BABERGH DISTRICT COUNCIL

To: Strategy Committee	Report Number: L108
From: Director of Finance	Date of meeting: 24 November 2011

FUTURE OF HOUSING REVENUE ACCOUNT FINANCING

1. Purpose of Report

1.1 To provide Members with an update on the current position on the proposed self-financing regime for Council Housing and the Housing Revenue Account, which replaces the current arrangements and the subsidy scheme, due to come into effect from April 2012.

2. Recommendations

2.1 Members are asked, subject to further consideration of the overall proposed business plan, to note the position on maximising HRA rental income, maintaining the link with the rent restructuring regime as per paragraph 9.3.1.

2.2 Members to also note the issues relating to the debt and treasury management strategy as set out in paragraph 9.3.3.

The Committee is able to approve the above matters.

3. Financial Implications

3.1 Under the new self-financing regime, the Council will be taking on a share of the national housing debt in return for leaving the existing HRA subsidy system – where the Council pays over £5m a year in 'negative' housing subsidy to the Government.

3.2 As a result of this, it is imperative that the Council has a Business Plan that can demonstrate its ability to meet the required investment standard to the existing stock and sustain balances without falling into deficit over the next 30 years.

3.3 A new business plan is being modelled for the council housing service which will include all financial and other information based on the strategies and policies that are felt to be appropriate in the context of a sustainable 30 year plan. It is intended that this will include:

- A summary of the main plans for council housing for the first 5 years in detail
- A 5 year plan for capital investment and maintenance
- A 5 year plan for service development and improvements
- Identify options for additional investment as resources become available immediately and throughout the lifetime of the plan

3.4 The indicative debt settlement figure provided by Communities and Local Government (CLG) in February 2011 (currently estimated at around £81m, is subject to change in respect of a number of key areas:

- Update of inflation assumptions
- Update of stock numbers
- Rebasing of the allowances calculation
- Projected right to buy sales

3.4 It is difficult to accurately estimate at this stage how this position may change. We understand that the final draft settlement will be released on or around the 21st November for consultation with finalisation on the 27th January 2012. Funds for the debt settlement must be agreed with the Public Works Loan Board (PWLB) by 26th March 2012 and the transaction to transfer funds to the Government Debt Management Office will take place on the 28th March. Officers will advise Members verbally at the meeting if the draft determination has been published by then.

3.5 Babergh's debt take-on of around £81 million is likely to increase as it is linked to the future rental income which is subject to the September inflation figure of 5.6%. It is understood that current external debt (HRA and General Fund combined) of £5.9m will also transfer to the HRA bringing the total HRA debt at the beginning of 2012/13 to at least around £87m

3.6 Whilst this will result in additional interest charges to the HRA, there will no longer be the annual subsidy payment that costs the Council around £5m. In addition, CLG has announced that PWLB rates will be reduced for Housing Reform only until 26th March 2012. Therefore, if interest was charged at 5% on the estimated debt settlement of £87 million it would be in the region of £4.4million, creating an immediate resource for the HRA against its previous subsidy liability. No indication has yet been given by PWLB whether a one-off arrangement fee will be charged to local authorities for the new borrowing arrangement.

3.7 Due to the debt local authorities hold being accounted for nationally as the part of the Governments debt, and as the Government is looking to control its debt, it has felt the need to place a cap on borrowing, but only for the HRA. For Babergh this is equal to the existing debt plus the debt taken on. It is expected that the proposed debt cap will remain, which will result in no future borrowing unless debt is repaid. Borrowing headroom will exist, however, where borrowing approvals were given within the subsidy system but not actually exercised.

3.8 Babergh has submitted their HRA Base Data return to CLG to include an additional £8m to cover the potential cost of PV/Solar panel installations. Our external auditors have accepted this submission, and it is therefore anticipated that CLG will simply increase the debt cap to cover this amount.

3.9 Once the draft settlement is received, officers will determine any changes that need to be made to the 2011/12 Prudential Indicators in the Treasury Management Strategy, in particular to increase the Authorised Limits and Operational Boundary for External Debt.

4. Risk Management

4.1 Risk management issues for the HRA business plan will need to be seen in the context of Babergh's corporate risk management strategy – this will be in accordance with the corporate approach and will contain a statement as to how governance of the HRA business plan addresses risk.

4.2 There will be a summary within the HRA Business Plan of the main risks, to include:

- Economic issues / interest rates
- Cost and budget pressures in the short term
- Adequacy of information on stock and assets
- Failure to manage budgets and financially plan effectively
- Failure to deliver services effectively
- Modelling as a basis for risk development – current policy risks are numerous, including welfare reform, ending lifetime tenure, shortage of housing and the impact of cuts on vulnerable communities (e.g. Supporting People).

4.3 This report is most closely linked with the Council's Corporate / Significant Business Risk No. 6 – Performance and Cost Management and. Key risks are set out below:

Risk Description	**Likelihood**	**Impact**	**Mitigation Measures**
Higher than expected borrowing costs	Low	Critical	Benchmark is to borrow from the PWLB whose rates are more favourable for Housing Reform.
Housing Strategy delivery plan actions/outcomes are not achieved	Low	Critical	Continued challenge and action in dealing with identified variances from the Strategy/plan.
Budgets and costs are not actively managed	Significant	High	Close and proactive monitoring of budgets and key risk areas by Head of Housing and budget holders.

5. Consultations

5.1 Due to the uncertainty surrounding the whole issue of HRA self-financing, consultation to date has been limited but, as more detail is issued by CLG, Members, tenants and other stakeholders will be fully consulted.

6. Equality and Diversity Impact

6.1 No equality analysis has been carried out as this is a purely factual report. However a full analysis will be carried out as the HRA Business Plan is developed.

7. Shared Service / Partnership Implications

7.1 Whilst this report relates just to Babergh's HRA Business Plan, Members are advised that the same advisors are working on the HRA Business Plan for Mid Suffolk and both authorities have engaged the same company to carry out the stock condition surveys to ensure that as much consistency as possible can be obtained between the two authority's plans.

8. Key Information

8.1 The Government has issued proposals to reform the HRA, namely the abolition of the current subsidy system and implementation of self-financing following a one-off debt settlement at the end of 2011/12. This will happen through primary legislation via the forthcoming enactment of the Localism Bill (expected in late November). This has been reinforced with a policy document, published on 28th July, which sets out the proposed arrangements around the transaction in detail.

8.2 There have been various initial assessments modelling the potential financial position for the 'new' HRA based on the best available data at the time. These have demonstrated that the Council will benefit from moving to the new regime with the possibility of repaying all or most of the debt. However, careful consideration must be given to all policy and financial aspects that are included in the financial modelling of the business plan. The Council has commissioned a stock condition survey as part of the business plan modelling and the latest outputs of this are currently under consideration.

9. Next Steps

9.1 As mentioned above, it is expected that the draft debt settlement will be issued week commencing the 21st November and this will give the authority an opportunity to test some of the assumptions used to arrive at the settlement figure, with responses to the Government required by the first week of January 2012.

9.2 A new business plan will be constructed to take into account:

- The latest debt settlement figure
- The rent increase for April 2012 and future rent setting policy
- The updated stock condition survey
- Initial strategy for financing and managing the debt

9.3 This will inform the 2012/13 HRA budgets for management costs and income. Therefore there are some key decisions that will be required over the coming weeks to determine future housing strategy and policies relating to key aspects of HRA operations.

9.3.1 April 2012 Rent Increase

- The Council has been following the Governments rent restructuring policy to date, which has dictated increases (linked to subsidy payments) and this has now been used as the basis for determining the debt settlement. Under rent restructuring, the Council's average rents are required to converge with the formula rent by 2015 (the formula rent being the average local RSL rent level).

- As part of the rent restructuring formula, rents increase by the previous September's Retail Price Index (RPI) plus half a percent, plus a percentage of the resulting gap between the formula rent for each property (which in turn also increases by RPI plus half a percent).

- In Babergh's case, the average actual rent is currently £74.63 (52 weeks) with an average formula rent of £79.48. The September 2011 RPI of 5.6%, plus the additional 0.5% and the need to converge with formula rent by April 2015 date, would result in an average increase of 7.7% or £5.75 in April 2012.

- Whilst the HRA benefits from the withdrawal of the subsidy system, it will be important to maximise income given the future demands for investment in the stock. A voluntary reduction in rent increase of, say, 1% would result in lost income in the region of £133k in 2012/13, but there would need to be higher rent increases in the following years to enable convergence with the formula rent.

- As a result of the increase, this would enable higher investment levels in the housing stock (both HRA and affordable housing) than has previously been possible.

Members are asked to note that, subject to further consideration and agreement when the business plan is presented to Members for final approval, the basic principle of any rent policy should be based on delivering the maximum income from future rent increases. Further, that the full implications of any alternative policy will be presented to Members before this decision is made.

9.3.2 **Stock Condition Survey Results**

It is possible when the results are finalised, that some re-profiling of the expenditure included in the current approved capital programme will be required and decisions made around the timing of any elements of work that may need to be reconsidered. Further reports will be brought before Members at the beginning of 2012.

9.3.3 **Treasury Management Strategy**

As mentioned above the Council will need to fund the additional £81 million, and this will have to be funded from borrowing. The Council therefore has to make decisions around the source of funding, its duration and risk to interest rate fluctuation. Arlingclose, the Council's treasury advisors will provide **the options available** and provide advice on and around the following:

- Separation of the current Housing and General Fund debt by transferring the current debt of £5.9m to the HRA (to the limit of the Capital Financing Requirement (CFR) or continue with a one pool approach and share the debt costs.

- Whether to fix loans at currently historically low interest rates or to be exposed to variable rate risk?

- Whether to repay debt as early as possible or retain funding in the business plan over a longer period to allow flexibility over future business needs?

- Whether the money should be borrowed from the PWLB or elsewhere? PWLB rates are unlikely to be matched by rates offered in the wider market.

10. Background Documents

Communities & Local Government – Self-Financing: Planning the Transition – July 2011

Cipfa's Code on Practice on Treasury Management ("the Code")

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