Supplementary Committee Agenda

Overview & Scrutiny Committee
Thursday, 27th January, 2022

Place:	Council Chamber - Civic Offices
Time:	7.00 pm
Democratic Services Officer:	Vivienne Messenger Tel: (01992) 564243 Email: democraticservices@eppingforestdc.gov.uk

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10. HRA BUSINESS PLAN (Pages 3 - 12)

A list of FAQs on the HRA Business Plan is attached for information.
(NB: paper copies are not being provided).

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Housing Revenue Account Business Planning

Frequently Asked Questions

1. What is the HRA?
   The HRA is the Housing Revenue Account. This is a ring-fenced account which has been in existence since the 1930's. All Councils with more than 199 units of social rented stock are required to account for annual income and expenditure on those properties separately from the General Fund. The HRA is bound by legislation which defines what can and cannot be charged to the HRA.

2. What does the "ring-fencing" mean?
   "Ring-fencing means:
   - Operation of a separate income and expenditure account
   - Operation of a separate HRA reserve
   - HRA reserve cannot go into deficit
   - There are separate rules in relation to capital and debt financing

3. What changes in legislation have affected the HRA?
   - **1989 Local Government and Housing Act** – ring-fenced HRA with capital and borrowing controls and a redistributive Housing Subsidy System (this was controlled by Central Govt, and the opposite of running a "business-like" service)
   - **HRA Resource Accounting 2001** – introduced a Major Repairs Allowance (spend on capital) and a Major Repairs Reserve
   - **Rent Restructuring from 2002 onwards** – moving existing social rents towards a comparable rent across England based on capital values, bedroom numbers and wage levels
   - **Local Government Act** 2003 – Prudential Code – replaced capital controls
   - **2006 – 2012** – work to move to Self-Financing HRAs
   - **2012 – abolition of the Housing Subsidy System** and introduction of the self-financing debt settlement with a debt cap
   - **2018 – abolition of the HRA Debt Cap**

   Effectively a journey towards increasing freedom and flexibility – within the context of a legislatively controlled accounting framework.

4. What is the HRA Business Plan?
   The HRA business plan can include a written plan for the future of the housing stock and estates, but in terms of the finances, the business plan is a set of assumptions about income and expenditure over 40 years. Starting from the base information that we know about the housing stock and budgets now, the assumptions allow us to estimate future cashflows arising from Council housing given economic forecasts. A survey of the stock gives us a reliable idea about how much investment is needed to keep the stock in a decent condition. The remaining amounts after accounting for day-to-day budgets need to be enough to allow the Council to pay interest on its loans and/or repay its HRA debt.

   The Council uses Abovo-Consult's Fortress HRA Business Planning and Stress-Testing Model to forecast its 30-year business plan and combines both capital and revenue funding to produce a holistic view.

5. Where do the assumptions about future inflation come from?
   The underlying estimates of Consumer Price Inflation (CPI) and Retail Price Inflation (RPI) for the next 5 years are taken from the estimates of the Office for Budgetary Responsibility (OBR) published figures based at quarter 2.

   Inflation on staffing costs is provided by the Council's annual estimates for the Council as a whole.

6. What income is included in the HRA?
   Revenue income comes from:
   - tenants' weekly rents on homes and garages
   - charges for services and facilities
   - miscellaneous land and property rents such as shops, land, hardstanding.

   The HRA also received contributions from the General Fund toward expenditure incurred where a share of costs relates to the wider residential area.

   Within statute it can also include sums directed by the Secretary of State that are income in accordance with the Code.

   Revenue income may be used to finance revenue expenditure in the HRA, and may also be used to finance capital expenditure, thus reducing the amount of borrowing that would otherwise have been required.

7. What is Capital Income?
   Capital income either arises from the sale of Council Housing land and property or from grants given to support the financing of new development or other capital projects. Capital income can only be used to finance future capital spend it cannot be used to fund revenue expenditure in the HRA.

   Examples are Right to Buy sales receipts, income from equity sales in shared ownership properties, grants from Homes England, sales of land in the HRA and contributions to works from leaseholders.

   Money borrowed is also capital income.

8. How are social rents calculated?
   Social rents are usually historic rents that have been moved towards a formula based "target" rent since 2002. Many rents will have converged with the formula or target rent, but others may not yet have done so.

   The social rent formula aimed to allow rents to converge to a formula rent originally by 2013. The formula rent is calculated for each property by local authority area with an allowance for the size of the property (number of bedrooms), its capital value compared to the national average and an affordability adjustment by comparing wages in an area to the national average. Capital values were set in 1999. The formula is a weighted average figure by property taking into account 30% of the value in relation to the value and 70% in relation to the wage effect.

   Each year, the formula rent is increased, regardless of whether the actual rent is increased or decreased. Originally, the increase was RPI + 0.5%, but in 2015, this was amended to CPI + 1%.

"Target Rents" can be set at up to formula + 5% for General Needs properties and formula + 10% for Supported housing. This is known as "flexibility" or "tolerance". Whatever figure is chosen for the rent be it the formula or formula + flexibility is known as the "target rent".

From 2002 to 2015, actual rents were allowed to rise by RPI + 0.5% + a max of £2 per week so that they converged towards the target. Convergence in year was terminated form April 2015, making it impossible to converge existing tenants to target rents.

The flexibility cannot be introduced once a property has been let for the first time.

9. How are affordable rents calculated?
   Affordable rents can be set for properties that are developed or purchased using grant for the purpose of affordable housing – this includes the use of Right to Buy 1-4-1 receipts.

   Affordable rents are set at first and subsequent re-lets by taking the market rent for a similar property including any service charges and then setting the rent at a maximum of 80% of that figure. Service charges cannot be added on to the affordable rent separately after calculating the 80% of a non-serviced market rent. It may often be the case that the market rate does not cover the actual cost of services provided, but this is a risk that must be considered at the time of taking the grant support. The market rent will set the value that people are prepared to or ae able to pay, the reduction to 80% of that value is designed to make the property affordable at the time of letting to a social tenant.

   The Council has its own policy of setting affordable rents at the minimum of the calculated value and the relevant Local Housing Allowance.

10. How can rents be increased?
   Social rents including affordable rents from 2020 are regulated by the Regulator of Social Housing (RSH) in the same way as Housing Associations. Rents must be set in line with the Rent Standard and breaches must be reported to the RSH.

   The Rent Standard states that social rents (i.e. those set by reference to the "formula rent") that are less than or equal to the formula rent + allowed flexibility may increase by a maximum of the CPI (based on September in the year prior to the April increase) + 1%. The rate of CPI in September 2021 was 3.1%, so the maximum allowable increase in rents in April is 4.1%. This increase can be assumed for up to the next two financial years and then further guidance will be required.

   Social rents that are less than the formula or "target" rent may be increased in a rent year to that target if the property is re-let to a new tenant.

   The Rent Standard also applies to affordable rents (i.e. those set by reference to 80% of the market rent) and the same principle applies. Affordable rents can increase by a maximum of CPI + 1% until 31 March 2025.
   On re-let, an affordable rent must always be referenced back to the market rent for a similar property including service charges and a rent set at a maximum of 80% of the market rent. Market rents can go up and down.

   The Council has its own policy which limits an affordable rent to the Local Housing Allowance (LHA) for the area that the property is within. If the affordable rent is below

the LHA, but an increase of CPI + 1% would mean that it will be above the LHA, then the LHA rate is the rent that will be set. Note that since April 2020, LHA rates have been frozen and no increase is expected within the next two years.
The Government can intervene at any time and have done so in the past. Between 2016 and 2020, rents were cut by 1% per annum in cash terms (about 12% in real terms).

11. How are service charge fees calculated?
    Some properties receive services that are specific to their property. This is more usually for flats and blocks of properties. Examples are warden / sheltered unit support charges, communal area heating and lighting charges, water and sewage charges and repairs recharges.

    The cost of these services are recharged to the tenants who specifically benefit rather than every tenant. The charges made in total must not exceed the cost of those services to the HRA each year.

12. What expenditure can be counted as revenue expenditure in the HRA?
    The HRA can be charged with the costs of:
    - Repairs and Maintenance
    - Supervision and Management
    - Rents, rates, taxes and other charges,
    - Depreciation and impairment of non-current assets (e.g. homes, garages, shops)
    - Debt Management Costs including interest on loans
    - Sums directed by the Secretary of State that are expenditure in accordance with the Code.

13. What can be counted as capital expenditure?
    The key principle is that everything is revenue unless you can prove its capital!

    There are three “routes” for qualification as capital and a large cost does not mean its capital.

    - Spending which creates a non-current asset
    - Spending which meets a definition specified in regulations made under the Local Government Act 2003 (does not create a non-current asset)
    - If Secretary of State makes a direction that spending can be treated as capital (does not create a non-current asset).

14. What is an asset?
    An asset is:
    - An item held for use by the authority
    - Used more than one financial year
    - Its cost must be reliably measured
    - The authority must gain future economic or service benefits form its ownership

15. What is a stock condition survey?
    A stock condition survey provides an independent view of the profile of expenditure that will be needed to maintain the Council’s housing stock and estate assets at a particular standard (minimum is the Decent Homes Standard) over 40 years. The

profile will not give the same amount of money every year as it takes into account the lifecycle of elements within the homes such as kitchens, bathrooms, roofs, etc.

The information is used in the business plan to indicate how much money should be spent each year with inflation added on and provide budgets for the capital programme

The information can also be used to procure programmes of work more efficiently from having accurate data about the work required. It can also be used to consider options for stock other than maintenance to achieve value for money.

16. What happens if the Council does not maintain its existing stock?
The Council must maintain its stock to at least the Decent Homes Standard (DHS). The DHS is not a high standard but ensures that a property is kept warm and weathertight with functioning kitchens and bathrooms.

Failure to invest in properties at the right time can lead to an increase in unlettable properties which leads to a loss of rental income. Less rental income leaves less money to invest in the properties without borrowing.

Failure to maintain a roof for example can lead to other issues such as damp and mould and eventually an increasing number of "spin-off" repairs. Money spent on additional repairs reduces the money available in the HRA to maintain or improve the service and develop new homes.

17. What money can be used to finance the capital programme?
The capital programme can be financed from the following sources:
    - Grants specifically for major works and/or development projects
    - Shared ownership sales receipts on staircasing of existing S/O units or new build first tranches
    - Capital receipts from the sale of land in the HRA
    - Major Repairs Reserve funds
    - Income set aside in earmarked reserves for example for new build (if the programme contains the type of expenditure agreed for the reserve)
    - Receipts arising from RTB sales specifically for the replacement of homes – if and only if development / acquisition is in the plan
    - Other allowable receipts that can be retained from RTB sales
    - Revenue contributions to capital outlay (RCCO) from the HRA
    - Borrowing

18. How much can the HRA borrow?
When self-financing was introduced for the HRA, the Council was given a debt cap, or maximum borrowing allowed of £185.457 million.
In 2018, the Conservative Government removed the debt cap for all Councils and allowed them to borrow as long as the borrowing is prudent. The HRA business plan is a method by which Council can estimate how much the HRA can afford to borrow and when it is required.

19. What is the value of loans in the HRA now?
In March 2012, at the start of self-financing, the Council had a zero debt. However, the debt settlement allocated £185.457 million to the Council, which meant it had to borrow this sum from PWLB to pay to the Government to start self-financing. The

£185.457 million was made up six loans ranging from 10-year repayment to 30-year repayment terms at rates from 3.46% to 3.5%. The loans at the time were on preferential low rates available only on a specific day to Councils needing to borrow for self-financing settlements.

The £185 million was not based on the cost of the housing stock, but was a calculated value to work out how much debt the Council could afford based on what income it expected to receive and expenditure it needed to make over 30 years from 2012. This was a Government calculation.

In March 2021, the HRA borrowed £4 million to fund its capital programme giving a total loan value of £189.433 million at 31 March 2021

The first loan of £31.8 million is due for repayment on 1 March 2022.

20. Where does the HRA borrow from?
    HRA debt does not have to be supported by actual loans, it can also be financed internally. The HRA Capital Financing Requirement (CFR) is simply the total historic outstanding capital expenditure which has not yet been paid for from either revenue or capital resources. It is essentially a measure of the Council's indebtedness, or the underlying borrowing need.

    The HRA normally borrows within the Council's overall treasury management policy as borrowing relates to the Council as a whole.

    Loans are available at short notice from the Government via the Public Works Loan Board (PWLB). PWLB loans can be short terms or for very long periods (> 50 years) and rates of interest are set by the Government. Loans can also be taken from the external funders and also the HRA can borrow internally from the General Fund, if there are spare cash resources available.

21. What is the risk to the Council in borrowing?
    The HRA no longer has a limit on how much it can borrow. Borrowing needs to be prudent which means that there is sufficient income over time to service the debt.

    Borrowing in the HRA is not backed by a charge over the homes, so there is no risk of the properties being repossessed by a bank. The HRA is not obliged to set aside a Minimum Revenue Provision each year to build up to repay a debt (unlike the General Fund). The business plan over 30 years gives a good estimate of whether the debt taken on is sustainable or not.

    Loans at present are at low interest rates and PWLB loans are available to Councils for very long periods of time. Loan repayment terms on PWLB are usually "bullet payments" which means interest is paid annually on the full amount loaned for the period of the loan and the amount borrowed is paid at the end of the loan period. Borrowing to fund new development for example should provide an income stream with which to repay the loan. Development requires upfront expenditure to deliver cashflows over the future. The self-financing assumptions did not assume any development, so the income from existing homes is really only enough to cover the management and maintenance and debt relating to those homes.

Borrowing to maintain existing housing stock should ensure that the rents from these properties continue to contribute to the HRA and tenants' properties remain safe and warm.

22. How is interest calculated and charged to the HRA on debt?
    There are several ways that Councils account for HRA borrowing and this can affect the time and the amount of loan that is repaid and similarly the interest charged.

    Some Councils have a single "pot" of borrowing which includes many loans all with differing rates and repayment dates. They calculate the amount of debt that the HRA is responsible for and work this out as a percentage of the total loan pot. They then work out what the average interest rate across the whole pot of debt is and make a charge to the HRA equivalent to the HRA's proportion of the interest each year. As new loans are taken out or old loans repaid, the interest on the pot will change each year, but can be estimated fairly accurately.

    Alternatively, the Council can have two pots – one pot of debt for General Fund borrowing and a separate one for HRA borrowing. The interest charged to the HRA will be based on the annual interest on the loans in its own dedicated pot rather than a hybrid calculation across all debt in the Council.

    Epping Forest takes the latter approach with individual loans accounted for in the HRA with interest rates for each loan and set repayment dates.

23. When do loans need to be repaid by in the HRA?
    Whilst there is no requirement in the HRA for a Council to become debt free over time, the Council's loans to PWLB and external funders do have repayment dates. If there is insufficient cash at the time of repayment, then the loan can usually be refinanced. This is a matter for the Council's treasury management strategy.

    Unlike the General Fund, the HRA is not required to set aside a Minimum Revenue Provision (MRP) each year to meet debt repayments.

    There are several methods by which Councils use HRA funds to repay debt:

    - Annual set aside, payment to GF – the HRA pays over an annual proportion of its total debt each year to the General Fund. The General Fund then uses this money either to pay down debt as it falls due, uses it to pay off other loans or to reduce the need to borrow at the time. The HRA assumes that its debt is reduced and it also pays a reduced interest charge as a result.

    - Annual set aside, held in a reserve for repayment of debt – the HRA pays over an annual proportion of its total debt into an earmarked account to be used to repay debt as it falls due. As the loan is due for repayment, the money in the reserve is used to repay the debt. The HRA does not assumes that its debt is reduced and it also pays the same amount of interest as it would have done without set aside. Setting aside HRA balances in this way means that they can no longer be used to fund revenue activities and can only be used for capital.

    - Allow HRA balances to build up to allow the repayment of the loan as it falls due. The revenue is then paid at the loan repayment date to the Council to extinguish the debt. Balances remain available to meet revenue issues over time. Interest charges assume that debt is repaid on the repayment date.

It should be noted that whilst long term loans can be repaid early, there is usually a financial penalty incurred should this happen. The penalty reflects the loss of interest to the lender that I would have assumed it would get together with an allowance for having had cash at an earlier date than expected. Where there is a cost this is known as a "premium", in the event of a saving (i.e. if interest rates allow) then this is known as a "discount".

If there are insufficient funds, the HRA can refinance a loan at the point of repayment. This may result in a lower rate of interest then the original loan.

24. How much of the receipt from a Right to Buy Sale can the Council keep?
The proportion of annual Right to Buy sales receipts (after discount) that the Council and/or HRA can keep depends on how the cumulative sales receipts since April 2012 compare to that expected in the self-financing calculation.

For each sale, the Council can keep £1,300 to pay for the administration of the sale.

Each year, the Treasury expects to receive an agreed sum from RTB sales and this is sum id shared or allocated to Councils based on their RTB sales pre 2012. There is a proportion of the receipt that the Council may keep for each sale – this is known as the LA share. Other parts of the receipts in the year depend on whether the Treasury's share has been reached or not.

If the Council regularly sells more properties than the self-financing debt settlement assumed, then it will be compensated for effectively having taken on more debt than it should have. The income from rents (after management and maintenance costs) from homes is assumed to be used to pay HRA debt off. If the number of sales is more than expected, then the net income will be lower than expected leaving less revenue to pay off debt. In this case, the Council can keep part of the receipts to help it plug this gap.

If after accounting for the administration fee, the LA share, the Treasury Share and the Allowable Debt, there are still some receipts left, then these are known as 1-4-1 Replacement Receipts and these must be used to finance the cost of replacing homes, or returned to the Government for redistribution.

25. What are RTB 1-4-1 receipts and how can they be used?
RTB 1-4-1 receipts are a share of the sales receipts arising from RTB sales. They are generated when the number and values of sales exceed set limits for the Council each year. These receipts were originally designed to help fund replacement of additional social homes lost as a result of an increase in 2012 in the level of discount offered to tenants wishing to buy their own home. The expectation was that the money could replace the additional sales on a 1-4-1 basis.

RTB 1-4-1 receipts can only be used to fund:

- New build development of homes in the HRA
- Acquisition of homes in the HRA
- Development by another Registered Provider

Unused receipts after a time limit are returned to Government with interest at 4% above the bank base rate.

From 1 April 2012 to 31 March 2020, the 1-4-1 receipts could only be used to finance up to 30% of a purchase / scheme – the rest needing to be financed from revenue /

borrowing. From 1 April 2021 the proportion is 40%. This cannot be combined with any grant income.

From 1 April 2012 to 31 March 2020, the 1-4-1 receipts had to be spent within 12 quarters of it being earned. Quarterly reporting was required. From 1 April 2021, the time allowed is 5 years from the year in which the receipts arise.

Originally, receipts could only be used to fund social and affordable rented properties in the HRA. From 1 April 2021, they can be used to fund shared ownership and First Homes (discounted market sales) tenures.

26. Does the HRA have to account for depreciation on assets?
Yes, depreciation is a cash charge to the HRA which moves an allowance from HRA reserves to the Major Repairs Reserve each year. It is designed to reflect the need to finance the replacement of components within homes over time

There are several options for calculation:

- Straight line based on property value;
- Linked to major repairs expenditure needs (e.g. using a survey);
- Componentised approach – each component in a house e.g. doors & windows, kitchen, bathroom, electrics, boiler, roof have replacement lifecycles ranging from 15 years top 60 years depending on the item.

The sum charges to the HRA is transferred into the Major Repairs Reserve (MRR).

If the amount of depreciation charged to the HRA based on the calculations of past costs is insufficient to meet the longer term capital spending estimates, a Council can “top up” the figure from the HRA reserves. Adding further sums into the MRR means it can only be spent on capital expenditure or repayment of loans.

27. What is the Major Repairs Reserve used for?
Councils with an HRA must have a Major Repairs Reserve (MRR). The Major Repairs Reserve is used to build up capital sums that can be used to finance the capital programme and repayment of housing debt.

The income to the reserve is based on the depreciation charge made to the HRA. It can also be “topped up” with further HRA contributions. The funds in the MRR are capital.

A minimum balance can be set on the MRR, but most Councils utilise the balance on the MRR each year to fund the capital programme alongside other capital receipts, revenue contributions and borrowing.

The MRR is used less now as a means of building up reserves as within self-financing it is possible to forecast the use of revenue income to fund the capital programme.

28. What is the minimum level of HRA reserve allowed?
The HRA reserve must not either fall into negativity or be budgeted to do so.

An annual HRA budget can be set to spend more than the income received in the year (e.g. to fund capital or loan repayments from HRA reserves) but this “deficit” will be taken from the reserve to leave the overall reserve total positive after doing so.

The Council can set its own minimum level of working capital that it doesn't want to fall below.

29. What is the interest cover ratio used for?

    Interest cover is the number of times that the annual interest charge could be paid out of the annual net income (income – revenue spend) – or operating surplus. This figure is before any loan repayments or interest have been made.

    For example, if the annual net income to the HRA is £2 million and the interest charges are £750,000, then the interest cover is £2million / £750k which is 2.67 times.

    The ratio is used to measure how affordable debt is in the HRA via its ability to pay interest on the loans. A prudent minimum interest cover is 1.25 times.

    Borrowing to build new homes may reduce the interest cover during the building phase as interest is increased. However, as the properties begin to generate rental income, the net income will rise (new homes need less maintenance) and thus the number of times that the operating surplus will cover the interest charged will increase.

    This is being used as a measure of affordability rather than the actual level of debt held.

30. What is the loan to value measure used for?
    Loan to value measures the proportion of the value of the Council's housing stock that is covered by loans. This measure is used by housing associations but is less meaningful to Councils at the present time. The value of the Council's housing stock is not what it cost, it is valued at its existing use value as a social home – this can be revalued and thus change the figure.

    Housing associations are required to allow the bank to take a charge over their assets in return for borrowing money. The bank would want to know whether the loans they have provided are greater than the value of the properties in case the housing association cannot meet its repayments.

    Councils do not have this requirement when borrowing, but Councils have not until recently been involved in large development programmes. The debt cap pre 2018, meant that Council debt as lower by comparison than housing association debt.