Report for Resolution

Report to	Council	**Item**
	21 February 2012	8
Report of	Head of finance	
Subject	Housing revenue account self-financing	

Purpose

To report on the outcomes of the council's work in preparation for HRA Self-Financing and seek approval for the financial and other proposals resulting.

Recommendations

That council notes cabinet's agreement:

(1) That the HRA Capital Programme should be based on the "Whole Home Upgrade (Norwich Offer)" standard;

(2) To note the impact of HRA Self-Financing on the HRA Business Plan;

(3) To note that a report on future governance arrangements will be presented to the 12 March Cabinet.

That council approves cabinet's recommendations of 15 February:

(4) That the head of finance be authorised to make the arrangements necessary for the additional borrowing

(5) That the Operational Boundary and Authorised Limit for External Debt in the Treasury Management Strategy 2011/12 be amended as shown in Appendix 2.

Financial Consequences

This report sets out the financial and other impacts of HRA Self-Financing. These are included in more detail within the HRA Capital Plan 2012/13-2015/16, the HRA Capital Programme 2012/13, the HRA Budget & Rent 2012/13, and the Treasury Management Strategy 2011/12 (updated) and 2012/13,

Risk Assessment

The risks to the council and to the HRA have been assessed in the preparation of the HRA Capital Programme, the HRA Business Plan, and the Treasury Management Strategies. Sensitivity testing has been undertaken to identify critical factors and mitigation, and appropriate advice taken from independent experts.

Strategic Priorities

The report helps to meet the strategic priorities "Aiming for excellence – ensuring the Council is efficient in its use of resources, is effective in delivering its plans, is a good employer and communicates effectively with its customers, staff and partners", "Safe and healthy neighbourhoods – working in partnership with residents to create neighbourhoods where people feel secure, where the streets are clean and well maintained, where there is good quality housing and local amenities and where there are active local communities", and "Strong and prosperous city – working to improve quality of life for residents, visitors and those who work in the city now and in the future"

Cabinet Members

Councillor MacDonald - Housing
Councillor Waters - Resources, performance and shared services

Ward: All wards

Contact Officers

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Report

1. The Housing Revenue Account (HRA)

1.1 The HRA is a “ring fenced” account that the authority must maintain in relation to its council housing stock. The HRA must fund all expenditure associated with the management and maintenance of the housing stock

1.2 In Norwich, the HRA includes income and expenditure associated with the stock of over 15,000 homes, with a turnover exceeding £120m per annum.

2. HRA Subsidy

2.1 The Housing Revenue Account Subsidy System is the current system for managing the financing of council housing nationally. Under this system, major financial decisions about council housing management are made by central Government and there is comparatively little control in the hands of councils. This makes it difficult for councils to plan for the long term to ensure that decisions about what and how services are delivered are linked directly to local needs

2.2 Under the current system, the Government calculates the spending needs of each local authority and compares it with their rental income. If a council’s rental income falls short of its spending needs, the Government provides subsidy to make up the shortfall. If a council’s rental income exceeds its spending needs, the excess is fed back into the subsidy system to help provide for those councils requiring subsidy. If any money is left over, it is returned to Government – this is increasingly the case as costs have been assumed to be fixed and rental income assumed to increase above inflation each year.

2.3 In Norwich, the government’s 2011/12 calculation of income totalling £52m and expenditure requirements of £44m result in “negative subsidy” payable to government of £8m. This sum would be expected to increase by £1m+ per year.

2.4 The current system is complex and does not deliver sufficient funding for councils to manage and maintain their homes to a good standard. It does not support tenant involvement in decisions about their homes and locality. Councils can not undertake proper business planning due to the annual nature of the system. The system assumes unrealistically low expenditure needs and so generates a large surplus for central government and accommodation that is not always adequately maintained.

3. HRA Self-Financing

3.1 The Government wants a solution that will work for all and is fair to both tenant and taxpayer, and is therefore shifting power from the centre to councils through the new self-financing system.

3.2 The objectives of self-financing are to make the system more flexible and fair, giving councils the power to make the best use of their housing stock, in a way which best meets the needs of individual households in their local area, and to enable tenants and local taxpayers to hold their landlord to account for the cost and quality of their housing

3.3 Implementing self-financing involves a reallocation of housing debt based on whether the valuation of each council's housing business is higher than their existing debt.

3.4 Where the value is higher than the level of debt, the council will pay the difference to central government. Where it is lower, central government will pay the difference to the council

3.5 Councils will only be asked to take on extra debt if their council housing will generate sufficient income to meet it after costs are met. The debt will not impact on what is delivered to tenants

3.6 In order to ensure that the country does not get into any more debt than we can afford at least initially, councils will be given a limit to how much more money they can borrow (a borrowing cap)

4. Preparation for HRA Self-Financing

4.1 The council has responded to the challenge of preparing for Self Financing through the establishment of a project team to develop the necessary workstreams and to identify, report upon, and implement the changes to investment, financing, and other activities.

4.2 The five workstreams were identified as:

- HRA Asset Management
- HRA Business Planning
- HRA Treasury Management
- Tenant Consultation
- HRA Governance

5. HRA Asset Management

5.1 Under the Housing Subsidy system, the council's ability to invest in its housing stock has been severely curtailed by the siphoning off of rent income to the government.

5.2 This has meant that the HRA Asset Management Strategy has been limited to the delivery of a "basic" Decent Homes standard (in accordance with government requirements) which has not fully met tenants' expectations. Although Decent Homes have successfully delivered to this minimum standard, there has been little or no ability to deliver further improvements, and projections have shown that even this minimum level was not financially sustainable beyond the short term.

5.3 The move to Self Financing will result in the long term in additional resources remaining within the council's HRA, rather than being paid over to government in negative Housing Subsidy. This will enable a higher level of investment, so that the council will have the ability to make choices over the standard of improvement and its pace.

5.4 Tenants have been consulted on several possible levels of investment, and have expressed a strong preference for a “Norwich Offer” which will deliver whole-home upgrades.

5.5 The Property Services department have therefore developed an investment programme in response to this preference, which provides for a cyclical approach to improvement works, and improved programming of planned maintenance.

5.6 The planned delivery of this programme has been aligned with the availability of resources under Self Financing through the HRA Business Plan as set out in paragraphs below.

5.7 This HRA Asset Management Strategy has been reviewed by independent experts to ensure its robustness and deliverability. The opinion of the independent experts is that the HRA Asset Management Strategy is fit for purpose.

5.8 Details of the HRA Asset Management Strategy are presented in **Appendix 1**.

6. HRA Business Plan

6.1 The future income and expenditure streams of the HRA have been projected through a 30-year business plan. The Business Plan allows the council to examine the impact of the Self Financing changes, to model the impact of varying assumptions on investment levels, rent income, and other factors, and to test the sensitivity of the model to external factors such as inflation, interest rates, RTB disposals, etc.

6.2 The Business Plan takes into account the additional borrowing required for Self Financing and identifies the resources available over the planning period for debt interest and repayment, investment in the stock, and management & responsive repairs.

6.3 The HRA Business Plan has been reviewed by independent experts to ensure its robustness and capacity. The opinion of the independent experts is that the HRA Business Plan is fit for purpose.

6.4 Details of the HRA Business Plan are presented in **Appendix 2.**

7. HRA Treasury Management

7.1 The government has determined, based on audited data submitted by the council that the total borrowing affordable by the council under its Debt Settlement assessment is £237m. This figure is also the “cap” upon future borrowing. The additional borrowing, over the borrowing limit previously included within the Housing Subsidy system, amounts to £149m which is the amount that the council is required to pay over to government.

7.2 The council has considered various approaches to meeting this borrowing requirement, including through the Public Works Loan Board (PWLB), through open market borrowing (from banks and other financial institutions) and by the issue (alone or in partnership) of corporate bonds.

7.3 The PWLB has announced that for Self Financing borrowing, a reduction to normal borrowing costs, so that the rate for PWLB borrowing will be 0.17% over government gilt rates. This reduced rate is more favourable than could be obtained through any other borrowing, and it is therefore proposed that the council will arrange its additional borrowing on this basis.

7.4 Although the Business Plan indicates that there will be an initial period when the investment plan will not require that borrowing is up to the limit of the cap, there are existing loans coming to an end during this period which will require repayment or re-financing. It is proposed that these loans are effectively re-financed in advance, by taking advantage of the low rates available for Self Financing borrowing.

7.5 Because the council must pay over the settlement figure to the government before 1 April, the borrowing must be done in March. This requires that the council's Treasury Management Strategy for 2011/12 is updated, so that the limits included can be increased to cover the additional Self Financing borrowing.

7.6 The Treasury Management Strategy for 2011/12 (updated) and for 2012/13 will be developed in conjunction with the council's existing treasury management advisors, with whose advice the Self Financing borrowing arrangements are already in discussion.

7.7 Details of the Treasury Management implications are presented in **Appendix 3**.

8. Consultation

8.1 Tenants have been consulted on the development of the council's plans for Self Financing through briefings and meetings with the Citywide Board (including sub-groups).

8.2 The consultation has primarily been around providing information on the impact of Self Financing on the availability of resources, and seeking feedback on the options for future investment.

8.3 Further consultation has taken place on 19 January on the council's proposals for a rent increase for 2012/13, and its effects on the availability of resources, and the HRA Capital Programme 2012/13 which will deliver the first year of the new investment programme.

9. HRA Governance

9.1 The Government is consulting on draft directions from the Secretary of State to the Social Housing Regulator. This includes a proposed direction on tenant involvement. This would support effective scrutiny by tenants by setting the expectation that local authorities should provide timely, useful information about their performance. There is also an expectation that local authorities issue an annual report to tenants, in a form which they should agree with their tenants in advance.

9.2 The Government's draft direction to the Regulator also proposes that the Regulator should set a standard to encourage social landlords to give tenants opportunities to form tenant panels – enabling them to hold landlords to account and help resolve tenant complaints.

9.3 The council is developing proposals for arrangements which will address the new requirements, in consultation with tenant representatives.

10. Conclusions

10.1 HRA Self Financing presents the council with an unprecedented opportunity to address historic investment shortfalls, to respond better to tenants' expectations and aspirations for their homes, and potentially to deliver new council housing.

10.2 The preparation undertaken so far by the council, validated where appropriate by independent expert advisors, forms a firm foundation through which the council's priorities can be expressed and resourced.

10.3 The HRA Asset Management Strategy, the HRA Business Plan, and the Treasury Management Strategy will inform annual revenue budgets and capital programmes under which improvements to tenants' homes will be delivered.

Appendix 1

HRA Asset Management Strategy

Self Financing (Self Financing) will allow real choices to be made about the level of investment the Council is able to afford to the housing stock. Focus groups have been held with residents around the following options:

Option 1: Decent Homes (DH) Standard.

This is how the improvement programme has been delivered and how the long term investment plan been produced since 2005/06. Carrying out work by this method will allow NCC to deliver programmed improvement works at the same level and to the same standard as the past 6 years.

Option 2: Decent Homes + Renewable energy solutions:

Based on option 1 and including additional spend on renewable and sustainable energy solutions and improved insulation works to reduce resident's energy costs and reduce CO_2 emissions such as:

Solar thermal heating/hot water being adopted with new boiler installs, accelerated external wall insulation programme, solar PV installs and air/ground source heat pumps.

Option 3: Whole Home Upgrade (Norwich Offer)

The whole home upgrade allows for increased levels of expenditure enabling the "bringing forward" of upgrade works which will ensure that the major internal elements, such as kitchens and bathrooms will be replaced before their lifecycle replacement date. This is an enhanced Decent Homes standard allowing for multi element replacements. This will mean that when we survey a property to assess works we will replace all elements at the same time if required, i.e. kitchens and bathrooms, new front and rear doors, rewiring, roofing and roofline and heating systems.

This will allow the Council to greatly improve the standard of the stock and carry out work that under current investment models would not be carried out for some time. As part of the new standard we will be looking at introducing a Programmed Preventative Maintenance (PPM) cycle. This approach will eventually see a reduction in the number of responsive repairs required due to the levels of work carried out during the PPM period.

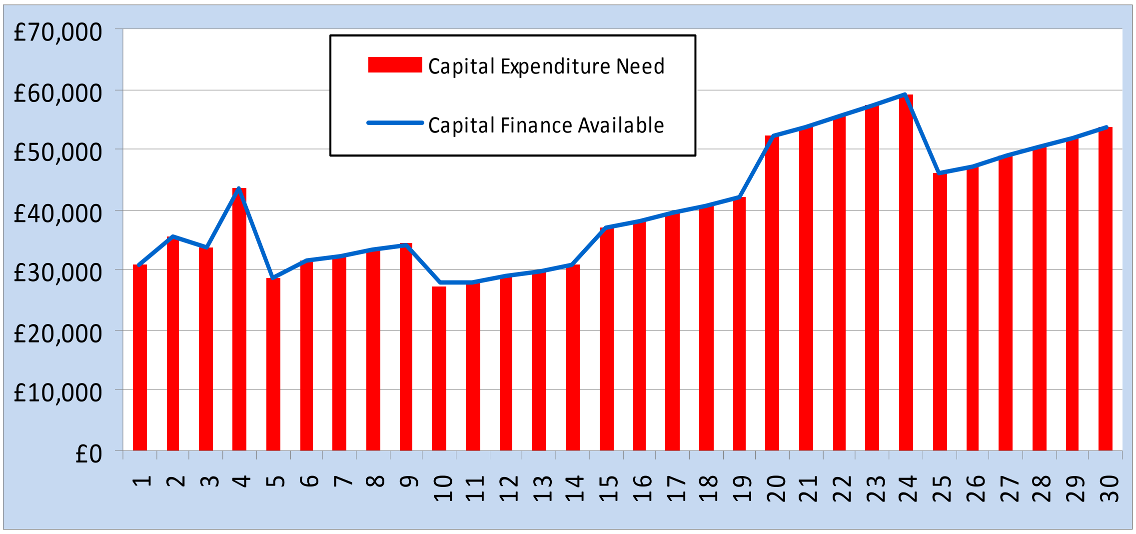
Option 4: Whole Home Upgrade (Norwich Offer) + Renewable energy solutions:

Option 4 is essentially Options 3 but with the renewable elements from Option 2. This will enable combined schemes to be carried out in addition to delivering the PPM element of work. For example where a new heating system is required to a property when the kitchen, bathroom and roofing has been identified we could install a solar thermal heating and hot water or air source heat pump instead of a new standard heating system.

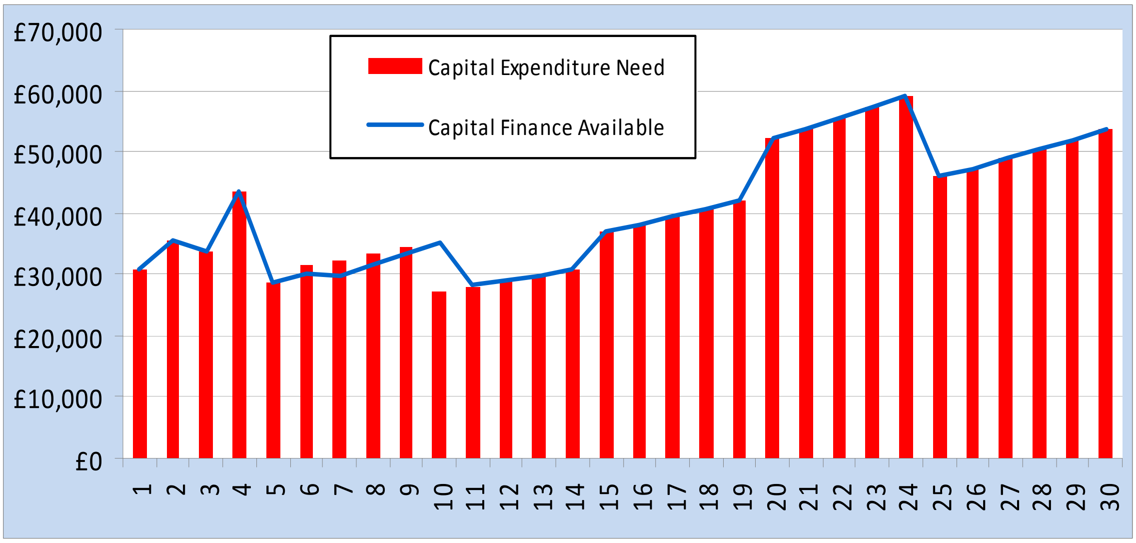
The level of rent increase will determine the speed with which we are able to carry out the chosen option and the frequency with which it then continues, i.e. the time between programmes of work being carried out to each property, once every five years etc.

The Council also has aspirations to develop new Council housing, however any investment plan will focus on investment in the existing stock as a priority.

The graph below is based on the higher rent increase of 8.3% and shows that Option 3 is affordable with the programmed cycle working on a five year cycle. However the renewable element is not affordable at this cycle (this could be lengthened to a longer cycle to allow for this) but there is a small amount of money for a very small new build programme.



The graph below is based on the lower of the proposed rent increases of 5.3%. This level of increase shows that Option 3 is affordable for the first five years but from year 5 the programme cycle would have to be longer intervals than five years. There would be no money for renewables at all and no new build.



Appendix 2

HRA Business Plan

The HRA business plan models all anticipated income and expenditure to the Housing Revenue Account projected through a 30 year period. It enables the council to forecast the availability of financial resources and measure the impact of variations to the initial assumptions.

Variations are modelled as 'sensitivities' to the original base model and may include:

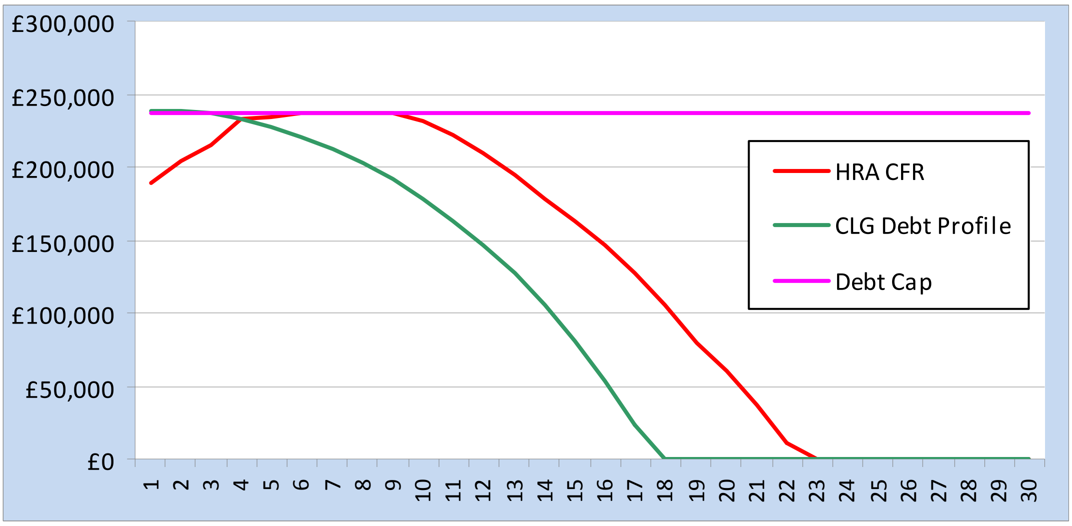
- Increase in bad debts
- Changes to anticipated levels of properties sold under Right to Buy
- Changes to planned level of stock disposal
- Increase in repairs and upgrade contractor costs
- Changes in inflation and interest rates
- Reductions in funding from government / other organisations
- Changes in legislation necessitating additional expenditure or restricting income
- Changes to levels of support grants provided

The original business plan model based on the HRA subsidy system, demonstrated that although the council was able to finance the Decent Homes standard of investment it was unable to maintain service and investment standards in the medium and long term.

The current business plan model, based on the self financing approach illustrates a more positive forecast in the medium and long term.

The model demonstrates that even when making prudent contingency provisions for a potential increase in contract costs, it should be possible to finance the 'whole house' upgrade approach over the next 30 years, whilst maintaining borrowing levels within the debt cap set by the government and repaying the full debt within 23 years, as illustrated below.

Table 1 – HRA Debt Repayment



Appendix 3

Treasury Management

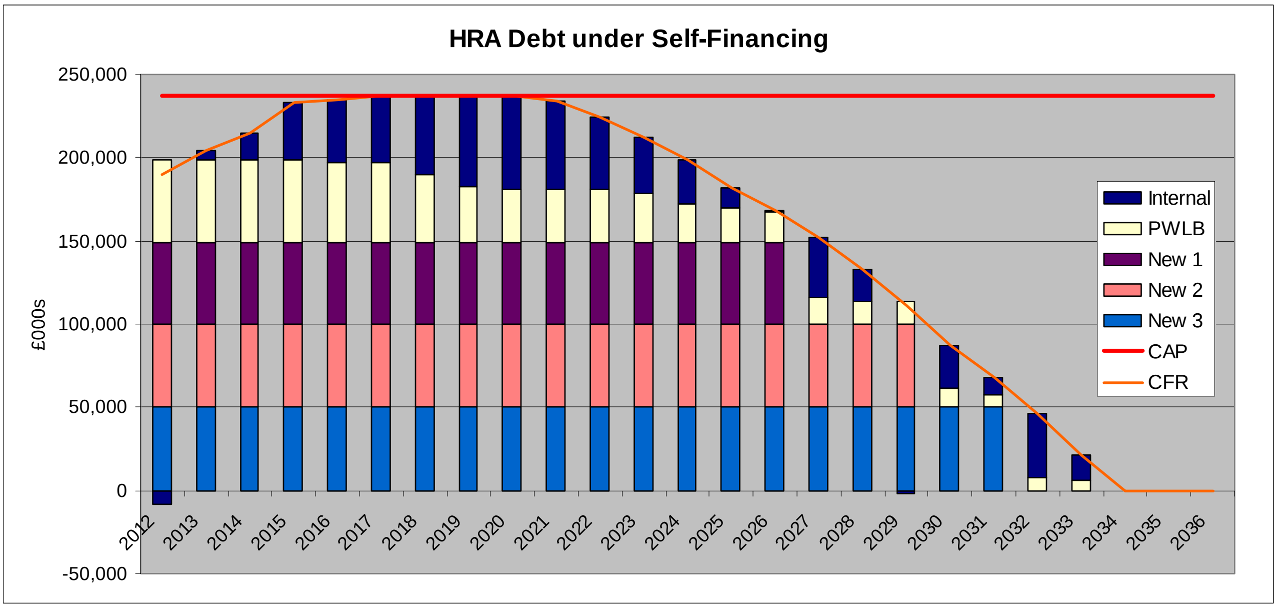
The council will be required to pay to the government a sum of £149m. As outlined in the report, the Public Works Loan Board has offered an exceptionally cost-effective interest rate, so that investigation of other options has been cut short. This has also obviated the need to procure any independent expert advice over the level funded in the existing Treasury Management advice contract.

The council will need to determine whether to adopt a one-pool, two-pool, or three-pool strategy for its existing and future borrowings. This will have consequences for the interest rates applicable to General Fund and HRA borrowings whether separate or consolidated, and for the overall cost of the council's debt management operations.

The council also needs to determine the package(s) of borrowing needed to make up the £149m payable to CLG, to what extent the payment could be funded from existing resources, and the extent to which further borrowing will be necessary in the future to finance the HRA capital investment requirements.

Decisions are also needed on the durations of individual tranches of borrowing, whether they should be on a repayment on an interest-only basis, and the impact of repayments on existing PWLB and market debt on future cashflows.

The following diagram shows one possible scenario, illustrating three new £50m tranches of PWLB borrowing tied to the HRA Business Plan's forecast of Capital Financing Requirement. The "Internal" borrowing requirements shown could be met wholly or partially from new (non-Self-Financing) borrowing, depending on the availability of internal resources and the prevailing costs of external finance.



Work is continuing to refine the options, and to ensure that the optimum balance between cost (interest rates) and flexibility (mixing fixed rates/terms with variable) is obtained for the council. The Head of Finance has delegated authority to conclude and determine these matters.

CLG requires that the Self-Financing payments are made on 28 March 2012, within the current financial year. The Item 8 Determination, which regulates the charging of capital costs between the General Fund and the HRA, will be amended to ensure that there is no adverse impact on the council from this early settlement.

However, because of this, constraints within the Treasury Management Strategy 2011/12 need to be amended to increase borrowing limits to include the Self-Financing amount of £149m and future borrowing to resource the housing investment programme.

The table below shows the expected movement in the Capital Financing Requirement and maturing debt which will need to be re-financed effect on the treasury position over the next three years, incorporating the new HRS Self-Financing borrowing. The expected maximum debt position during each year represents the Operational Boundary prudential indicator, and so may be different from the year end position.

£000s	**2010/11**	**2011/12**	**2012/13**	**2013/14**
Debt at 1 April	85,683	85,683	234,367	247,604
Expected change in debt as per TMS	0	-214	13,237	-142
HRA Self-Financing Debt	*0*	*148,898*	*0*	*13,599*
Debt at 31 March	85,683	234,367	247,604	261,061
Operational Boundary	**85,683**	**234,367**	**247,604**	**261,061**

The Authorised Limit for External Debt represents a control on the overall level of borrowing. This represents a limit beyond which external debt is prohibited, and this limit needs to be set or revised by full Council. It reflects the level of external debt which, while not desired, could be afforded in the short term, but is not sustainable in the longer term. This is the statutory limit determined under section 3 (1) of the Local Government Act 2003.

£000s	**2010/11 Revised**	**2011/12 Estimate**	**2012/13 Estimate**	**2013/14 Estimate**
Borrowing	97,051	98,394	262,035	263,378
HRA Self-Financing Debt	*0*	*148,898*	*0*	*13,599*
PFI	6,478	5,135	3,792	2,449
Transferred Debt	1,719	1,510	1,352	1,215
Other long term liabilities	435	430	425	420
Authorised Limit	**105,683**	**254,367**	**267,604**	**281,061**