EXECUTIVE – 11 OCTOBER 2018

HOUSING REVENUE ACCOUNT MEDIUM TERM FINANCIAL STRATEGY

Executive Summary

The Medium Term Financial Strategy (MTFS) outlines the cost pressures facing the Housing Revenue Account (HRA) to 2021/22. As discussed in the report there are a number of key factors which will effect the financial position of the HRA over this period. These include the impact of the Sheerwater Regeneration Scheme, the end of the rent reduction period, changes in Government policy, and the impact of the new build development schemes detailed in the Affordable Housing Update Report elsewhere on the agenda. The changes which have occurred since the introduction of Self-financing, and the combination of these key issues, mean it is relevant to now consider the HRA MTFS.

Previously the elements of HRA MTFS were reported as part of the budget report and any significant budget variances highlighted in the Green Book. This paper consolidates the reporting of the HRA MTFS into a single report.

At the Conservative Party Conference on 3 October 2018 the Prime Minister announced that the Government was scrapping the cap on how much Councils can borrow against their Housing Revenue Account assets. No details are available concerning when the cap will be scrapped or what the new arrangements will be. This report was prepared prior to this announcement.

Recommendations

The Executive is requested to:

RECOMMEND to Council That

the Housing Revenue Account Medium Term Financial Strategy report be approved.

Reasons for Decision

Reason: To approve the proposed use of HRA resources and set a framework for preparing the detailed revenue and Housing Investment Programme budgets for 2019/20 onwards.

The item(s) above will need to be dealt with by way of a recommendation to Council.

Background Papers: None.

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1.0 Introduction

1.1 On the 8 February this year the Council approved the HRA 2018/19 Budget and the Housing Investment Programme as part of the overall Council Investment Programme.

1.2 This paper outlines the HRA Medium Term Financial Strategy which identifies the financial risks facing the HRA to 2021/22. Previously the elements of the financial strategy were reported as part of the budget report and any significant budget variances highlighted in the Green Book. This paper formalises the reporting of the medium term financial position of the HRA.

1.3 The cost pressures facing the HRA are outlined in the summary forecast in section 10 of this report and are explained below.

2.0 Changes Since The 2018/19 Budget Report

2.1 Since the budget was approved a number of variations have occurred altering the estimated 2018/19 year end position. These changes are listed below;

2.2 When HRA properties within the Sheerwater Red Line become void they are being held as vacant to facilitate the commencement of the Sheerwater Project. The full year effect of these properties remaining vacant to the financial year end is £336,360.

2.3 New Vision Homes are forecasting an estimated under spend of £50,000 on responsive repair costs. Capital investment in the stock over recent years has allowed repairs\enhancements to be carried out on a planned rather than reactive basis. A review of the schedule of rates applied under the contract has also contributed to this under spend. However responsive repairs expenditure can be seasonal and may increase over the winter period.

3.0 New Build Schemes

3.1 The calculations explained below are based on the assumption that the HRA bids detailed in the Affordable Housing Update report are successful.

3.2 As detailed in the same report the HRA is delivering a number of new build schemes to increase the local affordable housing supply. Each of these developments will impact on the HRA Operating Account and the level of surplus or deficit they provide will be dependent on; the interest costs on the borrowing incurred in constructing the units, the rent level set, and the cost to maintain & manage the properties. As these schemes will be provided through the HRA it is proposed that the new units will be let at social rent in order to assist those with housing need as much as possible. Social rents are estimated to be 40% to 60% of market rents and the additional rental income generated is unlikely to cover the management, maintenance, and interest costs attributable to the dwellings. The net cost of these developments will therefore be subsidised by HRA surpluses. The estimated impact of the developments is included in the Summary Forecast in Section 9 and the assumptions used to calculate this impact are explained below.

3.3 The 2018/19 Budget assumed there would be additional borrowing of £7,481,000 to fund new build developments and HRA street purchases across 2017/18 to 2018/19. Due to the additional activity it is now estimated there will be £10,851,000 borrowing over this period with a further £19,691,000 borrowed for 2019/20. This is based on all the developments under sections 1 and 2 of Appendix A to Affordable Housing Expenditure report being carried out through the HRA.

3.4 It is estimated there will be additional interest costs of £480,000 in 2018/19 and £315,000 in 2019/20 (£795,000 in total) above the amount budgeted in 2018/19. This is based on an assumed interest rate of 2.95% for 2018/19 and 3.20% for 2019/20.

3.5 As these will be new build properties the rents will be let at the higher end of the social rent range. The highest rent allowable under social rent is at the bedroom cap level. The bedroom cap level, less 1% for each year of the 4 year rent reduction period, has been assumed for the rent on the new builds:

Number of bedrooms	Rent cap	Assumed Rent Level For New Build
1 and bedsits	£141.43	£135.85
2	£149.74	£143.84
3	£158.06	£151.83
4	£166.37	£159.82
5	£174.69	£167.80
6 or more	£183.00	£175.80

3.6 The formula for setting social rents is based on a 1999 valuation for the property. Once these schemes have completed, and the 1999 valuation can be determined, the rent levels above may change. A 1% allowance for voids and bad debts has been assumed which is consistent with other HRA properties.

3.7 The cost of maintaining and managing these properties has been calculated using the actual unit management costs under the New Vision Home contract and by using average costs for repairs, voids, maintenance, and major repairs allowance. It has been assumed that all support costs will be recharged through a service charge. The additional support costs for the Old Woking Sheltered Housing Scheme (OWSHS) will be significant and the recharge process for these will need to be reviewed when more details around the support arrangements are known. On this basis it is estimated that the total management and maintenance costs per unit will be £2,334 per annum.

3.8 The table below summarises the net cost of these schemes.

Development	Weekly Rent	Rent Per Annum less 1% Voids	Mgt & Maintenance	Surplus Per Unit	No Of Units	Surplus	Borrowing Cost	Net Surplus(+) / Cost (-)
Rydens Way	£151.83	£7,816	-£2,334	£5,482	7	£38,377	-£55,478	-£17,101
Hawthorne Road	£159.82	£8,228	-£2,334	£5,894	5	£29,469	-£40,198	-£10,729
OWSHS	£135.85	£6,994	-£2,334	£4,660	57	£265,610	-£415,587	-£149,977
Monument Way	£135.85	£6,994	-£2,334	£4,660	54	£251,631	-£341,140	-£89,509
Eden Grove Road	£151.83	£7,816	-£2,334	£5,482	2	£10,965	-£13,798	-£2,833
Lockwood Path	£159.82	£8,228	-£2,334	£5,894	4	£23,575	-£25,043	-£1,468
Bonsey Lane	£139.85	£7,199	-£2,334	£4,866	14	£68,121	-£77,952	-£9,831
Total					143	£ 687,749	-£969,198	-£281,449

4.0 Rental Income

4.1 In May 2014 the DCLG published amended guidance on rents for social housing from April 2015. This guidance recommended annual rent increases of CPI + 1% and the Government indicated this rent policy would apply for ten years from 2015/16. However under the Welfare Reform and Work Act a compulsory 1% rent reduction period was introduced from 2016/17 to 2019/20. This reduces HRA rental income by approximately £180,000 against the previous years rent. The impact of the final year's rent reduction is included on in the Summary Forecast. Had rents increased under the former CPI + 1% guidance the HRA would be better off by an estimated £5,147,000 over the 4 year rent reduction period.

4.2 However in October 2017 the Government announced that they would be providing a long term rent deal. Local Authorities and housing associations will be able to increase rents by CPI + 1% following the end of the rent reduction period (so from 2020/21 onwards). Based on a CPI of 2% this means rents will increase by approximately £525,000 in 2020/21. The rent increases from 2020/21 are included in the Summary Forecast.

4.3 In 2013 the Government increased the discount under the Right to Buy to £75,000. Take up of the Right to Buy is popular in Woking and it is estimated 20 properties per annum will be disposed of over the MTFS period. The estimated lost net rental income due to these disposals is approximately £60,000 per annum.

4.4 As part of the Housing and Planning Act the Government announced the Higher Value Void levy. Under these arrangements Councils would be required to make a payment to the Government equivalent to the market value of a proportion of the high value vacant housing owned by the authority. Under this summer's Social Housing Green Paper the Government abandoned the High Value Void Levy. Therefore no provision for the Levy is made in this MTFS.

5.0 Contractual Inflation and the New Vision Homes Contract

5.1 Offsetting the future rent increases discussed above is the inflation on the costs built into the HRA operating account. These costs include direct costs such as the New Vision Homes housing management contract and the Serco Grounds maintenance contract, and also indirect costs such as staff time in supporting HRA services (e.g. customer services, IT, and Finance staff costs). Different schedules within the NVH contract are inflated using different indices and staff pay increases are determined based on the overall financial position of the Council. Therefore the different cost elements within the HRA will increase at different rates.

5.2 For MTFS purposes it is assumed all HRA expenditure, other than borrowing costs, will be increased in line with CPI. This should be a prudent approach as any increases higher than CPI should be offset by savings opportunities\reviews on other areas of spend.

5.3 A CPI of 2% has been assumed which is line with the CPI assumptions in the Sheerwater cost model reported to Council in April 2018.

6.0 Sheerwater Regeneration

6.1 Under the Sheerwater Regeneration approximately 406 HRA dwellings will be demolished. The vacant land will be transferred to Thameswey Developments Ltd and the replacement affordable housing dwellings transferred to Thameswey Housing Ltd. The HRA will therefore lose the rental income from these 406 dwellings.

6.2 The total lost rental income from the demolished dwellings under the Sheerwater Regeneration is estimated to be £2,034,000. This will be partly offset by savings on repairs and maintenance costs of approximately £759,000.

6.3 £13,000,000 has been built into the Sheerwater Regeneration financial model to compensate the HRA for the debt taken on for the redline dwellings under the self-financing settlement payment (when the HRA was obliged to pay £98m to buy itself out of the old housing subsidy system). This report assumes the £13,000,000 will be used to repay debt providing an estimated annual saving of approximately £483,600.

6.4 The HRA is budgeted to make an additional Revenue Contribution To Capital Outlay (RCCO) of £1,120,000 in 2018/19. This RCCO is optional and is essentially using the HRA surplus for the year on additional investment in the stock. As shown in the Summary Forecast this will need to be reduced in 2019/20 in order to mitigate the cost pressures in that year. Under the Sheerwater project the RCCO will be reduced to nil in order for the HRA to mitigate the lost income from the demolition of the dwellings.

6.5 Preliminary calculations estimate the net impact of the Sheerwater Project to be approximately £791,000. However full modelling of the project still needs to be completed and this figure will change depending on the final project details. This calculation assumes that all the dwellings are demolished on day 1 of the project. In reality the demolition will take place over a number of phases spreading the impact on the HRA into the later years of the MTFS when the HRA surpluses are forecast to be higher.

6.6 The removal of the RCCO and the £497,000 saving on the Major Repairs Contribution for the demolished dwellings will see a combined estimated reduction in the Asset Management Plan budget of £1,617,000.

7.0 Item 8 Interest Costs

7.1 HRA interest charges for pre 2016/17 borrowing are fixed at the Council's average borrowing rate at 31 March 2016. The new HRA borrowing taken on to fund the affordable housing developments is charged at the annual average 50 year borrowing rate. This ensures that General Fund investment decisions made by the Council do not impact the HRA. The estimated interest costs relating to this new borrowing are included in the Summary Forecast.

7.2 As detailed above the MTFS assumes the £13m capital receipt under the Sheerwater Project will be used to repay borrowing. The MTFS makes no other allowance for repayment of the debt taken on for Self-Financing or for the repayment of the borrowing relating to the new build developments.

8.0 Reserves Position

8.1 As outlined above HRA Rental income will reduce significantly under the Sheerwater Regeneration. The majority of the existing balance on the HIP reserve has been earmarked to maintain the surplus on the HRA Operating Account during the early years of the regeneration. The remainder will be used to help finance the committed development schemes if the bids to increase the HRA borrowing cap are not successful.

8.2 It is estimated sufficient resources have been identified to cover the committed development schemes. However this will utilise all available HRA resources. As detailed in the Affordable Housing Expenditure Update report the Chief Finance Officer has determined to 'switch on' retaining one for one replacement receipts in order to finance the new developments. There is a risk that insufficient one for one receipts will be received in time to finance 30% of the new build and the HRA may have to provide interim financing.

8.3 As reported in the Green Book the HRA continues to incur significant expenditure in preparation of the Sheerwater Project. While this will eventually be recharged to the project it is temporarily financed by the HRA. The timing of this recharge will impact on the HRA's ability to deliver the new build schemes particularly if the HRA is to initially finance the demolition costs prior to the red line land being transferred to Thameswey Developments Ltd. Officers will need to ensure the construction timing of the developments is aligned with the financing timing of available resources.

9.0 Summary Forecast

9.1 The table below sets out the impact of the assumptions outlined in the sections above.

Cost Pressure	2019/20 £'000	2020/21 £'000	2021/22 £'000	2022/23 £'000	Total £'000
Prior Year Estimated Surplus (-)	-46	0	-23	-228	
Year 4 Final Rent Reduction	177	0	0	0	177
Rent Increases (CPI + 1%)	0	-525	-539	-554	-1,618
Net Rent Loss Due to RTB	58	61	64	67	250
Repairs Saving	-50				
New Build Developments:					
Additional Financing Costs *	480	315			795
Rydens Way	-38				-38
Hawthorne Road	-29				-29
High Street Old Woking	-133	-133			-266
Monument Way	-126	-126			-252
Eden Grove Road	-5	-5			-11
Lockwood Path	-12	-12			-24
Bonsey lane	-34	-34			-68
	-378	-310			-688
Contractual Inflation	260	265	270	275	1,069
Sheerwater - Net Loss Of Rental Income	0	791			791
RCCO Saving	-500	-620			-1,120
Estimated Surplus (-):	0	-23	-228	-440	**

* These are the additional interest costs above the budget (not the total costs relating to the new build developments).

** Future surpluses will be earmarked to be invested in the stock or used for further new build development.

10.0 Conclusion

10.1 This MTFS considers the period to 2021/22. The HRA 30 Year Business Plan will be updated to reflect the changes discussed in the report. The interest rates relating to the Council's self-financing debt are fixed however rent increases in the long term are forecast to increase by CPI + 1%. Therefore, as rents increase over the business plan period, it is likely that the surpluses on the HRA will grow. Nevertheless, following the completion of the new build developments and the commencement of the Sheerwater project, these surpluses are forecast to be low. Factors such as future legislation changes may also place further pressures on the HRA.

11.0 Implications

Financial

11.1 The financial implications are detailed within the report.

Human Resource/Training and Development

11.2 No specific Human Resource or Training and Development implications.

Community Safety

11.3 No specific Community Safety implications.

Risk Management

11.4 There are a number of specific risks to the figures included in the forecast as set out in the report. There is an ongoing risk in the medium term of changes in government policy which could affect the General Fund as well as the Housing Revenue Account and Thameswey Group.

Sustainability

11.5 There are no sustainability implications.

Equalities

11.6 There are no equalities implications.

Safeguarding

11.7 There are no safeguarding implications.

12.0 Consultations

12.1 There have been no formal consultations on this paper.

REPORT ENDS