been designed to close this gap by 2016. The aim of convergence is to equalise rents for all social landlords in an area. It was implemented in 2001/2002 with an initial convergence date of 2011/12, although it has since been changed to 2015/16.

3.62 However, as previously reported, convergence will not occur fully for all South Derbyshire tenants by 2015/16 and is currently estimated to be in 2018/19. This is due to the national formula previously capping increases for individual tenants each year, which has reduced average increases below that required by the Formula.

3.63 The average increase for 2012/13 was in excess of 8%. This reflected inflation of 5% and that the self-financing settlement assumed a certain base level of rent to ensure that the HRA was sustainable from its starting position.

Rent Increases under Self-Financing

3.64 Under the previous subsidy system, a proportion of the Council's rental income was transferred over to the Government as part of the redistribution mechanism. However, all rental income now stays locally with any increases or decreases directly borne by the HRA.

3.65 Under the previous system, the Council was effectively tied to the national framework because housing subsidy "penalised" the HRA for lower increases by clawing back a proportion of the increased revenue. Higher increases were capped under the Formula calculation and penalised through a Limit Rent which reduced benefit for rent rebates.

Limit Rent

3.66 This was also part of the subsidy system and constrained rent increases further. It still remains a key financial variable and effectively a control over future rent increases.

3.67 It is calculated by the DWP and is the maximum average rent each year which, if exceeded, would reduce subsidy for rent rebates on a sliding scale and therefore, reduce overall revenue in the HRA.

3.68 The Limit Rent is also being increased to equalise it with the Actual and Formula Rents upon convergence. However, all 3 rents started at a different base back in 2001 with the levels at 2012/13 shown below:

- Formula Rent - £75.45 per week
- Actual Rent - £70.55 per week
- Limit Rent - £72.62 per week

Reletting Void Properties at Formula Rent

3.69 The Committee approved this policy which has applied since April 2011. This has the effect of increasing rents to the Formula at a quicker rate for void properties during the year.

3.70 This increases average rents for a number of properties during the year (depending on turnover). Although it raises greater revenue compared to the budget during the year, overall convergence for all properties remains unchanged as only a relatively small number of properties are affected in any one year.

Overall Increase 2013/14

3.71 Based on the rent convergence methodology, the base line increase for 2013/14 is **3.1%** - i.e. RPI as at September 2012 of 2.6% + 0.5%.

3.72 In 2012/13, the Council's average rent remains 6.5% (£4.90p per week) lower than the national formula. In order to continue convergence, the average rent would need to increase by a further 2.5 % in 2013/14.

3.73 This makes the proposed overall average rent increase equal to **5.6%** (3.1% + 2.5%) for 2013/14 – an average of just under **£4 per week.** This maintains convergence by 2018/19.

Analysis of Increases

3.74 Based on the National Formula, all tenants will see an increase in their rents for 2013/14. This will range from £1.67p to £4.71p per week (3% to 7%).

3.75 The Council's average rent will increase from £70.55 per week to **£74.48 per week**. The average Formula Rent for 2013/14 is now **£77.79 per week – 4.3%** higher than the proposed actual of £74.48 per week.

3.76 Actual rents will range from £55 per week for bedsits to £97 per week for a 4 bedroom property. The Limit Rent for 2013/14 is still to be notified to the Council but is estimated to be £75.60 per week. The three various rent levels for 2013/14 is shown below.

- Formula Rent - £77.79 per week
- Proposed Actual Rent - £74.48 per week
- Limit Rent - £75.60 per week (to be confirmed)

Estimated Effect on the Base Budget and 10-year Projection

3.77 The proposed increase of 5.6% in 2013/14 is 1% over that estimated in last year's projection. This increases base revenue by approximately £113,000 in 2013/14 and in total equates to around £1.1m over the 10-year financial period.

3.78 In addition, the policy of reletting voids at formula rent during 2012/13 has increased base revenue by £36,000 in 2013/14 - £360,000 over 10-years.

3.79 With an increase in the base budget in 2013/14, every 1% variance from the proposed 5.6% increase equates to approximately £120,000 per year in cash terms (£1.2m over 10-years).

3.80 The forward projections continue to be based on the following annual increases in rent.

- 2014/15 – 4.7%
- 2015/16 – 4.1%
- 2016/17 – 3.1%
- 2017/18 – 2.5%
- 2018/19 – 2.4%
- 2019/20 onwards – 2.25%

3.81 These increases assume an inflation rate of 2.25% per year, a 0.5% real terms increase until 2015/16, with rent convergence by 2018/19.

HRA General Reserve

3.82 As highlighted earlier, the HRA reserve was higher as at April 2012 by £458,000 following the budget out-turn for 2011/12. Due to the additional base rent income and other changes detailed in the report, the projections show that the Reserve will increase from just over £2.4m in 2012/13 to approximately £3m by 2016/17.

3.83 This level of £3m is maintained over the remainder of the 10-year financial period as the HRA moves into surplus following the initial capital investment programme. As originally planned, future surpluses after 2016/17 will be set-aside to repay debt for when it matures.

3.84 The balance of £3m is in excess of the minimum level of £1m approved in the Council's Financial Strategy for the HRA. On a straight line basis, this equates to £200,000 per year (£2m) of additional resources over the 10-year planning period.

3.85 It is considered that proposed spending budgets are realistic but prudent and allow for inflation. The debt costs are sustainable and allow the planned repayment of debt. As highlighted in the report, medium term interest costs could reduce further if interest rates remain historically low, although this cannot be guaranteed and budgeted for at this stage.

3.86 Clearly, the most significant variable continues to be rent. As the report highlights, a relatively low change in percentage terms can have a significant impact in cash terms, particularly when projected over 10-years.

3.87 There is more flexibility over future levels although the Council needs to mindful of rent convergence to equalise rents, together with the Limit Rent.

Risks and the Use of Additional Resources

3.88 With projected reserves now expected to be much higher over the medium term, the HRA has several options as set out in the following table.

Options	Benefits	Risks
Set lower rent increases and delay rent convergence	• Lessens the potential for larger increases • Spreads the cost for individual tenants	• Constraining the main revenue source • Reducing the income base in the short term when resources are required in the longer-term • Potential for inconsistent rents across the stock • Government could intervene to ensure rent convergence in a timely manner – this could disproportionately increase the cost to tenants in one year
Set-aside and use resources for New Build or additional capital investment	• Would supplement other capital receipts and avoid more costly methods of financing New Build • Resources are maintained in the meantime and not immediately used	• One-off financing method, once resources are spent they cannot easily be replenished
Take advantage of borrowing headroom	• Additional debt costs are affordable • Interest rates still very low	• Additional borrowing could be costly longer term if financial position changes
Use resources for debt management - set-aside to accelerate the repayment of debt	• Prudent approach to financial management • Would reduce interest costs in the longer term	• Need to invest resources until debt matures – current investment returns very low • Repaying debt early could incur a premium, although

		interest rates have reduced and a discount may be available
Set-aside as a separate contingency	• Prudent approach to financial management	• Could be challenged for holding onto resources unnecessarily
Recharge a proportion of General Fund Housing costs to the HRA	• Lessens pressure on General Fund services	• Would need to adhere to accounting regulations associated with the HRA ring-fence

4.0 Financial Implications

4.1 As detailed in the report

5.0 Corporate Implications

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

6.0 Community Implications

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

7.0 Background Papers

7.1 None