Brent	**Housing Scrutiny Committee** 29 November 2018
	Report from the Strategic Director of Community Wellbeing

Housing Revenue Account Overview

Wards Affected:	All
Key or Non-Key Decision:	Non-Key
Open or Part/Fully Exempt: (If exempt, please highlight relevant paragraph of Part 1, Schedule 12A of 1972 Local Government Act)	Open
No. of Appendices:	None
Background Papers:	None
Contact Officer(s): (Name, Title, Contact Details)	Minesh Patel, Head of Finance Minesh.Patel@brent.gov.uk Tel. 020 8937 4043

1.0 Purpose of the Report

1.1 This report provides Housing Scrutiny Committee with an overview of the Housing Revenue Account (HRA) within a local and national context, along with key challenges and how they are being managed.

1.2 The report seeks to inform the Housing Scrutiny Committee of issues that determine how the HRA is managed, such as;

- The ring fence between the HRA and other Council budget structures
- The self-financing model
- The borrowing cap, including recent changes
- The balance between borrowing and increasing housing stock through new build
- The Right to Buy
- Asset management

1.3 The report also discusses recent legislative changes that have an impact on the HRA and what those impacts are.

1.4 The report provides a current breakdown of the income into the HRA and how it is spent in maintaining Council stock.

2.0 Recommendation

2.1 That the Scrutiny Committee notes the contents of this report.

How the HRA Works

3.0 Ring Fence

3.1 The management of Local Authority housing is contained within the Housing Revenue Account (HRA), which is a ring-fenced budget. The HRA takes its income from rents and service charges collected from tenants and leaseholders, and this money must be spent exclusively on the management and maintenance of these properties, including building new ones.

4.0 Self Financing

4.1 The Localism Act 2011 introduced a number of changes to how Local Authorities manage their properties, including the introduction of self-financing. As a result, Local Authorities are allowed to keep the totality of the rents they collect but had to take on a share of the national HRA debt.

4.2 The self-financing settlement in 2012 imposed a cap on future levels of debt for all authorities, the debt cap for Brent was set at £199.3m.

5.0 Borrowing Cap

5.1 HRA borrowing caps were first introduced in April 2012 for all 169 stock retaining councils as part of local government self-financing reforms. These reforms permitted councils to keep the rents they collected locally for the first time, whereas previously they were (partially) redistributed through a complicated national subsidy system.

5.2 The Treasury was nervous of stretching the national borrowing too far, so it set a cap on what could be borrowed. Each authority's debt level is set based on a complex calculation based on the previous HRA subsidy system.

5.3 The HRA debt cap set for Brent in April 2012 was £199.3m. The debt balance as at April 2018 is £148.6m. The difference between debt cap and current debt level is known as the 'headroom'.

5.4 Currently the projected headroom is £7.0m after accounting for earmarked investment in housing stock and existing infill developments.

5.5 The government announced in October 2018 that HRA borrowing cap will be lifted from 29th of October 2018. It was also suggested the new borrowing powers would be focused on additional units only, with a focus on mixed-tenure development including homes for social rent, affordable rent and shared equity products.

5.6 Further details are expected to be released around the practicalities of increased borrowing. It is understood that the new HRA borrowing rules will come under the Prudential Code, the rules which determine other types of council borrowing.

5.7 The Prudential Code was introduced in 2004 as a framework to support Councils and help them show effective controls of decisions relating to capital investment activity, including borrowing. Before this, capital investment levels in Councils were government regulated.

5.8 This self-regulated approach has enabled the Council to adopt borrowing and treasury management strategies that fit with its corporate plans and objectives. The framework allows the Council to judge for itself what is affordable and sustainable.

5.9 Each authority must set a total borrowing limit for itself in accordance with the principles of the Prudential Code. The borrowing limit will be related to the revenue streams available to the local authority, with which it can repay the debt.

5.10 Local authorities can access low interest loans through a government body, the Public Works Loan Board (PWLB). The PWLB does not need to know the reason a local authority needs a loan, provided it can afford the borrowing costs.

5.11 When deciding to borrow the two main costs in consideration are Interest on the loan and the repayment of the loan:

5.11.1 **Interest on the Loan**:

The cost of servicing debt in the HRA is currently estimated to be £6.5m for 2018/19, this is based on previously set interest rates at 4.75%. Any new borrowing in year is currently set at 3.05% (PWLB rates in October 2018, 30 year maturity), as a rule of thumb, at this present time, every £100m of borrowing will require approximately £3.1m revenue budget provision or rental income.

5.11.2 **Repayent of the loan:**

A Minimum Revenue Provision (MRP) represents the minimum amount that must be charged to an authority's revenue account each year for financing of capital expenditure, which will have initially been funded by borrowing. It is part of all authorities' accounting practices and is about making sure that an authority can pay off the debts it has from buying capital assets, such as building schools or care homes.

6.0 Borrowing for New Build Programmes

6.1 Brent's key strategic aims are to increase housing supply across all tenures, with a particular emphasis on affordable rented products. Council's planning and housing policies aspire to achieve 50% affordable housing in all new developments larger than ten homes, with a 70:30 ratio between rented and low cost home ownership options.

6.2 Brent was awarded £65.6m GLA grant in October 2018 to contribute towards building 817 new homes to be let at London Affordable Rents (LAR), which is set at 50% of market rents.

6.3 The initial plans are to split the GLA grant on the basis of 304 homes being developed in the HRA and 513 homes being developed in the General Fund. The HRA will need to borrow an estimated £51.6m to cover full cost estimated at £82.0m.

6.4 Detailed investment appraisal decisions for new build projects will need to take into consideration the payback period of debt principal, if this is not done the costs of servicing debt would rise over time and consume a greater proportion of the HRA revenue budget.

6.5 The total cost of all HRA capital pipeline proposals of 304 units currently amounts to £82.0m. As a result, capital financing costs (interest on borrowing) is estimated to increase by an additional £2.5m per annum.

6.6 In addition to financing cost, the cost of management and maintenance of the pipeline proposals is estimated to be on average £1.8m per annum, based on current expenditure levels projected in the business plan.

6.7 The pipeline proposals create a revenue budget requirement of £4.3m per annum which will need to be financed by rental income to make the investment affordable.

6.8 Based on the current high level assumptions on building properties at 50% of market rent (London Affordable Rent), the estimated average surplus generated per annum for 304 properties is £0.06m, after taking into consideration the cost of management, maintenance and debt financing, excluding debt principal repayments.

6.9 The surplus generated from new build properties will be impacted further due to loss of rental income from future Right to Buy sales, while at the same time it is important to note that the principal payments for borrowing still remains unpaid.

6.10 Detailed investment appraisal decisions will need to take into consideration the payback period of debt principal, if this is not done the costs of servicing debt would rise over time, leading to the position when day to day services to tenants will be impacted as interest costs consumed a greater proportion of the HRA revenue budget. This adds further challenge to the feasibility of increasing headroom due to limited levels of net surplus per property generated from building affordable housing.

6.11 **Scenario Analysis:**

6.11.1 The following scenarios are explored using high level assumptions on rental income, cost of management, maintenance and debt financing.

Table 1 – Scenario Analysis Summary:

Estimates over 30 years	Ave. Stock	Ave. Net rent p.a. (£000)	Ave. Interest p.a. (£000)	Interest v Rent (%)	Total debt in Year 30 (£000)	Operating Surplus at Year 30 (£000)
Scenario 1 - Existing Projections	7,466	67,057	8,461	13%	196,980	88,959
Scenario 2 - 304 Pipeline	7,770	70,167	12,727	18%	446,124	3,556
Scenario 3 - 608 Units	8,378	74,702	17,275	23%	684,034	2,519

6.11.2 Scenario 1 – assumes current business plan remains unchanged. The projected level of debt is £196.9m in year 30, with an operating surplus of £90.0m available for debt repayment. Debt servicing expenditure accounts for 13% of the annual rental income.

6.11.3 Scenario 2 – is updated with high level estimates for the current pipeline schemes of 304 properties and includes substantial investment in the existing stock. It is estimated to have an increased debt position of £446.1m in year 30, with an operating surplus of £3.6m. Debt servicing expenditure also increases as a proportion of the rental income (18%).

6.11.4 Scenario 3 – is further updated with an aggressive approach of borrowing to build 608 properties. It is estimated to further increase the debt position to £684.0m in year 30, with an operating surplus of £2.5m, this level of surplus will not realistically be considered for debt repayment, however it provides an indication of the maximum amount of investment in the HRA over a 30 year period.

6.11.5 These scenarios provide an indicative conservative position with average build costs, rent levels, management cost and substantial investment in current aging stock.

6.11.6 Further detailed work will need to be carried out to refine the options but if the council is to ensure that new build schemes are affordable in the HRA, some of the types of issues that will need to be considered are:

- Key assumptions on the size of development eg if we focus on bigger developments, the unit costs will go down.
- How do we drive more efficiencies within the HRA to reduce the per unit management fee to release income to pay back the loan principle earlier.
- Rent levels – could we decide to set an affordable rent at London Living Rent (65% of market rents) as opposed to London Affordable Rent (55% of market rents).
- Stock condition survey: The value of investing in current poor performing stock vs building new - should we release capital receipts by disposing of poor performing stock

6.11.7 In practice, each individual new build scheme is appraised on a case by case basis, once it is considered financially feasible, it will be built into the HRA business plan to see the overall impact.

7.0 Right to Buy

7.1 The maximum Right to Buy (RTB) discount is set by legislation, it is currently £108,000 in London. It will increase each year in April in line with the consumer price index (CPI).

7.2 There were 58 RTB sales in 2016/17 and 49 in 2017/18. The projected rate of RTB sales is expected to reduce as the number of applications show a declining trend.

7.3 RTB receipts must be spent on one-for-one replacement at any point within a three year period, failure to spend within the deadline incurs payment to government plus 4% interest above base rate. RTB receipts can only cover 30% of the cost of replacement and must be matched with 70% Council funding.

7.4 The Mayor’s Building Council Homes for Londoners prospectus May 2018, has introduced arrangements for pooling RTB receipts, which would be held by the GLA until a local authority is ready to deploy them, thereby extending the period to keep hold of the receipts without incurring a penalty. Brent has opted-in to this offer.

7.5 Previous limitations on HRA borrowing from the borrowing Cap had meant it was not possible to match fund receipts, therefore the option to grant fund Registered Providers (RP’s) using RTB receipts has been considered. In-return for the grant, the Council will seek nomination rights. Now that the borrowing restrictions have been lifted, this option is being re-assessed.

7.6 The Social Housing Green Paper August 2018 includes proposals to relax current restrictions on the use of RTB receipts. The consultation is due to end in November 2018 with outcomes expected in 2019.

8.0 Asset Management

8.1 Alongside this report, the Housing Scrutiny Committee will also be considering a report on Asset Management strategy. This report details the process through which an Asset Management Strategy will be developed and presented to Cabinet for agreement in April 2019. The Asset Management Strategy will inform a full re-profiling of major works expenditure and in combination with HRA Business Plan, will determine future major works budgets.

8.2 Type 4 fire risk assessments are also taking place, the findings from which may require significant spend on existing stock. Firm proposals on stock investment will be presented for discussion.

9.0 Influences and Impact

9.1 **Welfare Reform Act 2012**

9.1.1 For the HRA, two key points are important:

- Cuts to housing benefit related to non-dependent deductions, under-occupancy and the single room rate have reduced benefits for existing tenants and impacted on rent payments.
- The forthcoming implementation of Universal Credit (UC), payable monthly in arrears and not normally direct to the landlord, is likely to result in an increase in arrears or late payments.

9.1.2 The impact of Universal Credit (UC) is beginning to be felt, with average rent arrears for UC claimants totalling £618 (around 6-7 weeks rent), compared to £131 for those not claiming UC. This suggests as UC is rolled out, there is a risk of rising arrears that the HRA must prepare for.

9.1.3 Brent Housing Management (BHM) is putting in place a range of operational mitigations to include the following:

- Raising awareness with residents about Universal Credit, including what it means for them
- Developing future delivery partnership with Department for Work and Pension (DWP)
- Establishing delivery partnership agreement that supports the most vulnerable
- Increasing provision for digital inclusion and improve capacity for residents to manage accounts independently
- Exploring technology capable of analysing held data and predicting potential defaults before the happen

9.1.4 The impact of universal credit roll out will be on rent collection rates and increases the likelihood of bad debts.

9.1.5 Currently the budget for increases in bad debt provision is set at £0.4m. It is assumed to increase to 0.9m from 19/20 from anticipated roll out of universal credit.

9.2 **Welfare Reform Act 2016**

9.2.1 The Act requires 1% social rent reduction for 4 years from 1 April 2016, replacing the previous regime under which rents could rise by a maximum of the Consumer Price Index (CPI) plus 1% each year**.**

9.2.2 The impact of rent reductions has reduced rental income and bottom line surpluses previously assumed in the business plan. The total loss of income of £23m against previous regime along with increased capital expenditure on major works has meant that the major repairs reserve held in the balance sheet has been fully used to finance investment in existing stock.

9.2.3 In October 2017, the government announced a return to CPI plus 1% model for the five years from 2020.The approach beyond 2025 remains uncertain but there is an expectation that the model is likely to remain in place.

9.3 **Housing and Planning Act 2016**

9.3.1 Many of the provisions of this Act have yet to be brought into operation some uncertainty remains as to whether further changes will be made.

9.3.2 The Act provides for a “pay to stay” regime, permitting higher rents for higher earning households (over £40,000 in London). The scheme would operate on a voluntary rather than compulsory basis. The Council has no plans to introduce it in Brent and is not aware of any Registered Providers planning to do so in the borough.

9.3.3 The Act imposes a duty on local authorities to promote the supply of Starter Homes. These are classified as new dwellings, available to first time buyers aged under 40 and sold at 20% less than market value and for less than £250,000. Detailed provisions have not been released but Starter Homes will be classed as affordable housing within the National Planning Policy Framework (NPPF) and funding will be through the Affordable Homes Programme**.**

10.0 HRA Budgets

10.1 The HRA budget is set at a balanced position where income is matched by expenditure as summarised in table 1 below.

Table 1: HRA Budget 2018/19

Description	**Budget 2018/19 (£m)**	**Budget Narrative**
Rents	(48.5)	Rents, garage rents and tenants service charge
Non Dwelling Rents	(0.2)	Commercial rents
Leaseholders' Charge for Services and Facilities	(2.3)	Leaseholder service charges
Major Works and Other Contribution Towards Expenditure	(3.5)	Leaseholder major works Income and recharges to General Fund for services provided by Housing Management
HRA accumulated surplus	(2.5)	HRA operating balance brought forward from prior year
Total Income	**(57.0)**	
Repairs and Maintenance	11.8	Responsive and cyclical repairs
Stock Management	11.8	Housing management staff costs, share of corporate recharges, premises insurance, council tax on voids and provision for bad debts
Estate Service & Cleaning	4.3	Contracts for building cleaning, concierge services, communal utility bills, grounds maintenance and wardens
Depreciation of Fixed Assets	21.1	Depreciation of council dwellings
Capital Financing and Debt Management	7.9	Interest on borrowing and debt management
Total Expenditure	**57.0**	

10.2 Investment in existing stock and new build schemes funded by the HRA is summarised in table 2 below.

Table 2: Capital Budgets 2018/19

Description	Budget 2018/19 (£m)	Budget Narrative
HRA Acquisitions	6.0	Properties purchased on the open market for affordable rent
Infill Development	17.9	New build (Phase 1 & 2)
Major Repairs and Maintenance	25.2	Planned maintenance of existing stock (e.g. external refurbishment, mechanical and electrical)

10.3 **HRA Operating Balance Position**

10.3.1 Current projections are that an operating surplus of £1.2m per annum for the next 2 years will be maintained. A deficit must be avoided, therefore it is prudent to keep an operating balance target which is currently estimated at £200 per property. However, maintaining a reserve balance means budget growth on service areas will be further restricted.

11.0 Legal Implications

11.1 None

12.0 Equality Implications

12.1 There are no equality implicated associated with the content of this report.

13.0 Consultation with Ward Members and Stakeholders

13.1 None

14.0 Human Resources/Property Implications (if appropriate)

14.1 None

Report sign off:

PHIL PORTER
Strategic Director Community Wellbeing