COUNCIL BUDGET STRATEGY UPDATE REPORT APPENDIX A

SECTION 2 – HOUSING REVENUE ACCOUNT (HRA)

2. Key Points

2.1 Background

2.1.1 HRA self-financing was implemented in April 2012. The intention was to give Councils with HRA's more confidence in being able to forecast what were intended to be more sustainable future rental income streams to help with business planning, than was possible under the previous housing subsidy system. This included government's commitment to allow for annual uplifts in social rents by consumer Price Index (CPI) + 1%, at least to 2025.

2.1.2 Based on the above, the Council's self-financed 30 year HRA business plan was modelled to be financially viable, to the extent that it could deliver the following four objectives:

i) annual servicing of existing HRA debt (£216m actual HRA debt taken on as part of the self-financing settlement); included planned annual repayment of debt over the longer term in line with HRA loan repayment profile,

ii) delivery of capital improvements to existing Council housing stock (about 23,000 Council tenancies), to a decency standard over the 30 years, in line with forecast capital resource or 'affordability' requirements,

iii) continued delivery of housing management and repair service, broadly at current cost base, and

iv) inclusion of funding for a number of HRA strategic capital priorities and scope to consider further investment opportunities

2.1.3 Also as part of self-financing, Government set an upper limit or cap for HRA borrowing. The cap for Kirklees is £247m. The difference between this and actual HRA debt outstanding is also referred to as the 'headroom' potential for HRA new borrowing. While no new borrowing had been committed at this stage in relation to further investment opportunities, there was potential to explore this further, subject to HRA being able to service any additional debt commitments.

2.1.4 Government subsequently announced in March 2015 its intention to reverse its previous social housing rent uplift commitment, and would instead reduce social housing rents by 1% per annum, each year over the 2016-20 period. The context was the fact that a significant proportion of social housing rents are funded from housing benefit (about 2/3rds, both nationally and locally), and the rent reduction was part of a wider package of government proposals to reduce the national welfare bill in line with its own medium term public expenditure reduction targets.

2.1.5 The impact was a forecast rental income loss of £1.7m in 2016-17, compared to previous forecasts factored into HRA budget plans which had assumed CPI+1%. Further 1% annual rent reductions the following 3 years meant a cumulative annual rental income loss in excess of £10.5m by 2020. The scale of annual rental income loss, compared to previous budget forecasts, impacted across the remainder of the HRA business plan beyond 2020.

2.1.6 The overall financial impact of the 1% rent reduction on the HRA business plan was that the HRA was forecast to be only financially sustainable up to 2022 and that beyond this point, it went into an overall operating deficit, which also meant insufficient resources to be able to continue to deliver the 4 objectives set out in 2.1.2 above.

2.1.7 HRA approved budget plans over the 2016-19 period included about £4m revenue savings in 2016-17,and these represented early measures to start to address the 1% rent reduction loss referred to in para 2.1.5 above. The savings were based on a baseline re-alignment of current budgets to actual spend. Quarter 1 monitoring forecasts for 2016-17, reported to Cabinet on 23 August 2016, indicate that HRA is forecast to deliver on these savings, in-year.

2.1.8 There were no plans when setting 2016-19 HRA budgets, to review corporate treasury management policy with regard to HRA, which continued to reflect a prudent annual provision for HRA debt repayment.

2.1.9 HRA capital plan approvals for 2016-21 reflected pre-existing 5 years baseline capital plans rolled forward, plus a number of strategic HRA capital plan priorities. No new borrowing was included.

2.1.10Emerging proposals for the merger of the Council's building services department with the Council's arms length management provider, Kirklees Neighbourhood housing, were also acknowledged to offer potential for medium term efficiencies. Subject to the merger going ahead, potential future efficiencies would be explored in future budget rounds.

2.1.11 There were also a number of housing policy proposals contained within draft Welfare and Work Reform and Housing and Planning bill legislation, which were acknowledged could have further repercussions for the HRA business plan, in addition to the 1% rent reduction. However, the relevant detail and legislation underpinning these proposals was still at the draft stage.

2.1.12 The intention was for the Council, working in partnership with its arms length provider, KNH, to undertake a further detailed re-fresh of the HRA 30 year business plan in preparation for this budget round. This would also be informed by any further emerging national and local intelligence following the subsequent implementation of the Welfare Work and Reform Act (March 2016) and Housing and Planning Act (May 2016).

2.1.13 The HRA 30 year business plan re-fresh is covered in more detail in the following sections.

2.2 <u>HRA 30 year business plan updated – current work in progress</u>

HEADLINE ASSUMPTIONS

2.2.1 The starting point for the HRA business plan update is to roll forward current approved 3 year HRA revenue and 5 year capital budget plans.

2.2.2 There is a current review of the 30 year HRA capital affordability model, which determines capital resourcing requirements to maintain decency in Council housing stock over the longer term.

2.2.3 Existing affordability projections are being updated to reflect current stock survey data, and expenditure commitments are also being reviewed and re-profiled to create more manageable and effective capital programmes. At this stage, costs for carrying out work are to current decency standards, with no significant changes to component replacement lifecycles or efficiency savings.

2.2.4 Projected right to buy sales are also being reviewed, in light of current and forecast trends, and current government housing policy proposals which potentially accelerate the sale of existing housing stock compared to previous projections.

2.2.5 The financial impact of predicted stock reductions over future years is also being reviewed, in terms of the scale of corresponding reduction in repair and maintenance and capital improvement costs, compared to previous assumptions.

2.2.6 Government has still to clarify the detail regarding a number of social housing and welfare reform proposals, notwithstanding the implementation of the 2016 Welfare Reform and Work and Housing & Planning Acts.

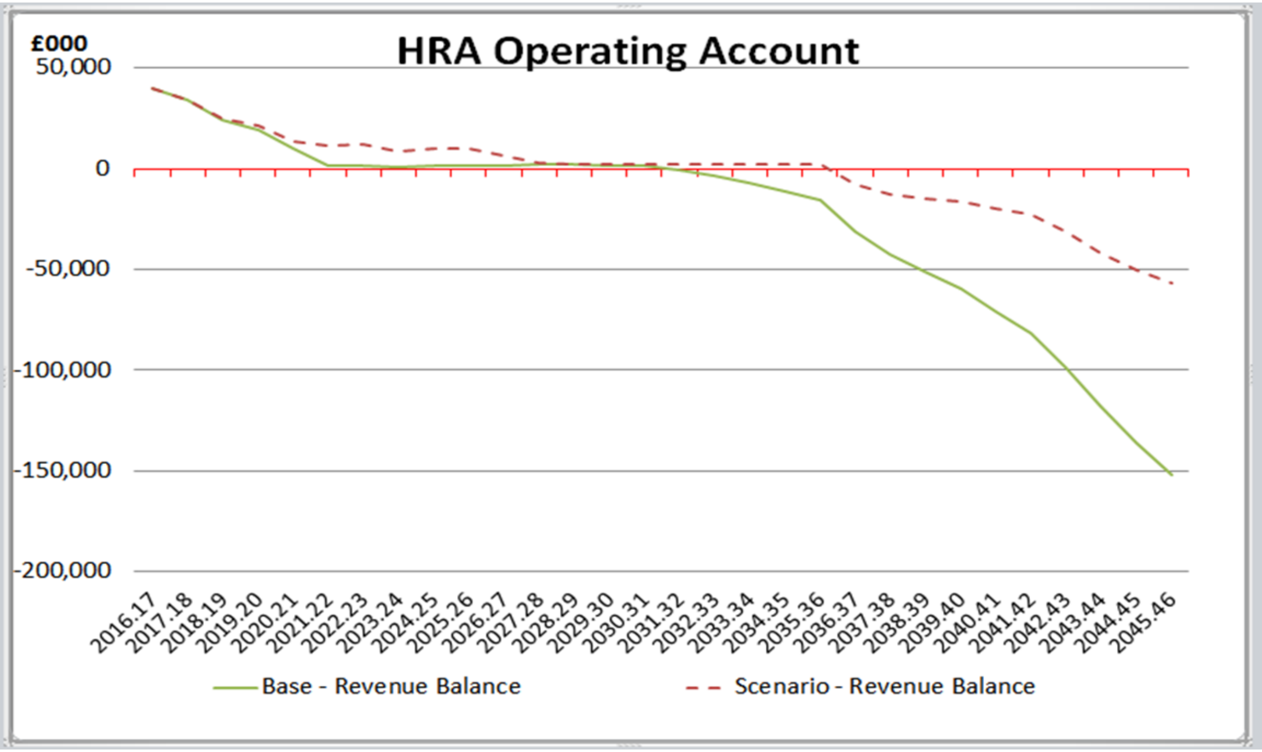
2.2.7 The HRA business plan update at this stage includes an early working assumption, based on current national intelligence, with regard to government proposals for a 'higher value' annual levy or charge, based on higher value property void rates. The levy is to be re-directed to private registered providers to compensate them for the loss of housing stock through the voluntary take up of the right to buy scheme in this sector. The working assumption is that the HRA would have to sell about 170 properties per annum at an assumed £65k average market value per property, to generate sufficient capital receipts to pay an annual levy charge of about £11m.

2.2.8 Other potential housing policy changes include pay to stay proposals, which mean that outside London, Council tenants with a combined joint household income of £40k or more will have to pay market rent (with some tapering between (£31k and £40k). The 'additional' rent collected would be paid over to Government directly. How this proposal would work in practice, its impact on potential further demand on right to buy, and the local administrative costs, have yet to be fully set out by government.

2.2.9 More prudent social rent uplifts have also been assumed from 2020-21 onwards. Current government policy indicates a reversion to CPI+1% from this date, but the business plan update assumes a more prudent CPI only uplift (in line with latest government forward inflation forecasts; 2% from 2020).

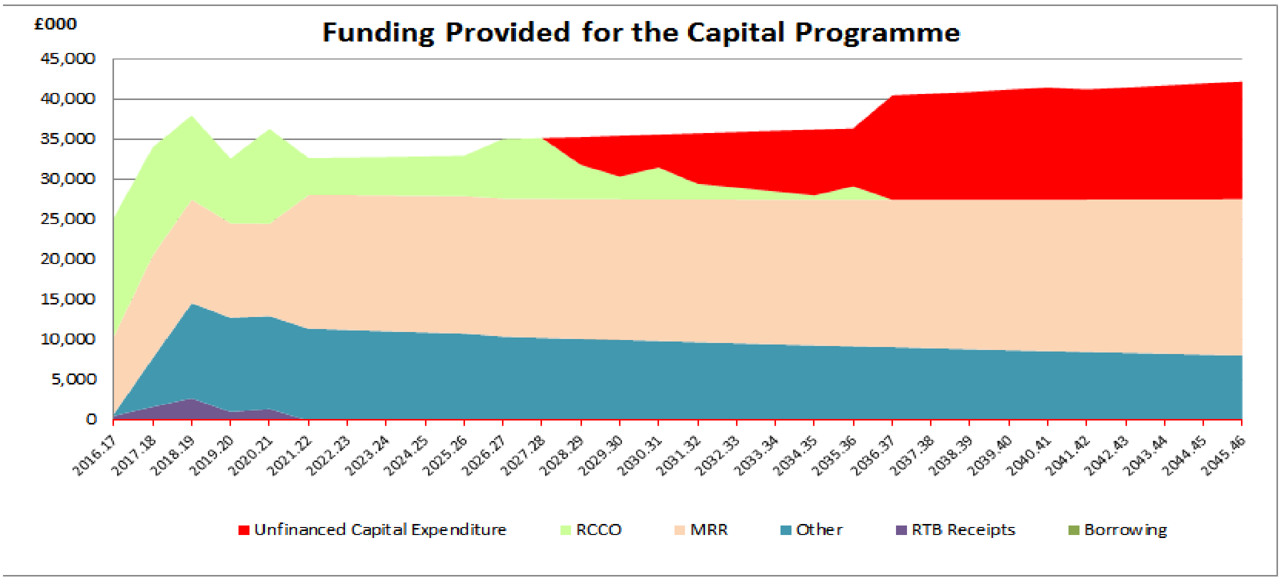
2.2.10 The net impact of the above changes on the overall ‘work in progress’ HRA 30 year business plan funding and spend projections, is illustrated below, graphically :

Graph 1 – HRA cashflow ; 30 year business plan current work in progress



2.2.11 Graph 1 above (dotted line) suggests the HRA would be able to maintain an overall balanced cashflow position to 2035-36, at which point the HRA starts to go into an operating deficit. However, while the revenue operating account is solvent (albeit with minimum balances of only £1.5m) by this point, the capital plan becomes unaffordable much earlier, by 2027-28. This is highlighted in the following graph :

Graph 2 – capital affordability over 30 years



2.2.12 The red shaded area in Graph 2 above indicates that the updated baseline capital plan resource requirement becomes 'unaffordable' from about 2027-28 onwards if the intention is to maintain existing housing stock at the decency standard over the entirety of the 30 year business plan. The above projection assumes no additional borrowing upto the HRA borrowing cap, but longer term the business plan is financially unsustainable, which indicates it cannot afford any new borrowing anyway.

2.2.13 The graphs as presented above are a work in progress, based on a current set of working assumptions and snapshot in time. In broad terms they suggest that there has been some progress in delivering at least in terms of short to medium term prospects for the HRA business plan, compared to 12 months ago, mainly due to the net impact of the current capital affordability baseline review which is ongoing, and delivery of £4m early savings in 2016-17 as part of last year's approved budget plans. However, a number of current working assumptions (e.g. annual levy, as per para 2.2.7 above), in the absence of government detail still awaited, need to be treated with caution here.

2.2.14 The illustrative scenario highlighted in the graphs above indicate that, notwithstanding further refinement of the business plan over coming weeks and months, the HRA business plan is nevertheless still some way yet from delivering financial sustainability over the longer term to the extent that it can continue to deliver the four key objectives set out at para 2.1.2 earlier, which remains the key focus for the self-financed HRA.

2.3 HRA RESERVES

2.3.1 Current and forecast HRA reserves are summarised at Table 1 below :

Table 1 – summary HRA reserves

	Balance at 31st March 2016	Forecast Movement in Reserves	Estimated Balance at 31st March 2017
	£m	**£m**	**£m**
General Reserves	(42.8)	-	(42.8)
Major Repairs Reserve (note 1)	-	-	-
total	**(42.8)**	**0**	**(42.8)**
Amounts set aside for specific purposes in future years:			
Business Risks			*8.5*
Working balance			*1.5*
Remaining reserves available to support HRA business plan requirements			**(32.8)**

(note 1) - opening balance of nil reflects the fact that there is an in-year contribution from HRA (annual depreciation charge - currently £15.6m) Which is then fully committed in-year to support HRA capital plan and pay down HRA debt. Statutorily this reserve cannot be used for any other purpose

2.3.2 Current HRA general reserves revenue commitments includes a set aside of £8.5m for business risks; in particular, with regard to proposed welfare reform changes, including a more wide-scale rollout of universal credit, which means direct housing benefit payments to Council tenants. The balance of commitments includes £1.5m working balance, and support to the HRA capital plan.

2.3.3 The forecast balance of reserves at £33m, are assumed to roll forward to support future year capital investment plans.

2.3.4 The annual HRA depreciation charge, which is just under £16m, funds the major repairs reserve. This reserve is fully committed each year, with no remaining balances to roll forward year on year.

2.3.5 A number of housing policy proposals following the implementation of the Welfare & Reform and Housing & Planning Acts remain subject to further government clarification. Depending on the outcome, some of the remaining reserves highlighted in Table 1 above may be required, at least short-term, to manage any significant financial impacts on the HRA bottom line, not currently factored in.