APPENDIX C.3

WAVERLEY BOROUGH COUNCIL

EXECUTIVE – 7 FEBRUARY 2012

Title:

HOUSING REVENUE ACCOUNT BUSINESS PLAN 2012-2041

[Portfolio Holder: Cllr Keith Webster]
[Wards Affected: All]

Summary and purpose:

This report introduces the new HRA Business Plan, detailing the move to self financing, recommending the repayment profile and outlining investment priorities.

How this report relates to the Council's Corporate Priorities:

This report relates to two of the Council's Corporate Priorities namely: **Improving Lives** – Improving the quality of life for all, particularly the more vulnerable within our society and **Affordable Housing** – Waverley will work hard to provide more affordable housing in the Borough for people in housing need. The Council aims to be an excellent landlord, managing its own housing stock well and improving the fabric and condition of its properties.

Equality and Diversity Implications:

There are none.

Climate Change Implications

There are none.

Resource/Value for Money Implications:

This report describes the financing issues affecting the Business Plan and the options for how the debt of £190m will be financed, together with interest rate assumptions and the sensitivities should interest rates fluctuate before 26 March 2012 when financing arrangements are agreed. Appendix C.4 includes the Revenue estimates for the Housing Revenue account for 2012/13 and Appendix C.5 the HRA Capital Programme for the year ahead.

Legal Implications:

There are none.

Background

1. Under the present housing finance regime, Waverley is required to return over 50% of rent receipts to the government as a “negative subsidy”.

2. This requirement has left the HRA starved of cash and unable to meet its obligations under the Decent Homes Strategy, or to fund other stock and service improvements to ensure a first class service.

3. Waverley established the campaign to bring about Self-Financing to replace the unfair subsidy system. In response the government consulted on proposals to effect changes to the way that Council Housing is financed in the future.

4. The result, effective from April 2012 is an entirely new way of funding the provision of council housing services in the future. Based upon a government formula most local authorities will have to accept a debt to be secured on their housing stock (Some authorities will have existing debt wiped out). In return local authorities will have much greater freedom over the management of their stock and the income derived from it.

Waverley’s HRA Business Plan

5. The importance of having a robust business plan for the Housing Revenue Account (HRA) is increased by the introduction of self-financing. The plan will be actively managed, rather than passively reported which was the case under the Negative Housing Subsidy regime, where many decisions affecting the landlord service were beyond Waverley’s control.

6 Under self-financing housing authorities are required to prepare a 30-year business plan for their HRA which includes all the income and expenditure attributable to the HRA. The plan is to be based on the self-financing settlement debt and must be sustainable, showing, with regard to financing, that

- debt can be serviced, and a prudent approach has been taken to its repayment
- the HRA will not go into a deficit position.

7 The attached HRA Business Plan at Annexe 1 sets out the recommended approach to the issues outlined above.

8 It has been drawn up with consideration of the Government model, prevailing interest rates and the 30 year stock investment plan.

What are the implications for Waverley?

9. The amount of debt which will be levied on Waverley is expected to be in the region of £190million and equates to approximately £40,000 per property. The final determination will not be known until the end of January. Given the value

of the council's housing stock of £295million (at March 2011) this gives a gearing ratio (debt/worth ratio) of approximately 64%.

10 Waverley is required to pay £190m to the Treasury on 28th March 2012. It is anticipated that the money will be borrowed from Public Works Loan Board (PWLB) as they are currently offering the cheapest interest rates. For example rates at 19th January are 3.16% for a 30 year loan.

11 In crude terms, to service the debt at current interest rates would cost approximately £8m per annum in the early years of the Business Plan, even if rates rise to the 4% assumed.

12 In 2011/12 Waverley's negative subsidy was £12.8 million. Thus, potentially the HRA will return a surplus for the first time in very many years, before considering principal repayments.

13 The Council needs to determine a policy for the use of any Business Plan surpluses. This needs to include adequate investment in the stock in order that the debt remains sustainable, the potential for new build and the need to repay the principal. This includes, but is not limited to, completing the outstanding Decent Homes work.

14 The Business Plan at Annexe 1 proposes, that based on the current business plan assumptions, the use of any surpluses over the lifetime of the plan will be as follows:

Year One to Five	1/2 stock improvement and 1/2 new affordable homes fund
Year Six to Ten	1/3 stock improvement, 1/3 new affordable homes fund and 1/3 debt repayment
Year Eleven to Thirty	1/4 stock improvement, 1/4 new affordable homes, 1/2 debt repayment

However, this proposal may be modified if the actual determination and actual interest rates differ from those modelled.

15 The scale and complexity of the potential housing works arising from the business plan will mean the Council needs to consider the level of resources necessary to deliver such a programme. This will require going into development mode and increasing staff capacity and commissioning external professional services as needed.

Debt Financing Options

16 There are a number of debt financing options that will have a significant impact on the Business Plan that need to be agreed before 1st April 2012. They are the:-

- **Source of loans**: The Government through the Public Works Loans Board (PWLB)/Bonds/Other Market Loans

- **Split between External and Internal loans**
- **Maturity Period**
- **Type of Maturity**: Maturity, Annuity or Equal Instalments of Principal
- **Basis of interest**: Fixed or Variable

17 These decisions will be taken with the advice of Arlingclose, the Council's Treasury management advisers appointed last summer.

18 Although the Council must take on a significant amount of new debt (latest estimate £189.503m) to buy itself out of the subsidy system the impact of servicing the debt as against paying negative subsidy is now mitigated due to the fact that interest rates are currently around 4%. The Government's decision to reduce the margin over gilt yields for Public Works Loans Board (PWLB) rates associated with HRA reform means that there is the strongest possible case for taking all of the debt from the PWLB. The requirement to agree to the borrowing on 26th March 2012 means that the Council cannot take any debt earlier, but has to rely on rates in the market on that single day.

19 There will be some scope to take some internal loans from the General Fund and HRA to reduce the amount of external loans required. It is estimated that it would be appropriate to fund £5m from internal funds which are not immediately required for cash-flow purposes. Using internal funds has the added advantage of reducing counterparty risk as those funds would normally have to be invested externally with banks and other financial institutions.

20 The decision about period to maturity must balance service priorities against the costs of debt financing. It is therefore not appropriate to simply opt for the cheapest overall financing arrangement because this would prevent the Council from meeting its housing objectives. With this in mind a number of options are considered which provide resources to meet the decent homes target, build new homes and improve the housing stock as well as repaying borrowing.

21 From certainty and affordability points of view, with loan rates currently extremely low, taking all debt at fixed rates would seem the most appropriate funding option. However, taking a relatively small element of variable rate debt, say up to 10%, could provide extra flexibility in the early years of the Business Plan if there are unplanned calls on expenditure which might mean that principal repayments are unwelcome at that time. The Council might plan for example, to start making principal repayments from year 6, but taking a 10 year variable loan with the PWLB would allow for re-payment at any point in the period without penalty if the financial situation became better or worse than planned. The risk of taking variable rate loans is that interest rates start rising and the costs of borrowing to the HRA also rise. A final decision will be taken on this on 26th March 2012, when Self-financing interest rates are published.

22 The following examples of Debt Repayment Profiles have been considered in the HRA Business Plan.

Options	Repayments	Years	Interest rates	Interest Paid over 30 Years	Balances to reinvest/repay debt
Option 1	No debt repayment	30	4%	£223m	£578m
Option 2	Repay from Year 1	15	Mixed Rate	£49.8m	£786m
Option 3	Repay from year 6	25	4%	£138m	£680m
Option 4	Repay from year 6	19	Mixed rate	£84m	£791m

23 Option 3 is the preferred option because it provides a reasonable balance between achieving and maintaining decent homes, stock improvements, providing new homes and allows for debt repayment, although it does not minimise the interest charges to the HRA.

Sensitivity Analysis

24 The key issue is the sensitivity in borrowing rates between now and 26th March 2012 and the impact that this has on the Business Plan and Financing Strategy. The following table illustrates the impact of movements from the modelled interest rate.

Borrowing rate	Interest costs £m	Impact on Business Plan (+/-)
3%	£104m	-£34m
3.5%	£120m	-£18m
4% (modelled)	£138m	-
4.5%	£154m	+£16m

Borrowing Options Risks

25 Making decisions about HRA debt finances involves the evaluation of risk. The following matrix highlights a variety of risks associated with the treasury management aspects of HRA self financing, together with indication of the level of risk associated with each financing option

Risk	Comment	Locking in to 30 yr Debt	Option 3 or 4	Earlier Repayment
Credit & Counterparty	Holding Debt & corresponding investment simultaneously	High	Low	Medium
Liquidity	Shortfall of cash, depending on any variable rate debt held	Low	Medium	High
Refinancing	Potential problem regarding replacing debt	Low	Medium	High

	at appropriate rates, either due to anticipated refinancing or as a result of an unexpected budgetary shortfall			
Interest rate – Borrowing the settlement	The nature of the HRA PWLB funding window concentrates risk on 26th March 2012 when initial funding rates will be agreed	High	Medium	High
Interest rates – ongoing borrowing	Exposure to an adverse upward movement in interest rates	Low	Low	Medium
Market	Relating to premature repayment of debt/adverse premium levels	High	Medium	Low
Legal & Regulatory	Compliance with relevant statutes, codes of practice and the approved treasury management strategy	Low	Low	Low
Fraud, error, corruption & contingency	The size of the settlement sum and transacting on one day increase risk	Low	Low	Low

26. A balanced repayment profile over a realistic period (Option 3) avoids a high exposure to each of the risks identified above. While risk can never be completely mitigated, a balanced approach to the debt structure will help ensure that the Council is not exposed to concentrated risk arising from unforeseen changes in circumstances. Risk will be limited via the use of a combination of different loan maturities. Borrowing at such low rates initially also helps mitigate liquidity risk as the terms of any refinancing necessary are likely to be favourable over the 30-year period. The actual profile will be determined by the actual interest rates available on 26th March 2012.

Conclusion

27 The financing of the Council’s landlord service will change from April 2012. Although Waverley is faced with taking on an unprecedented amount of debt, the Business Plan indicates that there will sufficient resources available to fund debt repayments as well as service aspirations as a landlord and for Waverley as a strategic housing authority.

28 The HRA Business plan sets out the proposal for balancing the key requirements of managing the debt, investing in the stock and the provision of new affordable homes in the Borough, over the next thirty years

Recommendation

That the Executive considers any comments from the Community Overview and Scrutiny Committee and makes the following recommendations to Council

8. approval of the Housing Revenue Account (HRA) 30 year Business Plan at Annexe 1;

9. authorisation to the Deputy Chief Executive to raise debt up to the borrowing cap, currently £193m, subject to the final Self-Financing Determination and on terms to be agreed in consultation with the Leader, Deputy Leader and the Chief Executive, having regard to the advice of the Council's treasury management advisors;

10. that the HRA debt can include internal borrowing from the General Fund of up to £5million;

11. authorisation to the Deputy Chief Executive to agree the debt repayment profile in consultation with the Leader, Deputy Leader and the Chief Executive having regard to the advice of the Council's treasury management advisors; and

12. to request that officers report to the Executive in March with a headline delivery action plan for the developments referred to in the Business Plan.

Background Papers

Implementing self-financing for council housing February 2011; HRA Self-financing Determinations November 2011

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