

WAVERLEY BOROUGH COUNCIL
LANDLORD SERVICES ADVISORY BOARD

27 OCTOBER 2022

Title:

**HOUSING REVENUE ACCOUNT BUSINESS PLAN –
STRATEGIC REVIEW**

Portfolio Holder(s):

Cllr Nick Palmer, Co-Portfolio Holder for Housing (Delivery)
Cllr Paul Rivers, Co-Portfolio Holder for Housing (Operations)
Cllr Mark Merryweather, Portfolio Holder for Finance, Assets
and Commercial Services

Head of Service: Andrew Smith, Executive Head of Housing

Key decision: No

Access: Public

1. Purpose and summary

1.1 This report sets out the revised Housing Revenue Account Business Plan strategy following the completion of the strategic review commissioned in February 2022.

This report contains the following Annexes:

- Annexe 1 – HRA Business Plan 2022/23 to 2052/53
- Annexe 2 – Housing Reserves
- Annexe 3 – Housing New Build Summary

2. Recommendation

2.1 It is recommended that the Board make comments to the Executive on the proposals:

1. To approve the revised HRA business plan strategy set out in this report.
2. To approve the proposed movements, restrictions and purposes of reserves as set out in **Annexe 2**.

3. Reason for the recommendation

3.1 To provide the Board with the opportunity to assess the outcomes of the HRA Business Plan Strategic Review. Feedback on the proposal to manage resources to fund Waverley Borough Council's Landlord Services operations, maintenance programme, zero carbon commitments and building new affordable homes on a long-term financially sustainable basis.

4. Background

4.1. The annual update of the self-financing HRA 30-year Business Plan considered by Full Council on 22 February 2022 included a recommendation to undertake a strategic review to address the challenges faced within the HRA business plan and return it to a sustainable financial footing. The outcome of this review is reported below.

4.2. The HRA and General Fund are not separate legal entities, the HRA is a ring fenced account within the General Fund restricting the use of income and management costs of the housing functions in compliance with the Housing Acts (Statute). The HRA Business Plan is a rolling 30-year self-financing plan reflecting the key long-term strategies to deliver the commitments within the Corporate Plan including managing, maintaining, and building new social and affordable housing for Waverley's tenants. The plan complies with and is affected by government statute and policy whilst being independent of any central government support. The HRA Business Plan adjusted to reflect the outcome of the strategic review proposals is presented on **Annexe 1** and referred to in this report.

4.3. The Business Plan originated in 2012 to support the compulsory buy out of the government rent subsidy system costing the council £193m, funded from a schedule of borrowing to be repaid from the rent income over 30 years, whilst providing funding to build new homes. However, in the last 10 years, there have been changes to the statutory regulations such as lifting of the borrowing cap to facilitate new house building. Government rent control policy changes initially forcing a 4-year rent reduction then a 4-year capped increase and a long-term alignment with a common rent standard applicable to all Registered Providers including the council. More recently the Business Plan is being impacted by the economic shocks resulting from Covid, global supply issues and the Ukrainian war. These issues have presented challenges to contain the resulting inflationary spikes in cost and the need to resist passing the full effect of these short-term economic shocks onto the council's tenants in above long-term average annual rent increases.

Debt repayment and borrowing strategy

4.4. Over the next 18 years, the original business plan was set to repay the borrowing in tranches as a direct deduction from the rent income, with debt repayment ratcheting up each year from initially around £4m rising to £17m, and the business plan being free of borrowing after 18 years. The original business plan included an assumption of rent increases of 1% above the long-term HM Treasury inflation target of 2% to provide sufficient rent income to cover debt repayment and housing maintenance. Due to subsequent changes in government rent policy, which forced a real rent reduction of 1% per year over 4 years and the recent economic shocks, the plan to be debt free is no longer achievable because the annual rent income is not sufficient to cover debt repayment and maintenance. The council will now have to change its strategy and borrow to fund the contractual debt repayments over the next twelve years to free up rent income to fund the housing maintenance and energy efficiency programme.

Funding the housing maintenance strategy

4.5. The council must not borrow more than is necessary to fund its maintenance programmes and there are statutory rules on what kinds of maintenance can be funded by borrowing. This is conventionally limited to maintenance that can be capitalised on the balance sheet and amortised over the life of the components reflecting the long-term replacement cycles of key housing components such as central heating, bathrooms, roofs etc. The amortisation of components funded by this strategy will be set aside for debt repayment, instead of being used to fund further maintenance works, to prevent the council from building up an unsustainable level of debt which would ultimately be funded from the rental income.

4.6. The amount of borrowing required to fund debt repayment as it falls due each year will depend upon the detail of the stock condition survey currently being commissioned to inform a revised asset management plan. This work will take up to two years to complete. The business plan put to Full Council in February 2023 will reflect these logistics.

Staffing and management costs

4.7. The cost of managing the housing service must be funded from the rental income and there is a statutory prohibition on borrowing for such costs. There is a direct trade off between staffing and management costs and the funding of maintenance programmes. Every £1 increase in staffing and management costs reduces the rental income funding available for maintenance and therefore increases the need to borrow and ultimately the interest costs charged against the rental income. Staffing and management costs must therefore be optimised and achieve economies of scale through efficiencies and collaboration opportunities. It is recommended that these costs are cash limited for the next 4 years with an additional savings target supported by a strategy to deliver that reflects available efficiency opportunities. This detail will be worked up for the 2023/24 Business Plan due to be presented to Full Council in February 2023.

Rent Income

4.8. The original business plan assumed rent increases in line with HM Treasury long term inflation target of 2% plus 1%. For reasons already explained this has not held true. The government has set a maximum rent increase of CPI plus 1% for the next three years, in the current turbulent economic climate this policy does not work. It will generate significant rent increases resulting from what is predicted to be relatively short-term economic issues in a long term (30 year) business plan.

4.9. Rent increases need to be set with a long-term view and smoothed to reflect the actual long term inflation trend with appropriate weightings to iron out the short-term inflation spikes whilst ensuring the business plan is not unreasonably being deprived of resources. This is justified by the correlation of rent increases to the upward only year on year cost of living increase in staffing costs compared to the cost of maintenance and utilities which is much more fluid and flexible in a competitively tendered market.

Inflation pressures

4.10. Inflation within the HRA operational cost base has been assumed at 3% in the original Business Plan, this assumption has held reasonably true prior to the current economic challenges and has generally been benign. However, inflation is now a significant issue, and it is important that its impact on the different aspects of the Business Plan is understood beyond the broad media headline of CPI to ensure effective cost control strategies are implemented and rent increases are proportional to the long term inflation forecast. The table below demonstrates how inflation impacts different elements of the HRA cost base.

2022/23 budget	£x1000	%age	Inflation assumptions
Salaries derived cost	4,448	24%	Cost of living increase ~ 3%
Utilities	311	2%	Currently ~400%
Council tax	100	1%	Referendum principle ~2% Negotiable around CPI
Responsive maint contract	6,104	33%	~11%
Debt interest	5,328	29%	No inflation
Other operational costs	2,328	13%	Cash limited
Operational cost	18,619	100%	

4.11. Clearly within the cost base there is a wide scope to mitigate the impact of short-term inflationary pressures. Total salary costs can be cash limited with the inflation pressure managed through efficiency measures and delaying recruitment where adverse service impact risk is low or acceptable. Utilities relate to the cost of voids and supported living schemes, where usage can be actively managed and service charges reviewed. Council tax is entirely the cost of void properties and proportionally insignificant. The responsive maintenance contract inflation is negotiable, and the contract volumes are flexible, careful risk-based prioritisation of repair work can reduce cost exposure. Whilst the core maintenance programme does not feature directly in the operational costs, it also is affected by inflation, and there are options to manage inflation in this programme through careful management and prioritisation.

New homes building strategy

4.12. In the original business plan the council's ability to borrow to build new homes was capped by the government. To facilitate the funding of a small build programme the repayment of the £193m debt was delayed 5 years to enable a new build reserve to be accumulated.

4.13. The lifting of the borrowing cap four years ago has enabled a new strategy to be developed to fund the building of new affordable homes. The new strategy proposes that the construction/land costs are funded by a combination of Right to Buy sales receipts and borrowing. Financial viability is always challenging on new builds that are let at below market rent (i.e. affordable or social rent). Affordable rent on new homes does not usually cover the full annual cost of a home including the borrowing costs for quite a number of years and requires a subsidy to make up the shortfall. The solution is to subsidise the annual rent deficit (rent less costs) from the New Development Impact Reserve until the rent increase catches up with the annual costs (including fixed annual borrowing costs). This ensures the reserves funding can be utilised over a bigger number of new homes than the alternative to subsidise the build cost from the new build reserve to reduce the borrowing costs, which would quickly deplete the reserve. The pipeline of new build projects is demonstrated on **Annexe 3**.

Reserves

4.14. A full review of HRA reserves has been completed as part of the strategic review. It is proposed that the New Affordable Housing Reserve and the Stock Improvement Reserves are consolidated into a New Development Impact Reserve which will be used to cover the revenue impact on the business plan from New Development Schemes.

4.15. It is a statutory requirement to maintain a HRA minimum working balance, there is no statutory prescription on how much this should be and the Chief Finance Officer (Section 151) considers £2m to be appropriate. The modelling of the HRA Business Plan therefore focusses upon maintaining at least £2m in the HRA working balance across the full term of the business plan.

4.16. The use of Right to Buy receipts are restricted to funding no more than 40% of the cost of a replacement home (whether through acquisition or new build) within 5 years of receipt or are due to be paid over to the government. To avoid clawback a pipeline of new builds is required, including the purchase of Affordable properties from developers under section 106 agreements.

4.17. The Unrestricted Capital Receipts reserve is a corporate reserve originally designated to support the new build programme prior to the borrowing restrictions being lifted. The requirement for this reserve now falls away under this new HRA Business Plan strategy and can be utilised to support other corporate capital project priorities.

Garages

4.18. Garages are currently accounted for within the HRA ringfence as they were originally provided by the Council under Housing Act powers in connection with the housing provided by the Council. However, over time these have mostly been let on a commercial basis to private tenants and no longer in connection with our HRA tenancy. Over 75% of garages are now rented privately by non-HRA tenants.

4.19. As the majority of the Council's garages are no longer rented by HRA tenants, they can no longer be considered to be required for housing purposes, and it is therefore proposed to appropriate them along with on-going maintenance liability and the income generated to the General Fund.

4.20. A separate report will follow on this including financial implications and recommendations.

Sensitivity analysis

4.21. A full sensitivity analysis has been completed to model the effect of different assumptions impacting upon the HRA Business Plan to ensure that the fundamental principles of the new strategy are viable. A full analysis of the sensitivities will be provided with the 2023/24 Business Plan due to be presented to Full Council in February 2023. Information on the sensitivity modelling can be seen on **Annexe 1**.

Local Government Act 2003 – Financial Administration

4.22. The Local Government Act 2003 formally introduced several specific sections covering:

- 4.22.1. Budget calculations, report on robustness of estimates,
- 4.22.2. Adequacy of reserves and
- 4.22.3. Budget monitoring

4.23. Robustness of Estimates - Full account has been taken of potential costs and adequate provision has been made. A prudent assessment of income has been undertaken and only income that has a high level of certainty of being received is included within the Council's budgets.

4.24. The Council's HRA Business Plan, together with information presented at the Annual Member Finance Briefings and subsequent reports demonstrate the financial challenges to Waverley Borough Council and Landlord Service in the future.

4.25. In view of the level of awareness amongst Members and the action taken to produce the Council's budget in 2022/23, the S.151 Officer is satisfied with the robustness of the estimates presented.

4.26. Adequate reserves - are necessary to meet significant cost that could not reasonably have been foreseen in the preparation of the budget. The levels of the HRA working and repairs fund balances have been reviewed and the working

balance is at least £2m. **Annexe 2** shows the schedule of HRA balances and reserves.

4.27. Budget Monitoring - It is the view of Waverley's Section 151 Officer that the arrangements for budget monitoring, referred to above, satisfy the requirements of the Local Government Act 2003. Budget Monitoring in 2021/22 shows that the HRA is staying within budget on capital and revenue overall.

5. Conclusion

5.1. The team has completed a comprehensive strategic review of the Housing Revenue Account and proposes appropriate strategies to ensure income stream increases, capital works, improvements and new build budgeted programmes and the maintenance of healthy reserves to deliver the HRA Business Plan objectives.

6. Relationship to the Corporate Strategy and Service Plan

6.1. Waverley's landlord service deals with the management and maintenance of existing council homes and delivering housing. The Corporate Strategy aims to maximise the availability of housing that meets the needs of local people at all income levels and emphasises the value and worth of all residents. A viable business plan needs to be in place to aid delivery of these priorities.

7. Implications of decision

Resource (Finance, procurement, staffing, IT)

7.1. All decisions made regarding the budget will impact on Waverley's resources.

8. Risk Management

8.1. Risks inherent with the delivery of a sustainable Business Plan have been identified along with appropriate solutions within the report.

9. Legal

9.1. Section 24 of the Housing Act 1985 provides that a local authority may make such reasonable charges as they determine for the tenancy or occupation of their houses. The Council must review rents from time to time and make such charges as circumstances require.

9.2. Under Section 74 of the Local Government and Housing Act 1989, the Council is obliged to maintain a separate Housing Revenue Account and by Section 76 must prevent a debit balance on that account. Rents must therefore be set to avoid such a debit and the Council must set a balanced HRA budget.

10. Climate emergency declaration

10.1. The New Build contribution to the Council's environmental and sustainability objectives includes working with consultants to develop climate positive design and developing carbon off-set opportunities in materials used in construction

10.2. The consultant and contractor shortlisting / tender process supports the Council's ambition of being carbon neutral by 2030. Tender criteria are used to enable the Council to take account of the qualitative, technical and sustainability aspects of the tender as well as price when evaluating and reaching a contract award decision.

10.3. Demolition contractors are required to operate in an environmentally responsible manner with a firm commitment to recycle and reclaim the maximum materials recovered during the demolition and dismantling process.

10.4. Our build contractor appointment includes an assessment of responses in relation to minimise the carbon impact on delivery of schemes with specific references to addressing their environmental impact, pre-construction activity, build and post construction phases and management of their supply chain.

10.5. Contractors are required to demonstrate areas of innovation that they have developed, or suggest products and advise how they might be used in projects delivered with the council; having regard to the council's current Design Standards and Employers Requirements to deliver energy efficient and sustainable homes for existing and future tenants

10.6. The Waverley Borough Council Housing Design Standards were reviewed by the Housing Overview and Scrutiny Working Group and the resulting recommendations were formally adopted by the Executive in September 2021. The focus of the review was on opportunities and methods of delivery of carbon neutral / Passivhaus homes and value for money.

10.7. The development teamwork with other teams to identify ways the delivery of the Council's new build and regeneration programme can support delivery of other elements of the Council's Climate Change and Sustainability Strategy and Strategic Carbon Neutrality Action Plan.

10.8. Sustainability and reducing carbon are central to the review of the Asset Management Strategy, Responsive Repairs contract and capital works programmes.

10.9. Meeting the climate change emergency in respect of the council's housing stock is both financially and resource intensive. Detailed work will be done alongside the stock condition survey to understand the works required and how best to delivery them within the HRA Business Plan.

11. Consultation and engagement

The Portfolio Holders and the Landlord Services Advisory Board have been consulted on this paper. The Resources Overview and Scrutiny Committee will scrutinise the HRA Business Plan Strategic review at their meeting on 7 November 2022.

12. Other options considered

Alternative rent increases have been included in the sensitivity analysis referenced in 4.21.

13. Governance journey

Landlord Services Advisory Board on 27 October 2022 and Resources Overview and Scrutiny 7 November 2022, Executive on 29 November and Council 13 December 2022.

Annexes:

Annexe 1 – HRA Business Plan 2022/23 to 2052/53
Annexe 2 – Housing Reserves
Annexe 3 – Housing New Build Summary

Background Papers

There are no background papers, as defined by Section 100D (5) of the Local Government Act 1972).

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