
Housing Revenue Account Business Plan 2024/25 and 2025/26

Report and Commentary

Final Report

January 2025

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1. Introduction

1.1. Background

Medway Council has retained Savills Affordable Housing Consultancy to support officers in the production of the annual Housing Revenue Account (HRA) Business Plan.

This report summarises the business plan outputs for 2025/26 and sets out the financial capacity and capability of the HRA to deliver on the Council's objectives towards the delivery of landlord services, stock investment, regeneration and new supply. The approach taken is consistent with the requirement for the publication of Prudential Indicators specific to the HRA.

Savills have worked with officers to update the previous iteration of the HRA business plan that was produced commencing financial year 2023/24 and published in February 2024.

In developing the plan and preparing this report, we have taken account of key economic and inflationary drivers as well as a number of policy and related changes at a national level introduced as a result of and alongside the Budget of 30 October 2024, as well as key local drivers within Medway. In summary these could include:

- Increased repair and capital investment costs in the existing stock due to high levels of inflation and shortages in the labour sector, coupled with improved stock condition data
- Increased development costs in respect of the new build schemes that are currently being undertaken due to the same cost pressures as above
- Continued high levels of interest rates available from the PWLB, albeit with discounts applied for HRA borrowing currently
- Costs of enhanced regulation arising from the Building Safety Act 2022 and Social Housing (Regulation) Act 2023
- Potential for significant continuing inflationary pressures on operating costs which could outweigh income growth in the short-term
- A government consultation on future rent increases, including CPI+1% increases for 5 years from 2026 with proposals to extend this to 10 years
- Changes to the Right to Buy (RTB), including reductions in discounts and the retention of 100% of all RTB receipts for reinvestment in Medway
- The potential for the HRA to have to provide for employers National Insurance cost increases as provided for in the government's Budget, if not met through 'new burden's' funding.

The plan is based on 2024/25 forecast outturn and 2025/26 draft budgets, and is therefore subject to further changes for in-year variations and budgetary amendments if these arise as the business plan goes through the formal approval process.

1.2. Approach

This report sets out our findings as follows:

1. The outputs from the latest HRA business plan model in the light of the latest market conditions, national policy changes, local policy initiatives and other factors (as set out above).
2. Outputs from financial modelling and sensitivity testing (where appropriate) to establish alternative delivery scenarios for the business plan.

2. Business plan model - Baseline

2.1. Introduction

The latest version of the HRA Business Plan financial model has been developed from information provided by officers based upon the estimated outturn position for the 2024/25 financial year and the proposed budget for 2025/26; the baseline plan model provides the basis for this report.

The model has been developed via a series of meetings with officers from finance, housing and regeneration teams to agree the methodology and assumptions.

2.2. Overview of methodology and assumptions

Overall

The plan is based on the overarching principles as set out below.

- 30 year projections launched from 2024/25 based on the latest forecast outturn for 2024/25 and the 2025/26 draft budget
- Core inflation projected at (subject to scenario testing):
 - 2.7% for 2026/27
 - 2.2% for 2027/28
 - 2.0% from 2028/29 onwards
- Rents increasing at:
 - An assumed increase of 2.7% for April 2025 (in line with the current social rent policy of September 2024 CPI plus 1%)
 - Rent increases of CPI plus 1% for the following 5 years, before reverting to CPI only from April 2031
- Garage inflation assumed to be in line with dwelling rent inflation
- Provision for depreciation increasing at CPI throughout
- Capital maintenance of the existing tenanted stock (subject to Right to Buy sales) is initially modelled at a total of £275 million (at today's prices before any adjustment) over the 30 years from 2024/25. This equates to £90,920 per property (including £19,210 per property for increased energy works), which is above benchmarks based upon recent LGA research undertaken, but with averages rising as more condition surveys are completed.
- Inclusion of a range of new build schemes as included in the capital plan
- Inclusion of a notional new build programme from 2028/29, delivering 30 homes per year in line with a commitment to increase supply by 1% per annum.

- Interest calculated using the HRA Capital Financing Requirement (CFR), at a rate of 4% for existing borrowing at 1/4/2024 and market rates beyond this for new borrowing.

The overall methodology within the plan is founded on the following key approaches:

- Borrowing for new build and investment in the existing stock is approximately £413m, with a significant proportion of borrowing in the later years in respect of new build supply
- The HRA debt (Capital Financing Requirement or CFR) is adjusted annually in line with the Council's debt repayment policy, which requires debt repayment or minimum revenue provision to be made on an annuity basis.

We have set out below further details in respect of some of the key inputs and assumptions.

Rents

Rents follow current guidance with relets to new tenancies at the relevant formula rent (rather than the outgoing rent).

Void rates of 1.73% have been adopted from 2025/26, and an annual contribution to the bad debt provision of 0.33% has been modelled throughout the plan (2025/26 has been included at a lower level in line with the proposed budget).

The government has previously announced that rents will go up by a maximum increase of CPI plus 1% as at September 2024 from April 2025, which will equate to 2.7%. The draft Policy Statement on Rents for Social Housing assumes a continuation of increases at CPI plus 1% for a further 5 years from April 2026, with a clear intention to extend this for up to a further 5 years (subject to a consultation process that closes on 23 December).

The baseline plan assumes that rents will increase in line with the draft Policy Statement, with CPI plus 1% increases for a further 5 years for prudence whilst the outcome of the consultation is awaited. Any national decision to extend CPI plus 1% increases for rents beyond the initial 5 years will positively impact the plan, and has therefore been modelled as a sensitivity.

Right to Buy sales volumes

The level of sales is modelled at 7 per annum in 2024/25, 10 in 2025/26, reducing to 5 per annum from 2026/27, with the recent government announcement surrounding returning to the pre-2012 maximum discount levels from 21 November 2024 not expected to have a material impact on the small volume of sales experienced in Medway. The discount changes have now reduced the maximum discount from £102,400 to £38,000.

Estimated sales over the next 30 years account for a stock loss of 5.2% over the plan period (excluding any regeneration schemes). It might be expected that the Council will see a marginal increase in sales volumes in the latter part of 2024/25 and early part of 2025/26 due to a higher than normal volume of applications prior to the discount changes coming into effect, and a reduction to below 5 sales per annum once the reduced discounts take full effect, although any impact will be marginal. We have made adjustments to rents, repairs and future investment expenditure to reflect the stock losses incorporated.

Capital Works to Existing Properties

The model reflects the existing capital programme for the first 4 years, moving to the latest estimates from the stock condition survey as below from April 2028, with backlog works assumed to be completed over a 10 year period from 2028/29 onwards.

The energy uplift investment, which allows for the replacement of gas boilers with heat pumps from year 11 onwards is included as part of the baseline financial model.

Table 2.1 – Stock Investment Requirements (base year prices)

	Backlog	Years 1 to 5	Years 6 to 10	Years 11 to 15	Years 16 to 20	Years 21 to 25	Years 26 to 30	Total
Communal Works	840,049	744,527	1,014,989	369,486	1,691,298	1,154,102	940,479	6,754,930
External Work	7,422,335	15,893,440	14,968,041	8,793,620	4,761,005	3,965,993	6,901,011	62,705,445
Internal Works	6,501,263	20,277,135	14,747,888	10,727,713	12,808,360	14,319,611	15,470,082	94,852,051
Other Works	0	5,683,330	5,333,330	5,333,330	5,333,330	5,333,330	5,333,330	32,349,980
Energy Works	0	2,000,000	2,400,000	4,000,000	4,000,000	4,000,000	4,000,000	20,400,000
Total	14,763,647	44,598,432	38,464,248	29,224,149	28,593,993	28,773,036	32,644,902	217,062,406
Energy Works	0	0	0	11,808,050	22,885,530	11,638,150	11,808,050	58,139,780
Total Including Energy Uplift	14,763,647	44,598,432	38,464,248	41,032,199	51,479,523	40,411,186	44,452,952	275,202,186

The total level of expenditure over 30 years in the above table has increased by £97 million from data used for the previous iteration of the plan, equivalent to a 56% increase. This is not only to take account of the latest investment requirements and contract prices, but also to incorporate £58m of energy investment to ensure a more sustainable heating and hot water source is installed in homes during the life of the plan.

New Build Assumptions

The plan provides resources and external funding assumptions for the delivery of 179 new homes over the first 4 years of the plan, on sites already approved in the capital plan.

The plan also includes provision for the delivery of an estimated 30 homes per year from 2028/29 onwards, to fulfil a commitment to increase council rented housing supply by 1% per annum on an ongoing basis.

Rents for new properties are modelled at affordable rent levels as anticipated for each scheme, or at an average of the 1- and 2-bed Local Housing Allowance rates where rent levels are not yet available. A provision for future repairs and capital maintenance costs is made within the plan.

Interest Rates

Medway Council has a debt repayment policy, which requires debt repayment or minimum revenue provision (MRP) to be made on an annuity basis each year. Debt repayment in respect of the opening HRA debt, has been incorporated into the financial model in line with the annual values supplied by the Council.

Short-term external borrowing rate assumptions have increased marginally since last year, but with a long-term market rate of 4% still assumed for new borrowing. The rate assumed for the existing HRA borrowing has reduced from 4.2% to 4.0%.

The opening HRA CFR is £45.5 million with no fixed loans attributable to the HRA. In line with previous iterations, the business plan makes provision for the part-repayment of loans as part of an MRP mechanism. The values have been calculated on annuity values provided by the Council. It should be recognised that there is no statutory requirement for the repayment of debt, and given the 'one-pool' nature of the council's treasury management for both the HRA and General Fund, there may be a need to revisit this as future borrowing is required.

All new borrowing rates for development and investment in the existing housing stock have been included based upon general market assumptions, and are:

- 4.95% for loans drawn down in 2024/25
- 4.85% for loans drawn down in 2025/26
- 4.85% for loans drawn down in 2026/27
- 4.50% for loans drawn down in 2027/28
- 4.00% for loans drawn down from 2028/29 and beyond

All new borrowing is treated as a 'revolver' loan type facility within the financial model, with interest charged at the above rates, and no repayment or minimum revenue provision has been assumed.

2.3. HRA Business Plans Projections – Baseline

As set out above we have modelled the capacity of the business plan not only to meet existing minimum revenue provision commitments, but also to invest in existing homes to improve their energy efficiency, whilst also demonstrating overall financial sustainability. In doing so, a minimum balance for the HRA at 10% of gross income has been applied, resulting in a minimum balance for 2025/26 of £1.9m in place of the £750k incorporated last year.

Various methodologies can be applied for arriving at a minimum reserve balance:

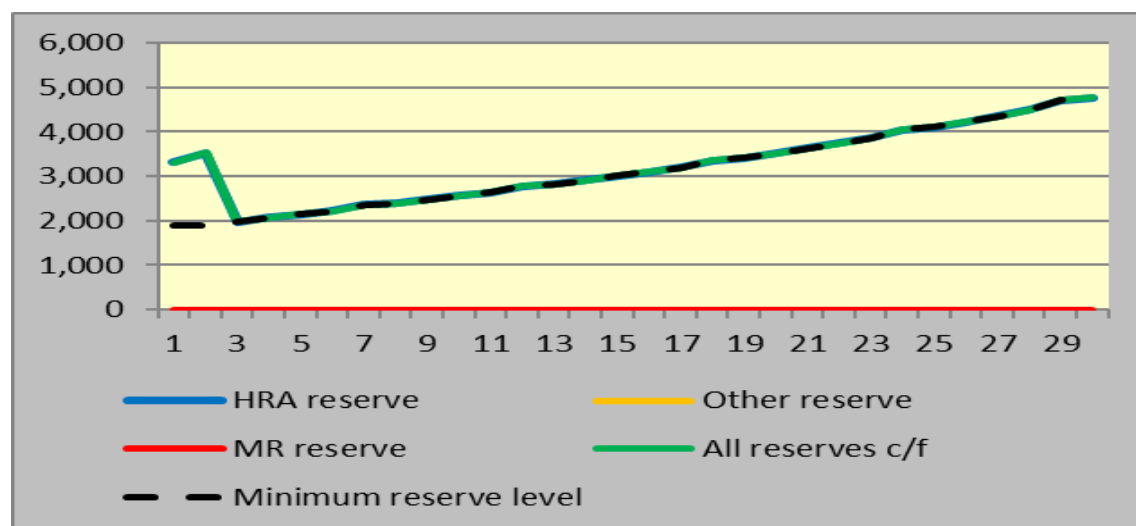
- Equivalent to a period of gross expenditure. In the case of Medway Council £1.9 million is equivalent to 1.6 months of expenditure; elsewhere we have seen 1.7 months set as a basis

- A percentage of turnover is also adopted at other LA's, with authorities we have worked with having set the target limit at minimum 10% of turnover, as adopted by Medway as part of this iteration of the business plan
- Finally a straightforward allowance per unit could be used, which equates to £628 per unit whereas values closer to £900 per unit are modelled elsewhere.

Having considered the above benchmarks, the previous starting level of reserves of £750k included in the business plan last year has been reviewed, resulting in a revised policy to maintain reserves at 10% of gross income from 2025/26.

Therefore, the charts below show HRA reserves, maintaining a minimum balance of 10% of gross income with the maximum level of resources available from the HRA utilised to finance the capital programme.

Chart 2.1 – Projected Initial HRA balances



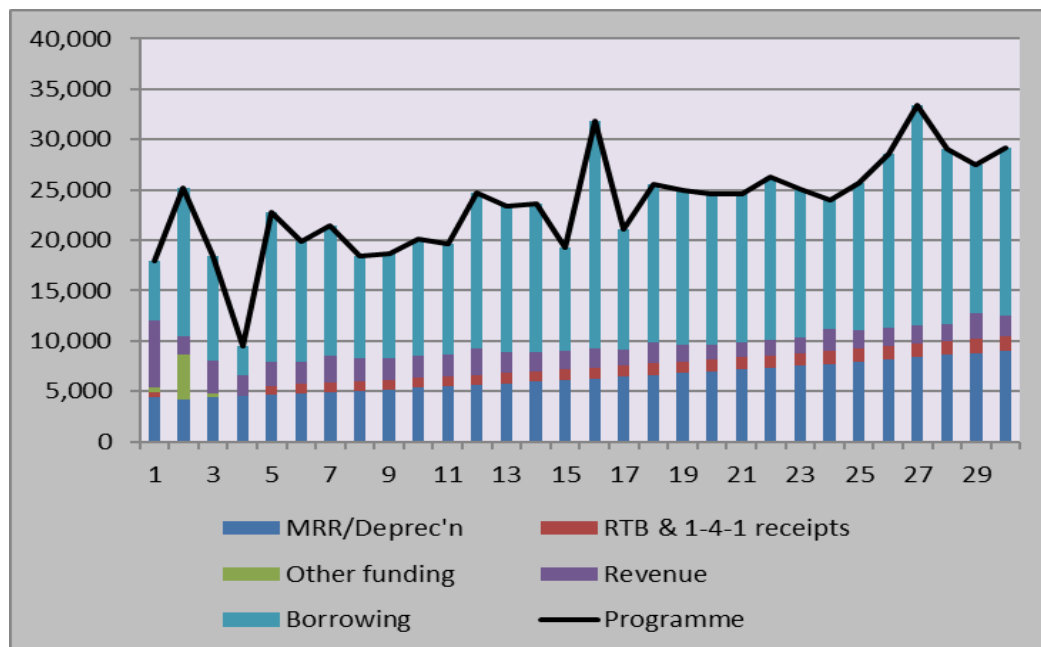
These projections demonstrate that in all years the HRA is able to maintain reserves at, or above the minimum level set, which increases over time as income is inflated.

The above graph demonstrates that projected balances will be maintained at the suggested 'golden-rule' of 10% of turnover, but providing no additional revenue contingency (surplus) within the plan.

The driver for the reduction in balances in year 3, is the assumption that following revenue contributions to capital in 2024/25 and 2025/26 in line with existing or proposed budgets, HRA reserves are thereafter utilised to make further revenue contributions "down" to the minimum level; this mitigates the need to borrow further in year.

The model maximises available revenue contributions to capital throughout the 30 years, whilst maintaining balances within the HRA revenue reserve at the agreed minimum.

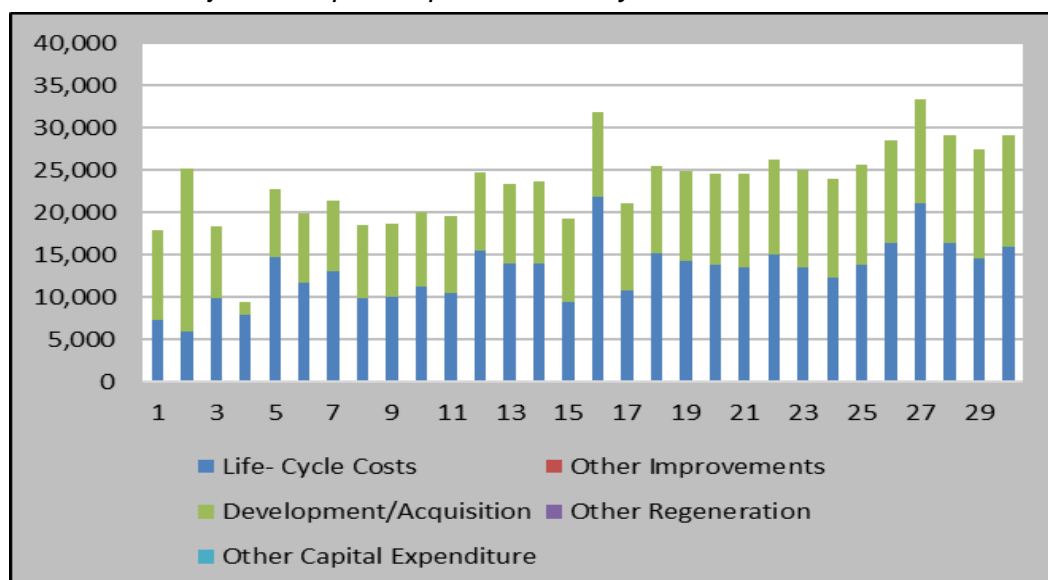
Chart 2.2 – Projected capital expenditure and financing



Capital expenditure is fully funded throughout the 30 years demonstrated by the horizontal black line, with significant borrowing required throughout the life of the plan in part to facilitate investment in the existing stock, but also to maintain an ongoing new build programme.

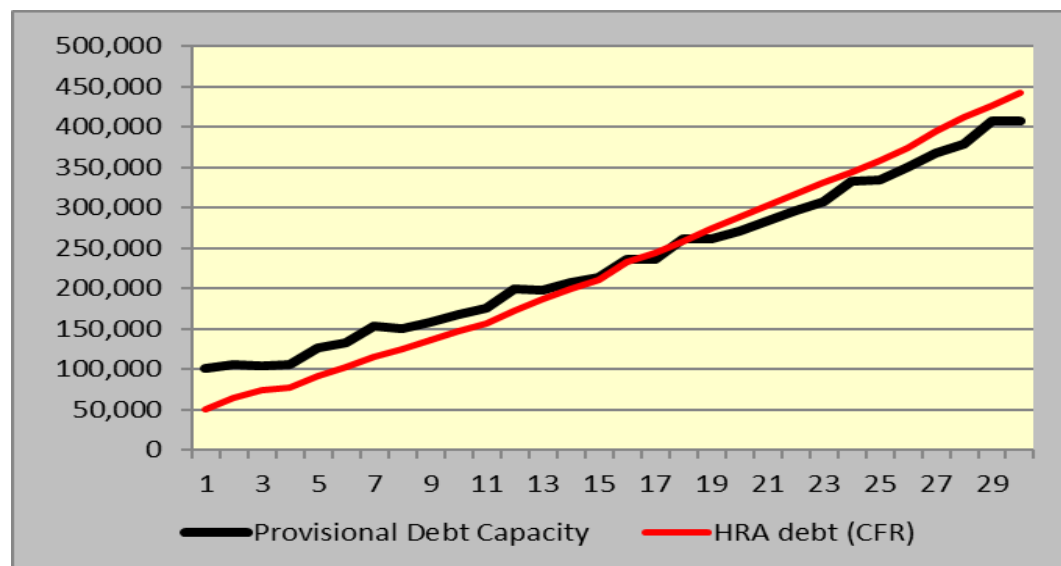
Capital expenditure gradually increases over the life of the business plan, with additional energy investment from year 11 onwards to enable gas boilers to be replaced with heat pumps, whilst also continuing to deliver a new build programme of 30 homes per year to meet the commitment to increase rented homes by 1% per annum.

Chart 2.3 – Projected Capital Expenditure Analysis



In order to finance the levels of capital expenditure demonstrated above (charts 2.2 and 2.3) the projected debt (HRACFR) is demonstrated in the graph below.

Chart 2.4 – Projected Initial debt profile (HRA CFR) and Provisional debt capacity



Borrowing is projected to increase throughout the life of the plan, to a total of £442m by year 30, with borrowing required throughout to meet both investment in the existing stock and the delivery of new homes for the HRA.

The provisional debt capacity in the chart above is measured on the basis of the Interest Cover Ratio (ICR) which sets out one basis for setting a prudent limit on borrowing based on the underlying net income generated within the plan. Borrowing sits just below the provisional debt capacity, as measured by an interest cover ratio of 1.25, until year 17, after which it moves above this level marginally to an interest cover ratio of 1.15 by the end of the plan, leaving no additional borrowing capacity in the plan.

The ICR is calculated as operating surplus divided by interest costs, and represents the cover that the HRA has against its interest cost liabilities in any year; the ICR is set to a minimum which provides comfort that if there were a sudden drop in income or increase in operating costs, there would be sufficient headroom to continue to cover debt interest. For housing associations, the usual definition of operating surplus is EBITDA-MRI (Earnings before Interest, Tax, Depreciation and Amortisation – Major Repairs Included).

There are financial pressures within the housing association sector that are parallel to those affecting local authorities and Medway Council. The average ICR for the HA sector in 2022/23 was around 1.03; typical lending covenants vary between 1.10 and 1.50 depending on the size and nature of the HA, with 1.25 being a typical 'golden-rule' expectation. This highlights that housing associations have had to accept that interest cover will dip below minimum levels in the short-medium term (effectively requiring a "carve out" from their funder covenants in the short-term).

For the HRA, operating surplus is best defined as:

- Turnover (dwelling rents, other rents, service charges, contributions) less
- Operating Costs (general management, special management, other management, repairs & maintenance, major repairs).

In the HRA, because of the treatment of depreciation as a cash transfer to the Major Repairs Reserve (MRR) plus an adjustment to reflect actual transfers to MRR, it is essential to include the net amount transferred to MRR in the calculation. This represents revenue expenditure on major repairs made legitimately as part of operating costs. Notwithstanding that these are subsequently treated as part of the capital programme, they are funded from revenue and properly an operating cost.

The above definition of ICR works in the HRA context as it determines the revenue surplus before interest, appropriations, and other “below the line” adjustments, and already takes into account a significant element of costs relating to major repairs before comparing to debt interest capacity.

The net operating surplus determining the availability of revenues to cover interest payments can also be expressed in %age terms as “operating margin”. The operating margin within the baseline plan starts at around 26% and rises to c. 42% over the long-term. Margins at these levels are much higher than benchmarks and highlight that the Council is generating greater levels of net income to support investment than other local authorities around the country.

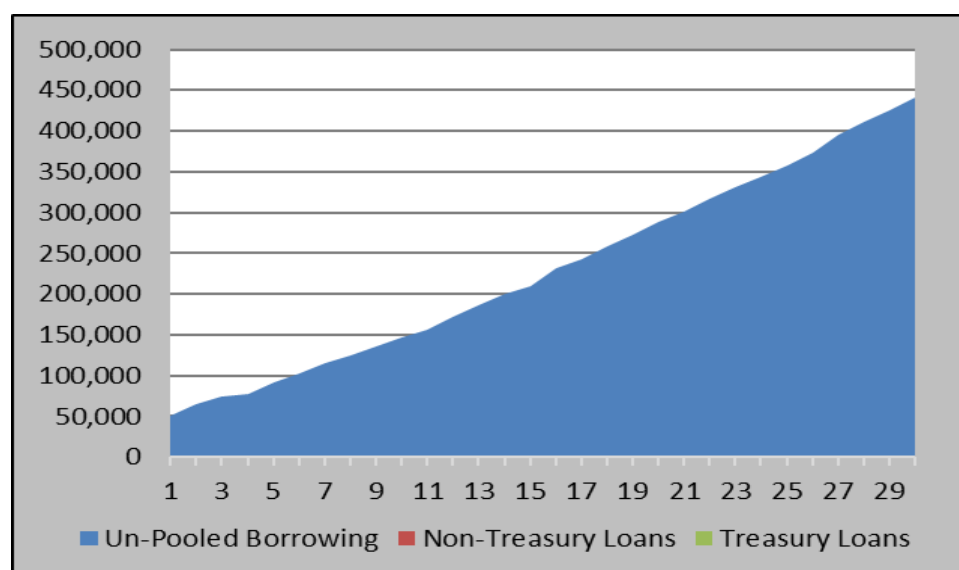
Chart 2.4 shows the provisional debt capacity (prudential borrowing) which is set at the “golden-rule” of interest cover ratio at a minimum of 1.25, with no additional borrowing headroom available in the later stages of the plan, as a result of the continued borrowing already incorporated.

The key drivers for the increasing borrowing are the inclusion of funding to replace gas boilers with heat pumps and the commitment to continue an annual programme of new build delivery on an ongoing basis. Assumed future income streams from net rental income for new homes helps to support the interest payments on the borrowing within the plan, but are not sufficient to maintain any margin of borrowing capacity in the later years.

Chart 2.1 shows that the HRA reserves currently held above the agreed minimum level are utilised during the first two years, before minimum reserves levels are maintained throughout the plan.

Financing of the above CFR projection is shown in the chart below.

Chart 2.5 – Projected Initial Debt Analysis (HRA CFR)



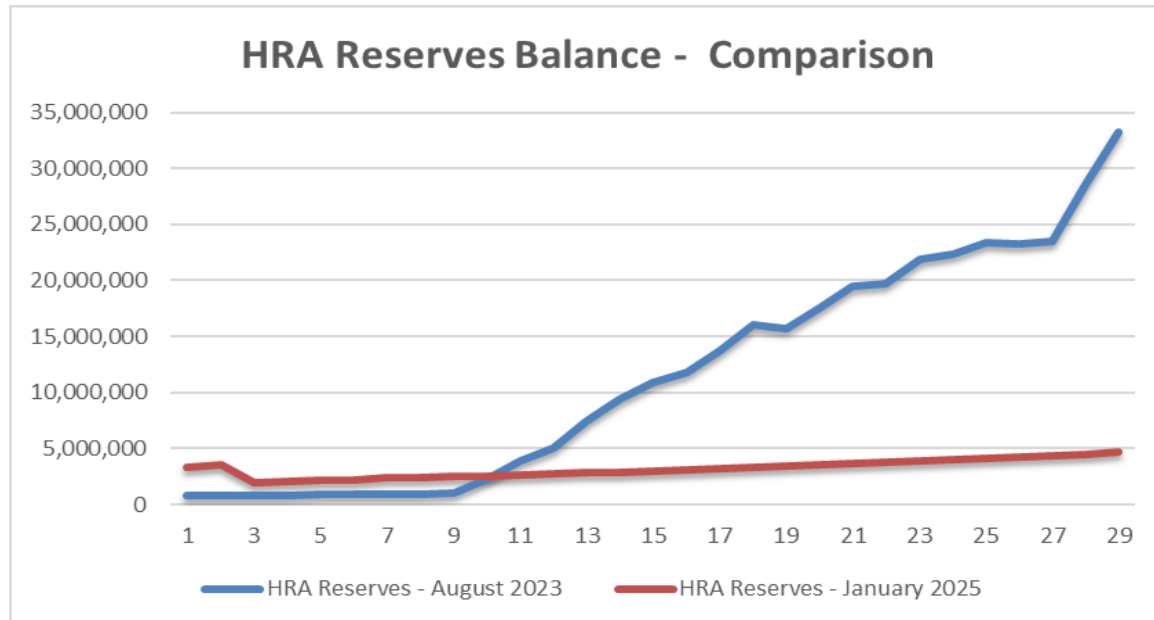
The blue shaded area represents the approach to financing of the HRA CFR throughout the life of the plan, with no fixed loans attributable to the HRA and both existing and new borrowing treated as pooled borrowing using a 'revolver' loan type of facility. Minimum revenue provision payments are assumed on an annuity basis for the opening borrowing only, with all new borrowing assumed to continue at the longer-term interest rate of 4%.

2.4. Comparison to January 2024 Projections

The current baseline plan differs quite significantly to the baseline plan from August 2023, with updated stock condition survey investment costs, additional energy investment to replace gas boilers with heat pumps (£58m at base year prices) and an ongoing programme of 30 new homes per annum (£195m at base year prices) all incorporated into the financial model.

To facilitate a direct comparison we have matched year 2 of the August 2023 model to year 1 of the current model within the graphs below, hence why the comparison is over 29 years rather than 30.

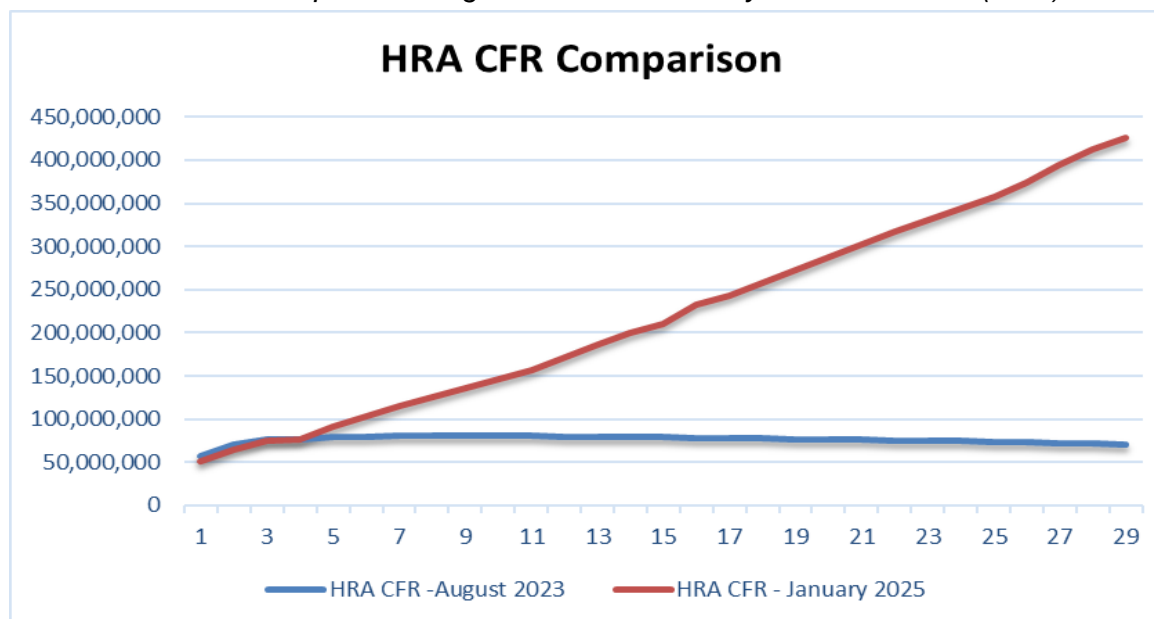
Chart 2.6– Models comparison: August 2023 and January 2025 HRA reserves



The chart demonstrates that HRA reserves no longer build up from year 9 onwards, but that resources are instead invested in improving the energy efficiency of the existing housing stock and in delivering an ongoing programme of new homes.

In the current baseline plan debt repayment will not be possible, but the HRA can support the level of debt, albeit marginally outside of the benchmark borrowing capacity within the plan in the later years.

Chart 2.7– Models comparison: August 2023 and January 2025 HRA CFR (Debt) balances



The differences between the two plans is as identified above, both investment of revenue surpluses and additional borrowing are required to facilitate energy investment coupled with the delivery of new homes. In the previous business plan, debt was reduced marginally across the life of the plan, whereas the current baseline assumes continued borrowing and investment, but it should be noted that, in the later years, this is marginally outside of the level that is indicated can be supported by the estimated revenue streams within the business plan to an appropriate level of risk management. The Council would own and manage an estimated 3,799 homes in the HRA by the end of the 30 years, compared to an opening stock of 3,027.

Debt would reach £426m by year 29, compared to £71 million in the plan last year. However, the closing stock would be an estimated 3,774 homes by the end of the 29 years, compared to a current stock of 3,027 and a “closing” stock of 2,925 in the previous iteration of the business plan financial model.

Stock investment comparison

The key variances in stock investment and development (new build and acquisition) are shown in the tables below.

The medium-term expenditure on existing stock is forecast to increase significantly over this period (£16.5m) based upon updated stock condition survey investment needs, recognising both update prices and beginning to address the existing backlog of decent homes work from year 5. New build and acquisition expenditure increase to a greater degree, with an increase from £28.1m to £90.6m recognising inclusion of an ongoing new build programme to deliver a 1% increase in rented homes each year.

Table 2.2 – Investment into the existing stock

Stock Investment Comparison £'000												
	1	2	3	4	5	6	7	8	9	10	Total	
	2024.25	2025.26	2026.27	2027.28	2028.29	2029.30	2030.31	2031.32	2032.33	2033.34		
Current Plan	7,259	5,908	9,946	7,956	14,709	11,724	13,111	9,960	10,036	11,209	101,818	
January 2024 Plan	11,020	9,359	10,688	8,160	9,988	6,943	8,036	7,897	7,124	6,117	85,332	

Table 2.3 – New build and acquisition expenditure

New Build and Acquisition Expenditure £'000												
	1	2	3	4	5	6	7	8	9	10	Total	
	2024.25	2025.26	2026.27	2027.28	2028.29	2029.30	2030.31	2031.32	2032.33	2033.34		
Current Plan	10,674	19,277	8,448	1,520	8,029	8,190	8,354	8,521	8,691	8,865	90,569	
January 2024 Plan	11,501	14,136	2,475	0	0	0	0	0	0	0	28,111	

The proposed increase in stock of approximately 1% per annum, coupled with the investment in the existing stock results in continued borrowing throughout the life of the plan. Whilst the plan benefits in the longer-term from the additional rental income from these dwellings, this is re-invested in supporting the delivery of further homes.

Summary

The plan shows a position that is sustainable in terms of HRA revenue projections, with reserves maintained at above minimum levels throughout and increased rental income helping to support the increasing level of debt taken on throughout the plan. The impact on the 'golden-rules' for setting prudential limits is affected in terms of:

- Forecast levels of debt (HRA CFR) increase throughout the 30 years as the supply of new homes continues to be delivered, with a modest funding contribution from right to buy receipts. The business plan could be significantly improved with the assumption that some grant may be available from Homes England to support the delivery of these homes. The authority may find it difficult to demonstrate financial viability for the delivery of these new homes on a scheme by scheme basis with the assumptions currently being made.
- No debt repayment is possible.
- Forecast borrowing marginally exceeds the interest cover 'golden-rule' of 1.25 during the latter stages of the 30 year plan, with an interest cover ratio of 1.15 by year 30. Borrowing headroom against the ICR 'golden rule' of 1.25 is negative by £34m at the end of the 30 years. (Note – some other authorities have adopted 1.15 as their target ICR ratio).
- The business plan therefore carries a degree of risk associated with the level of borrowing currently assumed, which will need to be carefully managed in the long-term.

3. Sensitivity and Stress Testing

Given the ongoing economic and policy uncertainty in respect of cost inflation, interest rates, longer-term rent increases and the impact of current and proposed changes to the Right to Buy legislation, we have specifically reviewed some sensitivities in respect of the impact of these.

The sensitivities considered are set out in the sections below, with a summary in the set of graphs at the end of the section. These measure the impact of each sensitivity against the closing level of debt, the closing level of HRA reserves and the minimum interest cover ratio during the course of the plan.

3.1. Interest Rate Risk

Due to the increased levels of borrowing in order to facilitate both new build and also investment in the existing stock, the level of interest charges have a significant impact on the plan.

The interest rates used within the plan are based on a view of the treasury advisory sector, with borrowing rates of 4.95% in 2024/25, 4.85% in 2025/26 and 2026/27, 4.5% in 2027/28, then 4% ongoing, but the markets, particularly Government gilts, are difficult to predict.

At the time of writing, PWLB maturity loan rates vary from 5.41% to 6.33% depending upon the term of the loan. The government's Autumn Budget on 30 October 2024 confirmed extension of the reduced HRA rate at 60 basis points below the standard PWLB lending rates – which will run until at least March 2026. After this the PWLB certainty rate of 20 basis points below the standard rate will still apply. Therefore the 4.95% rate for borrowing during 2024/25 is fair reflection of current costs if relatively short-term lending is assumed.

By way of example, we have demonstrated the impact of:

- Increasing borrowing rates by 0.5% from 2025/26 onwards
- Reducing borrowing rates by 0.5% from 2025/26 onwards.

The rates modelled for 2024/25 remain unchanged in both scenarios.

3.2. Inflation Risk

Within the plan, we have used inflation indicators as agreed with Medway, considering both the Bank of England (BoE) and Office of Budgetary Responsibility (OBR) forecasts for the next 3 years for CPI, before reverting to the Bank of England's core target of 2.0% from 2028/29. Similar assumptions have been used in other current business plans, valuations and asset performance modelling.

According to the OBR inflation is expected to be the following:

- 2.4% Quarter 4 2024
- 2.4% Quarter 1 2025
- 2.7% Quarter 2 2025
- 2.7% Quarter 3 2025
- 2.5% Quarter 4 2025
- 2.5% Quarter 1 2026
- 2.3% Quarter 2 2026
- 2.2% Quarter 3 2026
- 2.1% Quarter 4 2026
- Reducing to the Government's target of 2.0% by Quarter 1 2029

Therefore the use of 2.7% for 2026/27, 2.2% for 2027/28 and then 2.0% in the base plan are broadly consistent with this.

To test the impact of varying inflation on the plan we have modelled two scenarios in respect of cost inflation only, as detailed below:

Higher general cost inflation (CPI)

In this scenario we have modelled inflation for 2026/27 and 2027/28 at 3.0%, 2.5% for 2028/29, before returning to 2.0% from 2029/30

Lower general cost inflation (CPI)

In this scenario we have modelled inflation returning to the government's long-term target of 2.0% from 2026/27 onwards.

3.3. Future Rent Policy Risk

We have considered the impacts in both cost and non-rental inflation and interest rates, but there is uncertainty as to what the longer-term rent policy will be.

Currently, the baseline position assumes CPI plus 1% for 6 years (2025/26 and the following 5 years), which is prudent until the outcome of the current government rent consultation is determined.

To test the impact to the plan we have modelled two scenarios as detailed below:

- CPI + 1% for 10 further years, in place of the 5 currently assumed
- CPI + 1% rent increases for 30 Years.

3.4. Exclude Energy Uplift for Heat Pumps

The baseline financial model includes significant additional investment, without any assumption that external funding may be available, to replace gas boilers with heat pumps.

We have modelled a scenario that removes this higher level of investment to demonstrate the impact that this level of investment has on the business plan, helping to evidence the need for external funding support to facilitate this level of improvement in the social rented sector.

3.5. Resulting Sensitivity Impact

The graphs below demonstrate the impact of each sensitivity modelled against the minimum interest cover 'golden rule' of 1.25, the closing debt position at year 30 and the closing HRA reserves position at year 30.

Chart 3.1: Closing ICR modelled against above sensitivities

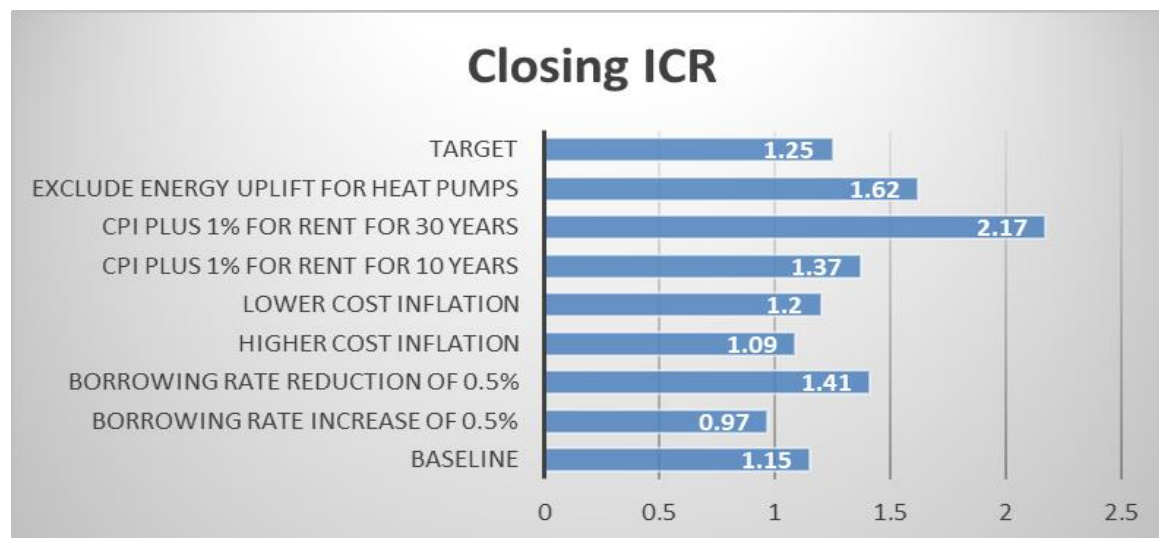


Chart 3.2: Closing HRA Debt modelled against above sensitivities

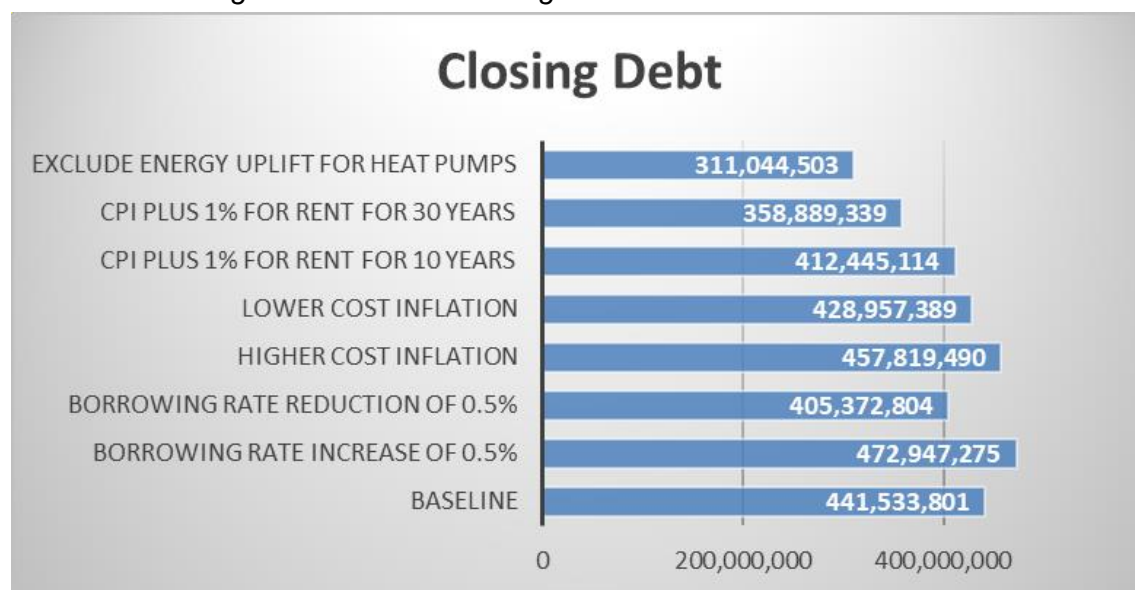
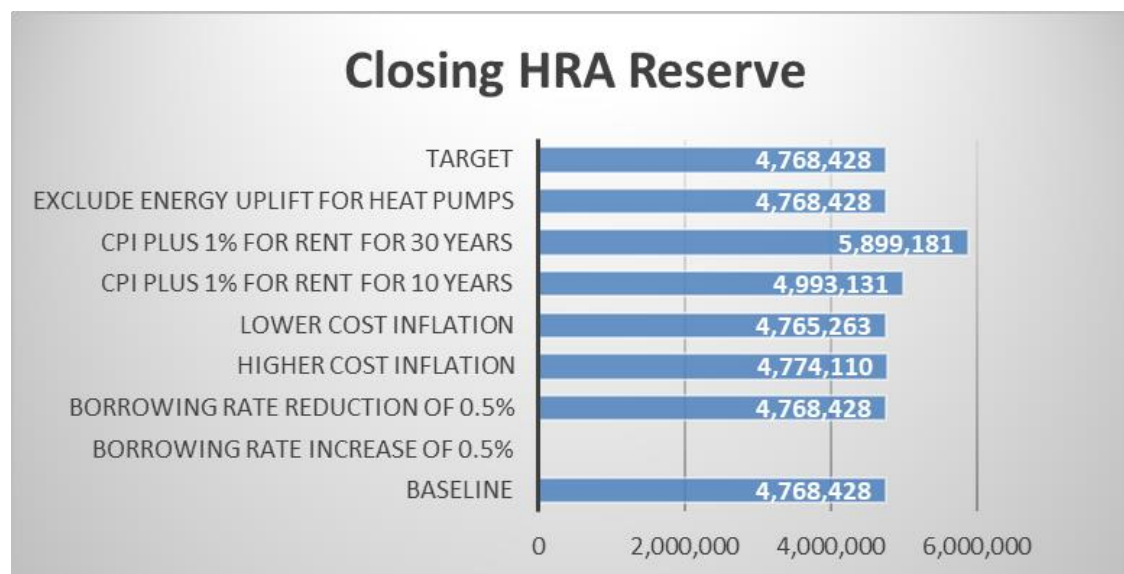


Chart 3.3: Closing HRA Reserves modelled against above sensitivities



As expected, the sensitivities and stress testing exemplified in the charts above highlight that the business plan (and therefore future financial viability of the HRA) is particularly sensitive to future rent policy across all elements of the plan, to future movements in interest rates as a result of the extent of new borrowing to be undertaken within the plan and the inclusion or exclusion of the investment required to replace gas boilers with heat pumps.

The Council will need to keep the plan under close and regular review to ensure that delivery of services and investment are able to be maintained.

4. Summary

1. The HRA business plan forecast as set out in our modelling for Medway Council shows projections for reserve balances, forecast debt (HRACFR) and future potential borrowing capacity.
2. The baseline version of the financial model demonstrates financial viability, but not without risk. Significant borrowing is required to deliver not only the investment in the existing housing stock, but also the ambitious ongoing programme of new homes delivery.
3. The baseline plan is constructed on a relatively sound financial basis, but given the potential for greater than normal variances in respect of rent increases, inflation and interest rates this could be considered an initial plan and we have run a number of scenarios which could potentially develop over the coming months.
4. Therefore, this is very much a position statement (as at December 2024) and we would expect the plan to develop significantly in the coming months. It is important that the Council continues to keep the plan under regular and rigorous review.

5. The Council will need to borrow extensively in order to deliver both its stock investment and new build programmes. We have identified how the level of borrowing compares to provisional 'golden-rules', with the plan identifying that proposed borrowing would be marginally outside the levels from the middle of the plan onwards, compared with what might be considered prudent against standard sector benchmarks. It is however recognised that all parts of the social housing sector are under significant financial pressure, and the interest cover ratio of 1.15 at the end of the 30 years, although below the 'golden rule' of 1.25, is consistent with levels that some other local authorities are adopting. For Medway, this is to be expected, as all available borrowing capacity is currently being utilised to invest in energy improvements and maximise the delivery of new homes. Given the nature of new build investment, where upfront investment is required, it is of critical importance to manage the pace and trajectory of borrowing with the availability of revenues and resources within the plan to cover what are expected to be increasing financing costs in the long-term.
6. Financing and interest costs are able to be met from existing reserves and revenues generated within the plan, reliant upon future newly arising net rental income to benefit the plan in the longer-term. However, there is no additional headroom for any further investment during the life of the plan, or any surplus HRA revenue reserves over a similar timescale. As a result any downside stresses or sensitivities may mean that the Council would need to reconsider its investment programmes.
7. The business plan reflects operating margins which are broadly above benchmarks, helping provide the revenue headroom to support the capital investment required in the stock and in the delivery of new homes. Currently new homes are included in the financial model with minimal funding from right to buy receipts and the balance met through borrowing. There is a strong argument, supported by the baseline plan, that the financial viability of these schemes would be much improved if assumptions were made that external grant may be available to part-fund the delivery of these much needed new homes.
8. It is clear from the sensitivities modelled that reductions in interest rates or positive changes in rent inflation would add significantly to future capacity.
9. The Council could review its investment standard in considering the plans for long-term viability and for the potential to release capacity for investment in the delivery of new homes. A level of investment per property of £90,920, albeit including the uplifted energy investment, is higher than benchmark values for other similar local authorities. With the level of investment for energy works contributing to the baseline plan performing outside of 'prudent' borrowing benchmarks in the later years, a strong argument can be made for the need for external funding support (grant) to support this.

Savills
January 2025