REPORT TO:	**OVERVIEW AND SCRUTINY COMMITTEE**	**AGENDA ITEM:6**
DATE OF MEETING:	**12th FEBRUARY 2014**	**CATEGORY: RECOMMENDED**
REPORT FROM:	**DIRECTOR OF FINANCE & CORPORATE SERVICES**	**OPEN**
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SUBJECT:	**HOUSING REVENUE ACCOUNT BUDGET 2014/15 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 5.5% (£4.16 per week) for tenanted properties is considered and approved for 2014/15.

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 2014/15 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.

2.0 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 2014/15 together with an updated financial forecast to 2024. The report also sets out details of the proposed rent increase and options for 2014/15 under the Government's National Rent Setting Policy.

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 2013/14 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 (self-financing) debt in accordance with the Council's Treasury Management Strategy.

Formulating the 2014/15 Base Budget

3.3 The estimates are generally based on service levels in 2013/14 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.

Planning Period

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

3.5 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 in the self-financing regime to demonstrate to all stakeholders that the housing service is sustainable.

The position entering the Budget Round

3.6 The financial plan was updated and approved in October 2013. This reflected:

- The 2012/13 budget out-turn as approved in June 2013
- The financial impact of delivering the approved strategy for New Build
- The Government's proposals for future rent policy following CSR 2013

3.7 The updated October Plan showed a continuing sustainable financial position over the medium term for the HRA. Within this, some risks were identified with substantial investment planned in capital works and New Build over the life of the MTFP.

3.8 The overall financial position was projected to improve due to the proposed change in the Government's rent policy from 2015/16, subject to consultation. Although this would end rent convergence after 2014/15, a proposal to raise future rents in real terms by 1% above inflation, would increase resources in the HRA compared to that previously estimated.

3.9 Based on this analysis, the level of the HRA's General Reserve was projected to rise to approximately £4.5m by 2023/24, compared to £3m in the previous projection. This included earmarking an amount of £1.4m for New Build as approved by the Committee in April 2013.

Updated Budget and Longer-term Projection

3.10 **Appendix 1** shows the approved base budget for 2013/14 and that proposed for 2014/15, with projections for the following 10 years to 2024. **Appendix 2** shows the proposed base budget for 2014/15 compared to that included in the previous 10-year financial projection.

3.11 **Appendix 3** then provides an overall reconciliation of the change between the previous and updated projections; this shows the effect of changes to the proposed base budget in 2014/15 over the 10-year planning period.

3.12 The figures continue to forecast a relatively strong and sustainable financial position over the medium term on the HRA.

3.13 Compared to the projection in October 2013, there is an improved position over the longer term planning period (subject to future rent increases). This is mainly due to lower costs, together with additional rental income estimated in 2014/15 (subject to the recommended rent increase).

3.14 Proposed rent levels and options on future levels are considered in detail later in the report.

The Updated Projection

3.15 **Appendix 1** shows the cumulative balances on the HRA and Debt Repayment Reserves by 2024. Compared to the previous projection (shown in **Appendix 4** for information) resources have increased overall by approximately £5.26m over 10-years as shown in the following table.

(Figures cumulative over 10-years)

Increase in estimated Property Rents	-£2,990,788
Decrease in Other Income	£587,306
Decrease in Supporting People Contributions	£500,000
Decrease in estimated Housing Repairs	-£1,120,336
Decrease in estimated Management costs	-£1,348,439
Decrease in Supported Housing costs	-£881,750
Other Changes	-£10,182
	-£5,264,189

3.16 This has increased resources available with the HRA General Reserve projected to be approximately £3.1m by 2024, well above the approved minimum level of £1m.

3.17 An analysis of the main changes between the projections is detailed in the following sections.

Increase in Estimated Property Rents

3.18 Proposals for rent levels are detailed later in the report. The main reason for the increase is that the base starting point for 2014/15 is approximately £120,000 higher if the recommended rent increase is approved.

3.19 The previous projection estimated RPI as at September 2013 at 2.25%, this is the base index for increasing rents under the current Policy. Actual RPI was 3.25%, with the 1% increase then compounded cumulatively over the long term financial projection.

(*Further analysis of the proposed rent increase and the impact upon average rents and individual tenants, is detailed later in the report*).

3.20 Future rent increases from 2015/16 are now based on current rent convergence ending after 2014/15 and being replaced with CPI + 1%, i.e. 3.25% per year. This is in accordance with the Government's intention to change national rent policy as set out in CSR 13. However, this is still subject to consultation and final approval.

3.21 The longer term projection has also been adjusted to reflect the change in accounting methodology previously reported, to smooth out the incidence of "53 week" years (every 5 years) by accounting for rent on a daily and not weekly basis. Overall cash income remains the same over the longer-term financial period although there is a reduction in 2013/14.

Council House Sales

3.22 These have increased over the last 2 years following the Government's policy of increasing discounts to tenants to buy their homes. The revised income figures reflect a greater level of council house sales in 2012/13 (18), together with revised estimates of 20 in 2013/14, 15 in 2014/15 and 10 in 2015/16 (compared to 5 previously).

3.23 The loss of estimated income as a consequence has been partly offset by continuing the policy of reletting void properties directly at Formula Rent.

Total Rent Income

3.24 Based on the above factors, total rent income is estimated at £12.3m in 2014/15, rising to £16.3m by 2024. During this period, it is estimated that the current dwelling stock (excluding any New Build) will reduce by around 100 units from the current level of just over 3,000.

Decrease in Other Income

3.25 Approximately £50k per year has been taken out of the base budget for income from garage rents (£30k) and rechargeable repairs (£20k). Other income in the HRA amounts to over £300,000 per year.

3.26 Income from the letting of garages continues to decline and the base budget has been updated to reflect this position. In addition, income from rechargeable repairs has been reduced to reflect what is actually recharged and paid; this can vary between years.

Decrease in Supporting People Contributions

3.27 This relates to the contribution from the County Council towards costs associated with their services provided to council tenants. The budget has been reduced from £350,000 to £300,000 per year to reflect a change in how the contribution is calculated following a review of service provision.

3.28 This contribution could reduce further as the funding body are examining closely their overall budget for supported housing in future years.

Decrease in Estimated Housing Repairs

3.29 After allowing for an inflation increase of 2.5%, the estimated spending on responsive repairs and minor planned works has been reduced by £1.1m over the financial period. This is mainly due to the base budget of £100,000 for minor adaptations being accommodated in proposed capital expenditure, effectively meaning that revenue provision is no longer required.

Decrease in Estimated Management and Supported Housing Costs

3.30 Total expenditure on these costs is approximately £2.25m per year. The base budget in is just under £200k lower than estimated compared to the previous projection. There are several factors that make up this amount as highlighted in the following table.

	£'000
No inflation increase on the base budget in 2013/14	-60
IT System Development - one-off costs falling out	-28
Lower salary costs following senior management restructure	-27
Contributions/Management - Choice Based Letting Scheme	-23
Salary costs and budget savings (following 2012/13 out-turn review)	-21
Careline and Telecare Equipment - lower maintenance charges	-16
Additional income from court fees, lettings and tenancy management	-13
Relocation of Careline Service into Oaklands - lower service charge	-12
	-200

3.31 Some of these savings are being realised due to “one-off” costs incurred over the last couple of years now falling out. In particular, these relate to IT development of the main housing management system, together with development costs associated with the Choice Based Lettings Scheme.

3.32 Following a review of the base budget, several savings are being realised such as the relocation of the Careline Service from its temporary accommodation, together with lower equipment maintenance costs.

Main Assumptions

3.33 The impact of a change in the base budget can have a significant impact cumulatively over the longer-term financial period. Although the cost base is estimated to reduce, the key assumptions underpinning the projection on the revised base remain unchanged; these are detailed below.

General Inflation

3.34 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. Excluding national pay award increases, the HRA in recent years has actually spent within the inflated budgets as shown in the previous table.

3.35 Where a provision for inflation is not required, this is effectively returned to the HRA’s General Reserve. This also reduces the base level of spending for future years by approximately £60k per year, based on the base budget for 2014/15.

3.36 Spending on day to day repairs and maintenance is usually targeted at the inflated amount each year, subject to any changes in policy or capital expenditure.

Income (excluding Housing Rents)

3.37 Following a prudent basis no provision, on the updated base budget, for inflation is factored into the projection for income from fees, charges and contributions.

Debt Interest and Capital Investment

3.38 Amounts for interest on debt and capital expenditure are those set on the implementation of self-financing and have not changed. Predominantly, the self-financing debt is fixed with an approved maturity profile as set out in the Council’s Treasury Management Strategy. The first repayment is due in 2020.

3.39 The capital expenditure profile may change over time, although the total amount of expenditure is fixed. In addition, contributions to the New Build programme may also follow a different profile over time depending on delivery, but the total is currently fixed, as approved, at £1.4m until 2019.

Rent Levels and Proposed Rent Increase 2014/15

3.40 Under self-financing, councils are still expected to follow the national rent setting framework as applied under the previous subsidy system and continue towards rent convergence by 2015/16. Within the system, there are 3 different rent levels as follows:

- The ***Actual Rent*** – the current rent charged locally

- The *Formula Rent* – the rent which should be charged - this is the level to which actual rents have been converging over time.

- The *Limit Rent* – a rent set by the Department for Works and Pensions for which the actual rent cannot exceed at any one time without a financial penalty being incurred.

3.41 By the time rent convergence is fully implemented, all 3 of these rents should be at the same level, i.e. converged.

3.42 The previous HRA projection reported in October was based on a proposed change (subject to consultation) in the Government's rent policy from 2015/16. Although this proposal would bring to an end rent convergence after 2014/15, a further proposal to raise future rents in real terms by 1% above inflation would increase resources in the HRA compared to that previously estimated.

3.43 Although the Council does have some flexibility in setting rents, its current policy is to adhere to the national rent convergence framework and bring all tenanted properties to their Formula Rent.

3.44 As highlighted above, within the current framework, a Limit Rent also exists and average rent cannot exceed this Limit without incurring a financial penalty through loss of benefit subsidy for rent rebates.

3.45 As previously reported, the Council's average rent has remained below its Formula, although the gap has narrowed each year. For 2013/14, the headline rents are as follows:

- Average Rent - £74.93
- Formula Rent - £77.79
- Limit Rent - £75.83

Future Rent Policy

3.46 Following CSR 2013, the Department for Communities and Local Government (DCLG) wrote to representative housing groups. This set out the Government's intention to end rent convergence after 2014/15 and to introduce new policy direction from 2015/16.

3.47 The DCLG confirmed that, subject to consultation, rents in the social sector will be increased by the Consumer Prices Index (CPI) plus 1% annually from 2015/16 to 2024/25.

3.48 It is assumed that this would apply across the board for all tenants without any individual caps or adjustments with the rent level in 2014/15 being the base starting point. Details are due to be provided in a consultation exercise later in the year.

3.49 Consultation aside, the Government appears committed to ending rent convergence and setting new rent policy. In principle, this could have a significant effect on those councils (such as South Derbyshire) who have still to fully converge.

3.50 However, this will depend on how close actual rents are to the Formula and exactly what assumptions have been used in individual councils. In addition, the proposals indicate a change in the inflation index from RPI to CPI.

3.51 Historically, RPI has been a higher figure, although it should be noted that the new policy will include an on-going real terms increase in rents of 1% per year.

3.52 Under rent convergence, this has been 0.5% (*subject to caps being applied to individual tenants of inflation plus £2 per week*) and any real terms increase beyond 2015/16 has been uncertain until this announcement. Until October 2013, the Council's HRA projection had assumed no real terms increase beyond 2015/16, but this was changed based on the Government's announcement.

3.53 In summary, the rent projection was recalculated in October based on the revised national policy and this added an additional £2.7m into the HRA over the 10-years to 2024. This was based on a rent increase of 4.7% in 2014/15 (effectively now the final year of convergence) and 3.25% a year thereafter (2.25% CPI + 1%).

Proposed Increase 2014/15

3.54 Based on the rent convergence methodology, the base line increase for 2013/14 is <u>3.7%</u> - i.e. RPI as at September 2013 of 3.2% + 0.5%.

3.55 In 2013/14, the Council's average rent is £3.33p per week (4.3%) lower than the national formula. In order to continue convergence, the average rent would need to increase by a further 1.8 % in 2014/15.

3.56 This makes the proposed overall average rent increase equal to **5.5%** (3.7% + 1.8%) for 2014/15 – an average of just over **£4 per week.**

Analysis of Increases

3.57 Based on the National Formula, all tenants will see an increase in their rents for 2014/15. This will range from £2.09p to £5.46p per week (between 3.5% and 6%).

3.58 Within this, almost half of properties (1,474) would have their increase capped at 3.7% plus £2 per week under the rent convergence guidelines.

3.59 The Council's average rent will increase from £74.93 per week to **£79.09 per week**. The average Formula Rent for 2014/15 is now £81.08 per week **–** 2.6% higher than the proposed actual of £79.05 per week.

3.60 Actual rents will range from £58 per week for bedsits to just over £100 per week for a 4 bedroom property in certain parts of the District. The Limit Rent for 2014/15 is still to be notified to the Council but is estimated to be around £80 per week.

3.61 If the average rent increase of 5.5% is approved for 2014/15, there will still be approximately 1,700 properties below their Formula Rent to varying degrees because of the cap on individual increases that has applied in previous years.

3.62 If rent convergence was to remain in place, all properties would eventually convergence by 2018/19.

Rent Collection and Potential Arrears

3.63 It has previously been reported that arrears have been increasing over the last year. Based on the current level of arrears, there is a separate Bad Debts Provision of £180,000 against which uncollectable debts are written off.

3.64 The HRA projection allows for an increase in this provision of £20,000 per year. The provision was increased by £44,000 in 2012/13, so this will need to be kept under review. In the meantime, specific work is currently taking place with affected tenants to reduce the overall level of arrears.

HRA General Reserve

3.65 Based on the proposed rent increase of 5.5% and following changes to the Base Budget, the balance on the HRA Reserve is forecast to increase from £2.6m in 2013/14 to £3.1m in 2017/18.

3.66 This level of £3.1m is maintained over the remainder of the 10-year financial period as the HRA moves into surplus following the current capital investment programme. As originally planned, future surpluses after 2017/18 will be set-aside to repay debt for when it matures.

3.67 The balance of £3.1m is in excess of the minimum level of £1m approved in the Council's Financial Strategy for the HRA.

3.68 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

3.69 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. Depending on the outcomes of the consultation on proposed change to national rent policy from 2015/16, the projected rent levels could change again.

Potential Use of Additional Resources

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

Options	Benefits	Risks
Set lower rent increases	• Lessens the potential for larger increases • Eases 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 • Could be constrained by national policy
Set-aside and use resources for New Build or additional capital investment – could be used as a contribution to Phase 2 of New Build	• Would supplement other capital receipts and avoid technical and risky 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

Apportionment of Indirect HRA Costs

3.71 As reported last year, a comprehensive review was undertaken during this Budget Round of the apportionment of central services, senior management and other corporate costs between the General Fund and the HRA.

3.72 This included a review of 20 cost categories covering services such as HR, ICT, Finance and Customer Services, etc., together with the core management and democratic costs of the Council.

3.73 The review aimed to ensure that there is a fair and reasonable charge for these services in the HRA in accordance with accounting regulations. The last review of the basis for these charges was in 2004/05; since that time the structure of the Council has changed several times and the social housing function has also undergone significant change culminating in the implementation of self-financing in 2013/14.

3.74 The outcome is currently being assessed and validated by the Council's External Auditor and will be reported to the Finance and Management Committee on 20th February.

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 its tenants.

7.0 Background Papers

7.1 None