

**BUSINESS SUPPORT
OVERVIEW & SCRUTINY COMMITTEE
2 FEBRUARY 2012
HOUSING REVENUE ACCOUNT
CAPITAL AND REVENUE BUDGETS 2012/13**

Report from: Mick Hayward, Chief Finance Officer
Author: Marc Blowers Head of Housing Management
Kevin Woolmer – Finance Manager RCC /BSD

Summary

This report presents the Housing Revenue Account (HRA) revenue and capital budgets for 2012/13 and considers the impact of the introduction of self – financing from 1 April 2012.

It provides details of proposed rent and service charges levels for 2012/13 and considers rent-charging inconsistencies in two areas and proposals for correcting these.

The Committee is asked to forward any comments and recommendations to the Cabinet for consideration on 14 February 2012.

1. Budget and Policy Framework

1.1 In accordance with the constitution, Full Council is required to carry out an annual review of rents and notify tenants not less than 28 days prior to the proposed date of change. The Council is required under the Local Government and Housing Act 1989 to ensure that the Housing Revenue Account (HRA) does not fall into a deficit position.

2. Background

2.1 The Housing Subsidy System comes to an end on 31 March 2012. This will mean that the Council will no longer have to pay subsidy to central government (£1.8 million in 2011/12) but will be required to take on additional debt of some £19.5 million, the cost of which will fall to the HRA.

2.2 Self-financing will benefit the Council and detailed modelling has demonstrated that the 30 year maintenance needs for the housing stock can now be funded with surpluses available to repay debt or to invest in the service. This was not the case under the subsidy system, which would have necessitated a reduction in the investment programme.

2.3 Support in modelling of the impact of self-financing has been provided by CIH who are one of the leading advisors on housing finance. The briefing paper, which they have produced for Medway is attached at Appendix D and demonstrates the financial benefits and opportunities that self-financing will bring. The following charts extracted from that report visibly articulate the significance of the beneficial nature of the change.

Table 1. Stock Investment Requirement.

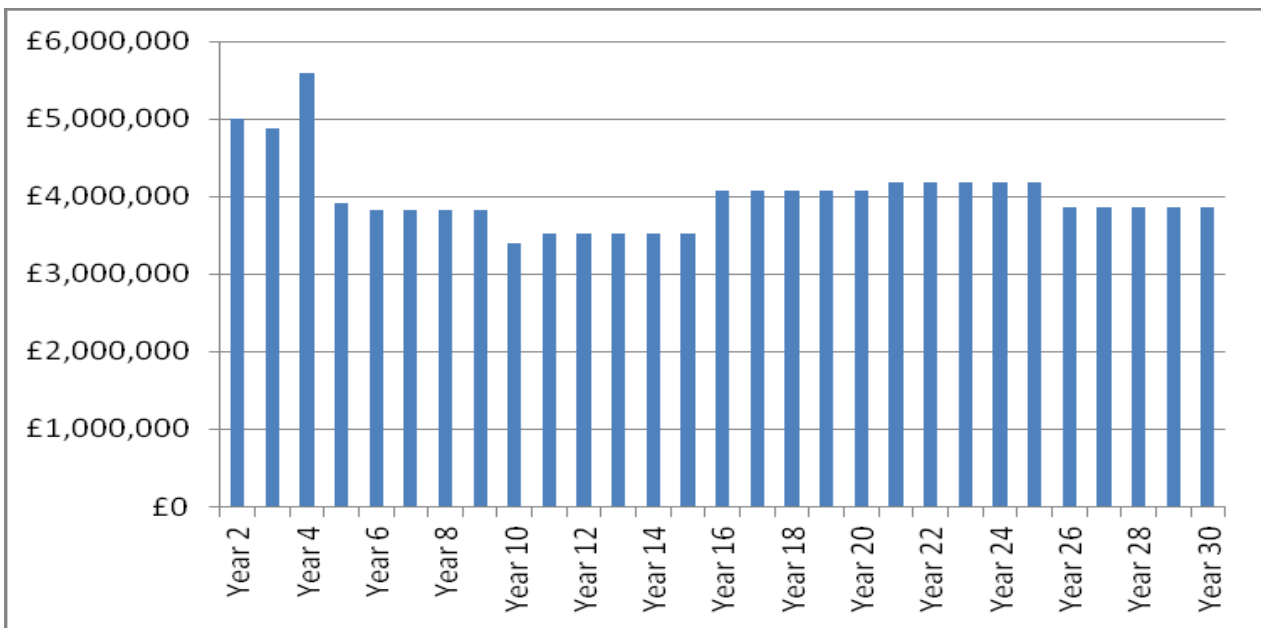


Table 2. HRA Debt (Subsidy)

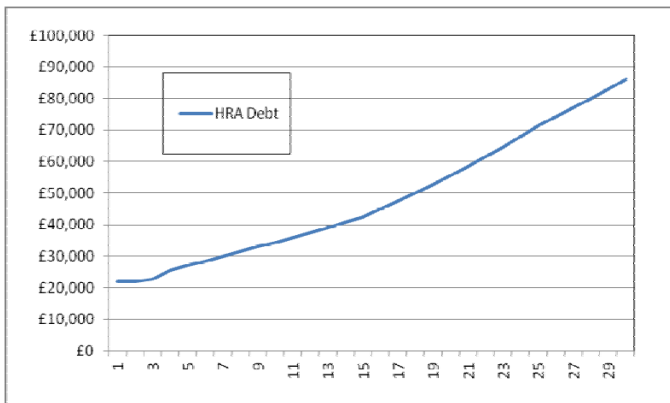


Table 3. HRA Debt (Self Financing)

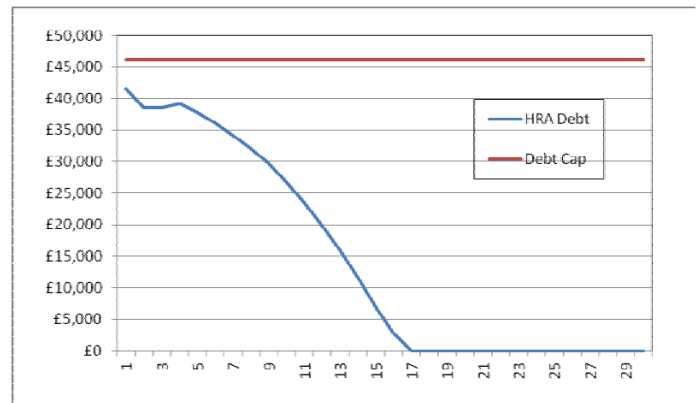


Table 4 HRA Balances (Subsidy)

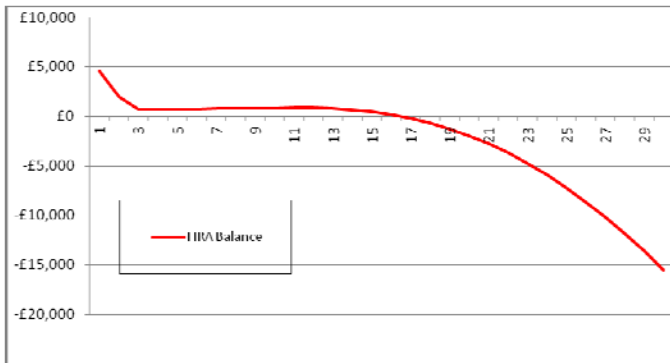
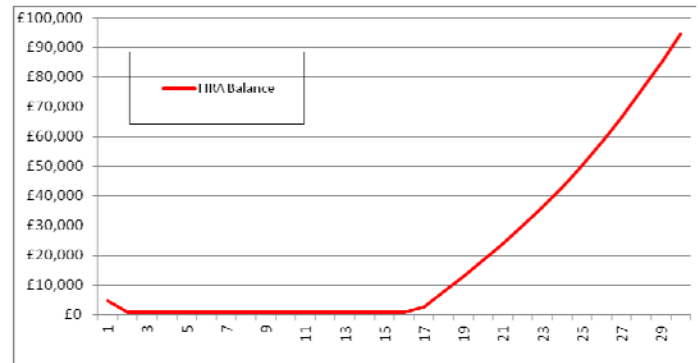


Table 5 HRA Balances (Self Financing)



2.4 This report does not seek to decide the medium to long-term strategy for the HRA. This will be considered in more detail when the annual refresh of the HRA Business Plan is presented later in the financial year. As part of that review there will be an opportunity to consider how the additional resources afforded by self-financing can best be utilised in terms of balancing rent increases or investment in revenue or capital initiatives (Including the repairs programme) and debt repayment.

2.5 The remainder of the report concentrates on proposals for 2012/13 including:

- Rent
- Services charges
- Performance management - voids and debt collection
- Expenditure assumptions
- Housing repairs
- Capital financing (impact of increased debt servicing costs compared to removal of requirement to make subsidy payment).

3. Rent

3.1 The Government policy to progress rent convergence between local authorities and registered social landlords remains in place under self-financing with a target date of April 2015. The underlying principle is that actual rents are required to converge with formula rents (based on beacon values). This is progressed by formula rents increasing by (Retail Price Index [RPI] (as at September) + 0.5%) whilst actual rents can rise in excess of this by a maximum of £2 per week, until formula rent is reached.

3.2 Appendix B attached details the proposed rent increases by property type. The proposals are in line with government guidance as detailed above and include:

- increases to target rent where the proposed increase falls within the upper transitional limit of RPI (5.6%) + 0.5% + £2.00.
- increases to the maximum increased allowance where the upper transitional limit does not allow an increase to the target rent level.

3.3 The proposed increases above will give an average rent increase of £5.39 per week or 7.26%.

- 3.4 Rents under this arrangement are exclusive of service charges. The rent restructuring initiative requires service charges to be disaggregated from the rent calculation, charged separately and is based on actual expenditure.
- 3.5 The 2011/12 rent charge for garages is £297 per annum for Council tenants and £396 per annum plus VAT for other residents. It is proposed that garage rents will increase by 2.5% from April 2012 and the new charge will be £304.50 per annum for Council tenants and £406 per annum based plus VAT for other residents. It is estimated that this will generate an additional income of approximately £5,269.00 over the projected income for 2012/13. Due to the number of voids and the current economic conditions, there is an option that garage rents could either remain at current levels for 2012/13 or be increased by a smaller percentage than given above. The additional rental income gained (and therefore foregone if the rents are not increased) will be equivalent to £2,107.50 per annum for each percentage point taken.

NOTE: Figures calculated at current let rate.

4. Service Charges

- 4.1 Service charges for 2012/13 will be calculated using estimated costs based upon actual charges for previous years. Guidance states that, whilst increases should be confined to inflation plus 0.5%, it is also recommended that the cost of providing services to tenants should be fair and fully recovered.
- 4.2 As part of the report last year it was highlighted that there were several service charge areas where cost is not being fully recovered. In order to try and achieve full cost recovery by 2014/15 it was agreed that above inflationary increases would be applied. The proposed charge for 2012/13 is based on this principle.
- 4.3 Some charges are funded through the Supporting People Grant, which has been cut for 2012/13. This has resulted in the need to carry out a wide consultation with sheltered housing residents and agreement was reached in terms of adjustments to the service to reflect this reduction in funding. A review of all items covered by the wardens service charge needs to be undertaken in 2012/13.
- 4.4 For services incurring a charge that are under the direct control of the Housing Revenue Account, a further option will be to consider whether current levels of service could be adjusted to reduce costs towards the levels of income currently generated, subject to appropriate tenant and leaseholder consultation. Appendix C details the projected percentage increases required against each type of service charge in 2012/13, and a comparison of the average weekly service charge levies from 2011/12 to those proposed for the next financial year.
- 4.5 The average service charge increase for 2012/13 excluding Supporting People eligible charges is 6.99% or 29p per week.

5. Longford Court – Warden Service Charge

- 5.1 As a result of a recent audit of the rent accounts, officers identified that the residents in the Annexe part of this sheltered housing scheme did not have a charge for the warden service included in their rent account. This is contrary to the practice in other schemes.
- 5.2 This issue affects five tenancies in respect of which four are in receipt of some form of Housing Benefit. Currently the warden charge is £13.46 per week. To rectify this issue and not cause undue financial hardship, it is proposed to apply this charge over a three-year period with effect from 1 April 2012 for current tenants. It will be applied immediately to new tenants.

6. Rent charging – past property modernisations – ground floor bedrooms Beatty Avenue and Cornwallis Avenue.

- 6.1 A recent complaint from a tenant has highlighted an anomalous situation with regard to the rental status of a number of properties in Beatty and Cornwallis Avenues. The complaint has now been escalated to the ombudsman as a consequence of the difficulty experienced in resolving the issue. The Council has now been able to properly research the problem, which is extremely historic in origin and is now in a position to propose a solution that should resolve the issue. The research included a survey of the properties involved so as to be precise as to the usage to which they were being put.
- 6.2 The origin of the difficulty stretches back to works that were undertaken by Gillingham Borough Council many years ago in the mid to late 1970's. The works involved the provision of a "Pod" on the ground floor of two bedroom properties, with an objective of increasing bedroom capacity.
- 6.3 However since then there has been an inconsistent approach to rent charging that has continued into Medway Council's assumption of responsibility for the housing stock. Similar properties with the same configuration of accommodation are differently classified as two and three bedded which is clearly an unfair and inconsistent approach.
- 6.4 The solution proposed is to re-classify all the 77 properties involved and determine the bed status on the basis of the number of upper floor bedrooms available. The consequence of this is that 38 properties that are currently classified as three bedroom properties will be re-classified as two bedroom properties. It is deemed appropriate that current tenancies should be retrospectively adjusted for the change since the Council assumed responsibility for the stock i.e. April 1998.
- 6.5 There will be a cost associated with this adjustment and this has been calculated at some £46,000, which will need to be borne by the HRA balance.

7. Performance Management

7.1 The financial management of the Housing Revenue Account is directly linked to key performance in a number of operational areas (void management, rent collection and arrears recovery).

7.2 Void Management

7.2.1 There is a direct correlation between the time a property remains void and the rent foregone.

7.2.2 For 2011/12 a target for void property rent and service charge loss was set at 0.81% of the rent debit, equating to £99,650. Quarter 2 reported performance was at 0.64%, which would produce a financial rent loss of £72,529 for the year if performance remains at this level for the year, an improvement on the previous year.

7.2.3 For 2012/13 the provision for void rent and service charge loss has been set at 0.72% or in financial terms £87,339 for the year. This is based on a void turnaround target of 21 days.

7.3 Rent Collection/Bad Debt Provision

7.3.1 The collection rate for rent and service charges and the performance in managing rent debt is critical to the financial position of the Housing Revenue Account and has a direct impact on the amount of bad debt provision that has to be set aside.

7.3.2 It has been calculated that the collection level of rent and service charges for 2011/12 will be 99.83%, which will result in current tenant rent arrears at 3 April 2012 of around £295,000. However, it is projected that total arrears, both current and former tenants, will be in the region of £800,000, which is an improvement on the previous year.

7.3.3 As at 31 March 2012, the projected requirement for bad debt provision will be £644,592 and will require an additional contribution from revenue of £68,417.

8. Housing Revenue Account Expenditure

8.1 Generally, all expenditure, including staff related, will remain at 2011/2012 levels for 2012/2013 to reflect the current economic climate in line with the Medium Term Financial Plan.

8.2 The cost of housing benefits under rent rebate limitation is the responsibility of the Housing Revenue Account. For 2012/13 it is projected that the cost of this will be just under £154,000.

8.3 Capital Financing Costs that are charges relating to the debt incurred by the Housing Revenue Account for capital schemes and include the charges relating to the additional debt incurred by the move to the self-financing regime.

9 Housing Repairs

- 9.1 Housing repairs expenditure covers both planned and responsive maintenance, some of which is capital funded. The funding is split between HRA balances and the major repairs allowance (MRA). The MRA can be spent on either capital or revenue works provided it is allocated to catch-up repairs. Government guidelines have stated that local authorities should be moving away from responsive repairs and towards increased planned maintenance expenditure to achieve a spend ratio of 30:70.
- 9.2 Whilst the detailed plan for capital works within 2012/13 is currently being revised in conjunction with the asset management strategy, it has been projected that the total cost of HRA capital works (including disabled adaptations) will be £5.5 million. This projected expenditure will be funded by way of:
- £3.7 million Major Repairs Allowance/Major Repairs Reserve
 - £1.8 million Contribution from HRA Working Balances
- 9.3 Based on the proposed draft combined capital £5.5 million and revenue £2.344 million work programmes the financial split in 2012/2013 is likely to be:
- Responsive Maintenance £1.919 million
 - Planned/Capital Maintenance £ 5.926 million.

This split will equate to a 24:76 spend ratio for 2012/13.

- 9.4 The revenue expenditure budget funds all general day to day repairs, emergency repairs, repairs to void properties, lift maintenance, estate improvements and repairs programme, and central heating maintenance.
- 9.5 The proposed capital budget of £5.5 million is split into planned maintenance and disabled adaptations with budgets of £5.25m and £250,000 respectively.

10. Housing Revenue Account Working Balance

- 10.1 There is a requirement to maintain a working balance to safeguard against unplanned and unavoidable increases in expenditure or losses of income. At 1 April 2011 the working balance stood at £6.156m. For a number of years the actual HRA balance has exceeded the recommended guideline of £500,000.
- 10.2 The latest monitoring for Quarter 2 predicts a balance at 31 March of some £4.8 million which is similarly well in excess of the guideline but given that the balance of reserve is also to cater for future investment it is appropriate to review the recommended minimum balance and it is proposed to increase this for business planning purposes to £750,000.
- 10.3 The draft 2012/2013 Housing Revenue Account budget, as presented at Appendix A produces a projected surplus of £1.454 million for the year and after allowing for a contribution to fund the capital programme of £1.8 million, the revenue balance is forecast to be £4.492 million at 31 March 2013.

10.4 The projected working balance is substantially greater than the minimum required. However the 30-year Housing Revenue Account business plan is likely to require significant revenue support towards the capital programme, specifically within the next few years to enable catch-up repairs and maintain all properties at the Decent Homes Standard.

11. Consultation

11.1 The Housing Act 1985 requires the issue of written notification to each tenant a minimum of four weeks in advance of the date that the increase becomes operative. For 2012/2013 the latest date for posting the notices is 2 March 2012.

11.2 The council has developed a resident engagement strategy detailing how we will consult and engage with tenants in partnership with tenants' forums. In order to support this commitment, a meeting to present the proposals within this report to tenants was held on 23 January 2012. Their feedback and views will be verbally feedback at the meeting to members.

12. Risk Management

Risk	Description	Action to avoid or mitigate risk
Housing Revenue Account Balance	<p>There is a requirement to ensure that the balance on the Housing Revenue Account does not fall into deficit and a business plan is required to model this need over a thirty-year period. There are two major factors with the potential to impact on this requirement:-</p> <ul style="list-style-type: none"> a) the level of expenditure required for housing repairs b) Government proposals for local authorities to leave the subsidy system in favour of a self financing Housing Revenue Account 	<p>A stock condition survey has been undertaken that will provide a sound basis on which to model future repairs investment.</p> <p>Once Government has issued full and final details of self financing the impact and options for Medway will be analysed and reported back to members</p>

13. Financial and legal implications

13.1 The financial implications are contained within the body of this report.

13.2 Under Section 76 of the Local Government & Housing Act 1989, the council is required, in advance of the financial year, to formulate proposals which satisfy the requirement that, on certain stated assumptions; the Housing Revenue Account for that year does not show a debit balance. The council is obliged to implement those proposals and from time to time to determine whether the proposals satisfy the 'break even' requirement. If not, then the council shall make such provisions as are reasonably practicable towards securing that the proposals, as revised, shall satisfy the requirement.

- 13.3 Under Section 24 of the Housing Act 1985, the council can make such reasonable charges as it determines for the tenancy or occupation of its houses. The council is obliged, from time to time, to review rents charged and make such changes, as circumstances may require. In exercising this function (determining and fixing rent), the council should have regard to the rents charged in the private sector.
- 13.4 A decision to increase rent constitutes a variation of the terms of a tenancy. Under Section 103 of the Housing Act 1985, in respect of secure tenancies, a notice of variation (specifying the variation and date on which it takes effect) must be served on each tenant. For non-secure tenancies (excluding introductory tenancies), a notice must be served that complies with Section 25 of the Housing Act 1985.

14. Recommendations

The Committee is asked to recommend to Cabinet:

- 14.1 The proposed revenue and capital budgets for 2012/2013, inclusive of an average rent increase of £5.39 per week (based upon 50 collection weeks and equating to an increase of 7.26%).
- 14.2 That service charges for 2012/13 reflect the costs incurred in providing that service, where possible, and that where costs are not fully recovered, the uplift is such that costs can be fully recovered by 2014/15 using above inflation increases to do so as per Appendix C to this report. The average increase will be 5.99%.
- 14.3 That the application of the Warden Service charge to residents in the Annexe at Longford Court be applied over a three year period with effect from 1 April 2012 for current tenants.
- 14.4 Properties identified with “pods” at Beatty Avenue and Cornwallis Avenue to be charged for only bedrooms on the upper floors of properties from 1st April 2012 and pods, regardless of their usage, be disregarded for rent charging purposes.
- 14.5 Refunds to be made to current tenants only, who have been overcharged for rent for properties in Beatty Avenue and Cornwallis Avenue.
- 14.6 That the approach for rent charging for any further properties identified that have “pods” fitted, be set as described in the context of this report in the future.

Lead officer contact :

Mick Hayward, Chief Finance Officer

Telephone (01634) 332220, E-mail mick.hayward@medway.gov.uk

Marc Blowers, Head of Housing Management

Telephone (01634) 334382, E-mail marc.blowers@medway.gov.uk

Background papers :

Housing Revenue Account Capital and Revenue Budget 2011/12

Housing Act 1985

Local Government and Housing Act 1989

Appendix A

HOUSING REVENUE ACCOUNT BUDGET SUMMARY 2012 -2013

Description	Budget 2011/12			Q2 Forecast 2011/12			Proposed Budget 2012/13		
	Exp	Income	Net	Exp	Income	Net	Exp	Income	Net
	£000's	£000's	£000's	£000's	£000's	£000's	£000's	£000's	£000's
HRA Working Balance B/F			(6,156)			(6,156)			(4,838)
Housing Management Total	1,169	0	1,169	1,191	0	1,191	1,169	0	1,169
Service Improvement Total	312	0	312	289	0	289	431	0	431
Community Development Total	88	0	88	86	0	86	88	0	88
Tenancy Services Total	1,326	0	1,326	1,296	0	1,296	1,334	0	1,334
Housing Maintenance Total	2,212	0	2,212	2,009	0	2,009	2,169	0	2,169
Homes for Independent Living Total	715	(2)	713	707	(2)	705	733	(2)	731
Estate Services Total	535	(4)	531	520	(4)	516	539	(4)	535
Housing Finance Total	194	(22)	171	193	(22)	171	194	(22)	171
Housing Benefits Total	154	0	154	154	0	154	154	0	154
Capital Financing Costs Total	3,235	(13)	3,222	3,235	(13)	3,222	4,974	(13)	4,961
Subsidy Total	1,763	0	1,763	1,772	0	1,772	0	0	0
Rent Income Total	0	(12,376)	(12,376)	0	(12,287)	(12,287)	0	(13,052)	(13,052)
Other Income Total	0	(129)	(129)	0	(141)	(141)	0	(144)	(144)
Total Housing Revenue Account	11,701	(12,548)	(847)	11,452	(12,471)	(1,019)	11,784	(13,238)	(1,454)
Revenue contribution to Capital Exp.			2,337			2,337			1,800
HRA Working Balance C/F			(4,666)			(4,838)			(4,492)

Appendix B

AVERAGE RENT INCREASES BY PROPERTY TYPE (50 WEEKS)

Property Type	Actual Rent 2011/2012	Actual Formula Rent 2011/2012	Proposed Rent 2012/2013	Proposed Formula Rent 2012/2013	Average Increase 2011/2012 to 2012/2013	Average Percentage Increase 2011/2012 to 2012/2013
Bedsit Bungalow	£58.93	£60.09	£62.89	£63.76	£3.96	6.72%
Bedsit Flat	£55.62	£56.89	£59.96	£60.36	£4.35	7.82%
1 Bedroom Bungalow	£66.65	£68.08	£71.22	£72.23	£4.57	6.85%
1 Bedroom Flat	£64.28	£65.93	£69.53	£69.96	£5.25	8.17%
2 Bedroom Bungalow	£76.24	£76.23	£80.88	£80.88	£4.65	6.10%
2 Bedroom House	£79.64	£ 79.98	£84.81	£84.86	£5.17	6.49%
2 Bedroom Flat	£71.80	£73.64	£77.46	£78.13	£5.65	7.87%
3 Bedroom Bungalow	£85.56	£85.56	£90.78	£90.78	£5.22	6.10%
3 Bedroom House	£88.46	£89.58	£94.70	£95.04	£6.24	7.06%
3 Bedroom Flat	£78.92	£ 83.12	£85.40	£88.19	£6.47	8.20%
4 Bedroom House	£96.15	£ 96.70	£102.55	£102.60	£6.40	6.65%
5 Bedroom House	£98.07	£ 110.45	£106.13	£117.19	£8.06	8.22%
Sheltered Bedsit for the Disabled	£54.96	£ 55.17	£58.54	£58.54	£3.58	6.51%
Sheltered Bedsit	£54.93	£ 55.16	£58.52	£58.53	£3.59	6.54%
1 Bedroom Sheltered	£62.04	£ 62.25	£65.97	£66.05	£3.93	6.33%
2 Bedroom Sheltered	£69.22	£ 72.28	£74.69	£76.69	£5.47	7.90%
3 Bedroom Sheltered	£76.47	£ 79.88	£83.21	£84.76	£6.74	8.82%
1 Bedroom Sheltered Bungalow	£64.25	£ 64.67	£68.29	£68.62	£4.04	6.29%
Overall Average	£72.34	£74.20	£ 77.53	£ 78.73	£5.39	7.26%

Appendix C

HOUSING REVENUE ACCOUNT - SERVICE CHARGES SUMMARY (50 Weeks)

	Average Weekly Service Charge 2011/2012 £	Proposed Percentage Increase for 2012/2013 %	Proposed Average Weekly Service Charge 2012/2013 £	Projected Weekly Variation 2011/2012 to 2012/2013 £	Projected (Surplus)/ Deficit 2012/2013 £'000
Eligible for Housing Benefit					
Adult Services Facilities	14.98	5.60%	15.82	0.84	0
Estate Services (Caretaking)	3.76	15.00%	4.32	0.56	118
Communal Electricity	0.99	10.00%	1.09	0.10	0
Grounds Maintenance	0.54	15.00%	0.62	0.08	26
Sheltered Helpline	2.05	9.00%	2.23	0.18	2
Linked Garage	5.94	2.50%	6.09	0.15	n/a
Sheltered Management	13.46	5.60%	14.21	0.75	151
Window Cleaning	0.31	5.60%	0.33	0.02	(1)
Not Eligible for Housing Benefit					
Cooker	0.64	0.00%	0.64	0.00	0
Fridge	0.64	0.00%	0.64	0.00	0
Communal Heating	7.56	5.60%	7.98	0.42	1
Water Rates	3.29	10.00%	3.62	0.33	2
Supporting People Eligible Charges					
Community Alarm	9.65	0.00%	9.65	0.00	n/a
SP Helpline	2.65	0.00%	2.65	0.00	n/a
Sheltered Support	11.22	(50.00%)	5.61	(5.61)	n/a

N.B. - Cells with an entry of N/a denote services where there is no specific attributable expenditure against which a surplus/deficit can be assessed. The levels for these charges have been set using the



**Medway Council
HRA Business Plan – Briefing Note January 2012**

1. Introduction

- 1.1 This report sets out the current position of the Housing Revenue Account, with forecasts over the next 30 years demonstrating its ability to meet the required investment standard to the existing stock and sustain balances without falling into deficit.
- 1.2 The coalition government has issued proposals to reform the Housing Revenue Account, namely the abolition of the HRA subsidy system and implementation of self financing following a one-off settlement at the end of 2011/12, which will happen through primary legislation via the passage of the Localism Bill. This has been reinforced with a policy document, published on 28th July, which sets out the proposed arrangements around the transaction in detail.
- 1.3 The indicative settlement figure provided by CLG in February 2011 has been superseded by the draft determination issued on the 21st November which is out for 6 weeks consultation with finalisation by the 27th January 2012. The transaction will take place at the end of this financial year on the 28th March 2012.
- 1.4 This report is therefore very much an initial position statement and will require updating once the final settlement values are known, HRA budgets for next financial year are approved, decisions have been taken as to how the settlement will be funded and further details on proposed changes to the Right to Buy policy are clarified.

2. Stock Summary

- 2.1 Medway Council currently has 3,046 tenanted properties. No estate remodelling or demolitions have been included within these projections.
- 2.2 The average actual 2011/12 weekly rent of the stock is £71.57 against formula rent of £72.58 per week on a 52 week basis. The formula or target rent is a government based formula to calculate a social rent for each individual property. It is calculated using a weighting factor for the number of bedrooms, the property value as at January 1999 and the county average earnings index. This formula rent is then increased by inflation (September RPI) plus 0.5% each year. The expectation of the government is that actual rents will increase to meet or converge with the formula rent for each property by April 2015. This means that Medway can expect slightly higher than inflation increases over the next 4 years to achieve convergence, though much of this rent increase has been taken into account in the self-financing debt settlement.

3. Housing Revenue Account Budget and balances

- 3.1 As a basis for the financial modelling projections detailed later in this report, the core sources of data will be the Housing Revenue Account budget for 2011/12 and future assumptions for movements in expenditure and income both national and local.

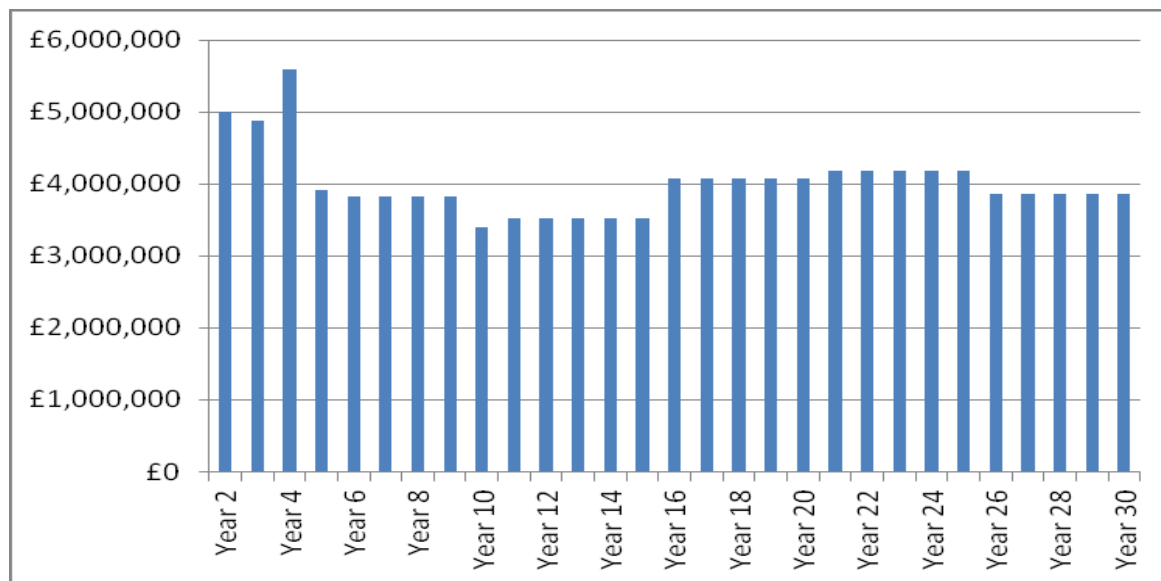
3.2 HRA reserve balances are forecast to be £4million at the end of 2011/12 with a proposed usage of £xxx in 2012/13 to support capital investment.

4. Stock investment requirements

4.1 The Council has produced an asset management strategy detailing future stock investment requirements based on a series of components, replacement costs values and life-cycles for each individual property from an external stock condition survey by Ridge.

4.2 The chart below shows the total level of expenditure required for each year for the current number of properties and at today's prices.

Chart 4.1 Stock Investment Requirements



4.3 We have uplifted the original stock condition survey costs by 5% to bring them to a 2011.12 price basis and sensitised the expenditure according to the reduction in stock where appropriate.

4.4 The required expenditure over 30 years on a per unit basis is £40,069. Whilst this level of expenditure is above benchmarks, it does allow for component replacement on a realistic basis and to a modern standard, above the minimum Decent Homes Standard. In addition, this figure provides for a provision for disabled adaptations. The debt allocation formula applied by Government assumed expenditure of £31,650 per unit for the same period.

4.5 We have identified the level of backlog investment required, against budget or actual capital expenditure for 2010.11 and 2011.12 at £0.5m and this has been reappportioned over years 2 to 6 of the plan. In addition we have been informed of the need to reprofile £0.5m of expenditure from year 2 to year 3.

5. Modelling Assumptions

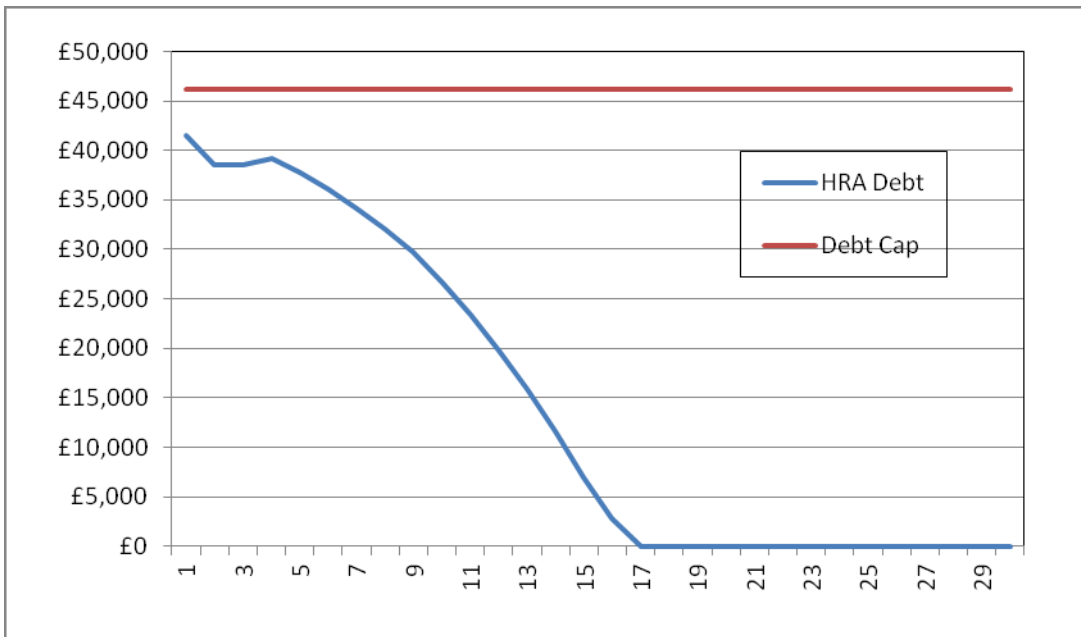
5.1 We have developed a model specifically for projecting forward the HRA and capital forecasts under HRA self-financing.

5.2 The model is launched using the budgets for the 2011/12 HRA and capital programme and the above stock investment requirements from year 2.

- 5.3 The model then uses a series of assumptions for both core inflation and real inflation factors to the base costs. There are exceptions to these and they are covered in the following paragraphs.
- 5.4 £750k min bal
- 5.5 RPI is factored at 2.5% throughout the model, with the exception of rent inflation for 2012.13. The 2011 September RPI has been published at 5.6% and we have facilitated this in the modelling with 2.5% from year 3 onwards.
- 5.6 Current rents are set in the model to converge by 2015/16 as described in paragraph 2.2 above.
- 5.7 Income for the following non rent income budgets has been set to increase at RPI only;
- Service charges
 - Garage rents
 - Other income.
- 5.8 General Management and Special (Service) costs are modelled at RPI only. Any future cost increases above general inflation such as increases to employer pension contributions, pay awards, supplies and services cost pressures, would have to be met by efficiency savings.
- 5.9 We have only increased capital and revenue repair budgets by inflation which will reflect the likely outcome from the 2012/13 budgetary process.
- 5.10 The void rate is set at 1.02% throughout to reflect current performance in year 1 and the bad debt provision is estimated to increase from 0.5% to 0.75% over the next 3 years to protect against the impact of future housing benefit reforms.
- 5.11 Right to Buy sale levels are estimated at an average of 4 per annum throughout the plan, again reflecting current levels, with corresponding adjustments to rental income. None of the available (un-pooled) capital receipt is forecast to be available to finance HRA capital expenditure. There is the potential that these assumptions will need revisiting when the consultation on changes to right to buy is published later, following on from the narrative within the national housing strategy. An average of 6 right to buy sales has been assumed within the draft debt settlement.
- 5.12 The stock condition survey does not provide for procurement fees and we are advised that these are included within the current management costs.
- 5.13 There are no increases above RPI for either capital and planned/revenue maintenance repairs and therefore any contingencies within the provisional costs will have to be utilised in the event of real inflation.
- 6. HRA outputs (HRA reform, self-financing)**
- 6.1 On the 1st February, the Housing Minister confirmed that HRA reform would go ahead and a revised national model was issued along with proposals for its implementation. The position has moved further forward with a policy document issued in July providing further details and dates on the transaction. The debt settlement figures have been revised as part of the draft determination issued on 21st November.
- 6.2 The settlement transaction will be implemented on 28th March 2012.

- 6.3 The new system is based on moving towards a 'self financing' HRA in which negative or positive subsidy, i.e. the amount paid over to, or received from Government, is exchanged for a single one-off adjustment of housing debt following which rental surpluses will be retained locally within the Council's HRA.
- 6.4 The allocation of debt is the Net Present Value of a cashflow estimate of rents, revenue and investment costs for all authorities over 30 years, based on subsidy rent assumptions, which achieve convergence with targets by 2016 and subsidy allowance assumptions, which include an uplift of funding. By linking the debt allocation to current and future subsidy assumptions, the government's intention is to make the settlement 'neutral' in national expenditure terms.
- 6.5 The headline debt settlement from CLG for Medway amounts to £46.187million, based on uplifts of allowances of 13.47% including an allowance for disabled adaptations.
- 6.6 Using the current proposed settlement of £46.187million, the debt adjustment for Medway would be £19.485million which is arrived at by offsetting the current Subsidy Capital Financing Requirement (HRA CFR) of £26.702million.
- 6.7 Therefore the net payment funded by the HRA required on 28th March 2012 is provisionally set at £19.485million.
- 6.8 In order to protect the public finances, the government will impose a debt cap on local authorities, set at the debt settlement value, being an estimated £46.187million for Medway. Given that the actual debt will commence at an estimated £41.498million based on existing debt of £22.013million there is therefore borrowing headroom of £4.689million, which can be utilised to fund future capital expenditure.
- 6.9 We have developed the model to allow debt to be repaid at the earliest opportunity in terms of demonstrating viability. The model ensures that the capital programme is fully financed, including top up from revenue contributions to capital from the HRA, whilst maintaining a minimum balance. In addition, if borrowing is required to meet needs in any year, the model allows for this up to the designated debt cap. Any capital shortfalls are carried over to the following year. Revenue costs are based on current expenditure and service levels, with an allowance for inflation (RPI only).
- 6.10 If capital expenditure can be fully financed, any remaining balances above the £0.75million minimum HRA balances are utilised for setting aside against the repayment of debt. This provides a debt graph that can be used to inform funding decisions. This graph is shown at chart 6.1 below.
- 6.11 The Council can explore a range of funding opportunities open to it to fund the settlement payment, but for the purposes of this initial modelling we have used an all-in average rate of 4.0% for calculating interest charges. It was recently announced that discounted rates would be available for funding the self-financing settlement from the Public Works Loans Board. Hence we have modelled a reduced rate of interest compared to previous iterations. It should be noted that the opportunity to obtain discounted funding is only available for one day on the 26th March 2012.
- 6.12 The graph overleaf demonstrates that the inherited debt and the debt taken in year one amounting to £41.498m and then the ability to repay from surplus revenue from year 2. There is the potential therefore, based on the assumptions set out above and the amount of the settlement allocation, for the debt to be repaid within 17 years.

Chart 6.1 Initial Base Debt Graph - £'000s



6.13 The straight red line demonstrates the debt cap placed on the authority on its HRA CFR.

6.14 The chart below shows that the required capital expenditure can be fully resourced within each year.

Chart 6.2 Initial Base Capital Expenditure and Resourcing - £'000s

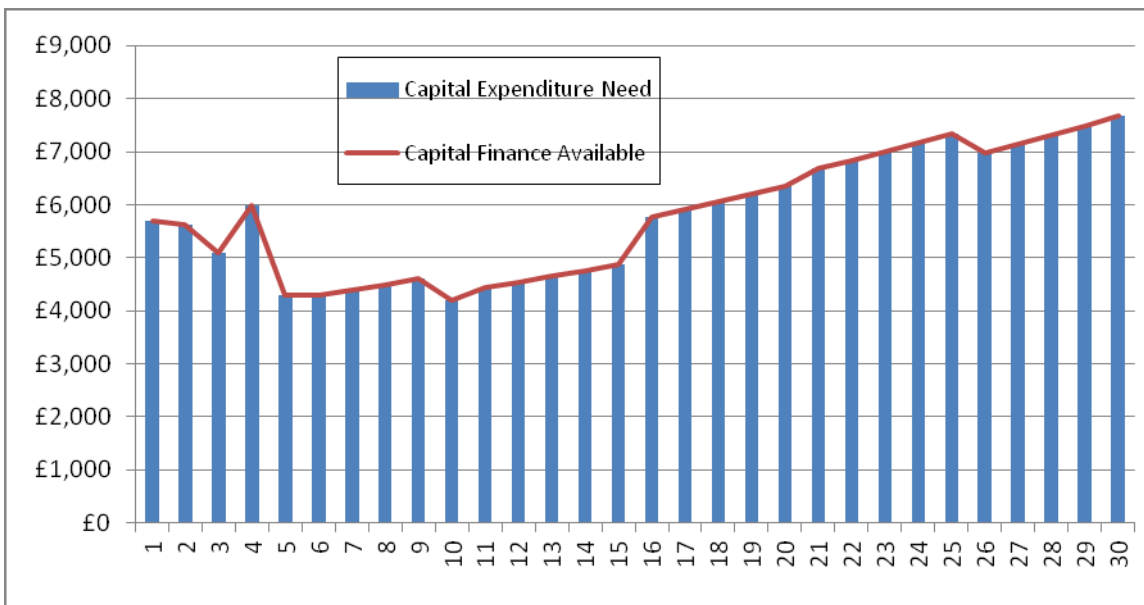
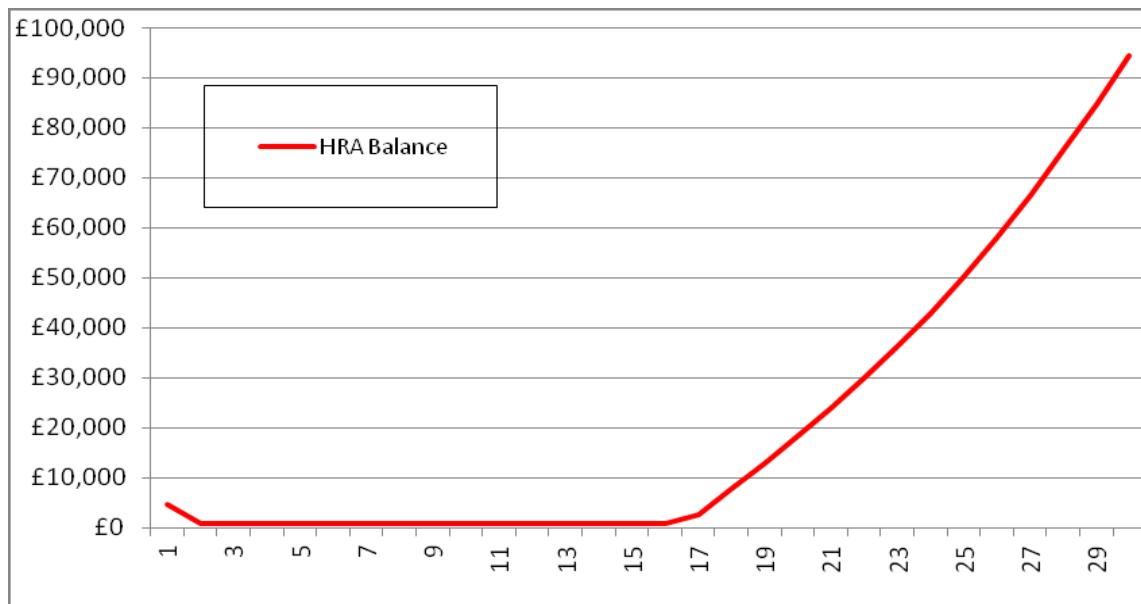


Chart 6.3 Initial Base Forecast HRA Balances - £'000s



- 6.15 The above graph shows the projected HRA balances over the next 30 years. The balance remains at £0.75 million, with an allowance for inflation, for the 17 years whilst the HRA fund both capital works and debt repayment where required. Following the position of debt repayment in year 17 balances will start to accrue to almost £95million in year 30.
- 6.16 In summary, the initial base business plan demonstrates a viable position, in fully financing capital investment requirements with the ability to service and repay the debt funding taken on for the self-financing transaction. Once debt is repaid balances will begin to accrue quickly within the HRA.
- 6.17 Whilst the plan demonstrates and is set to repay debt as early as possible, this may not be the best strategy. As identified balances start accruing in year 17 and decisions then would have to be made as how to best use those surplus requirements. Plans could be made now to bring those benefits earlier by extending the debt repayment period. For example such a decision would create an opportunity for new build, service enhancements or lower rent increases for the next 20 years plus. Also, the Government has stated that it reserves the right to revisit councils' debt settlements in the future. Whilst the Government has verbally given a commitment as to the reasons it might reopen the settlement there is always the risk that councils, like Medway, becoming debt free on the HRA after 20 years, and then forecasting massive balances, could be asked to take on further debt in future years. An alternative strategy to utilise surplus, combined with a more structured approach to debt repayment may be in the best interest of the council and tenant.

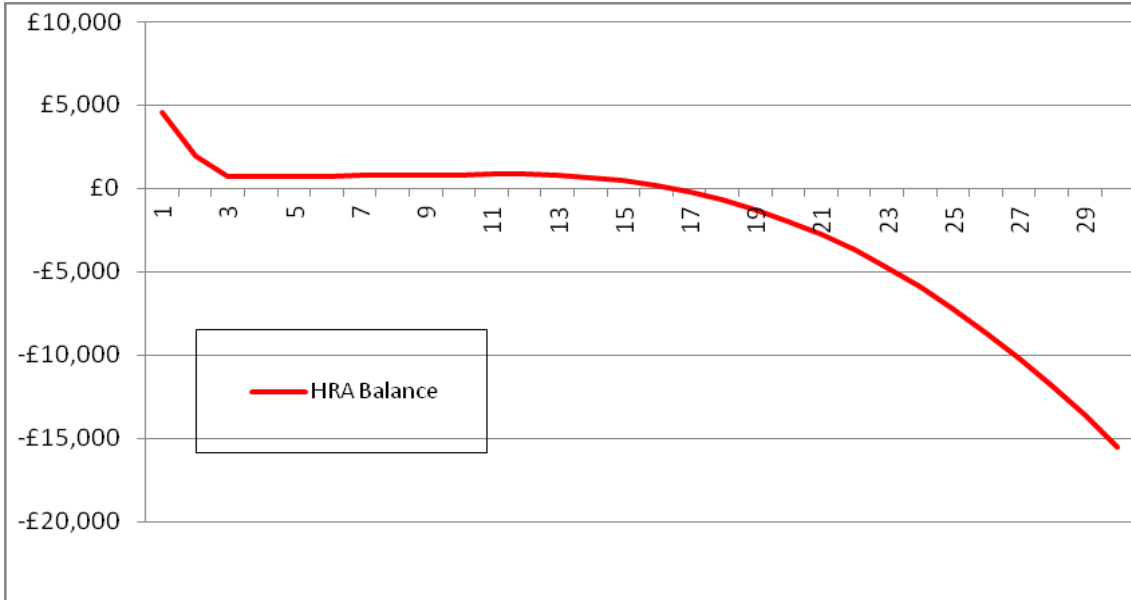
7. Original HRA outputs (Under the Subsidy System)

- 7.1 Whilst self-financing will commence on 28th March 2012 we have demonstrated the positive impact the abolishment of the subsidy system will have on Medway even though this it at the expense of taking on additional debt of £19.485m.
- 7.2 The charts below demonstrate how the HRA forecasts would look under the subsidy system were it to continue with the following assumptions.
- 7.3 We have assumed the same level of capital investment identified in section 4.2 and within chart 6.2.

7.4 To fully fund these works we have assumed that HRA would borrow prudentially in addition to the existing resources as the debt cap would not apply.

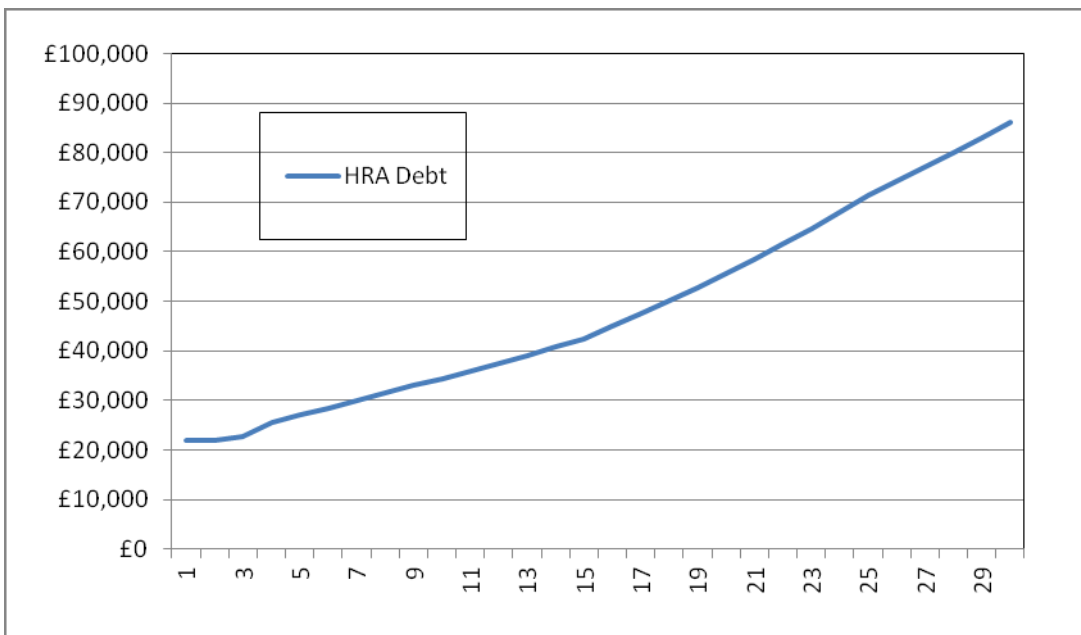
7.5 The chart below demonstrates that the HRA could only maintain a positive balance for 16 years. This is due to the increasing level of subsidy that would be payable and the newly arising interest on the prudential borrowing to meet the capital expenditure.

Chart 7.1 Initial Base Forecast HRA Balances IN SUBSIDY- £'000s



7.6 The chart below demonstrates the level of debt that the HRA would have under the subsidy system to meet the investment requirements.

Chart 7.2 Initial Base Debt Graph – IN SUBSIDY £'000s



7.7 At the point of the HRA falling into an illegal deficit in year 17 the HRA would have debt in the region of £44.489million.

8. Conclusion

- 8.1 Therefore under HRA reform Medway's business plan presents a viable position with capital expenditure for required investment in the stock met, with interest charges met with the total debt repaid in 17 years. Whilst in contrast if the HRA system were to continue the capital expenditure could only be met for 16 years to prevent the HRA from falling into deficit and the debt outstanding at that point would be £44.5million.

Simon Smith

January 2011