Appendix 4

Housing Revenue Account 30 Year Business Plan

1. Introduction

This report presents a baseline summary of the Housing Revenue Account.

This report summarises expenditure, investment, capital financing and borrowing projections in respect of New Forest District Council's housing operations over a 30 year period, starting in 2022/23. The report presents a baseline position that reflects the authority's best available data and assumptions at the current time. The baseline allows for inflationary pressures impact on budgets and programmes from 2023/24. It also assumes a continuation of existing Central Government rent policy, after applying a 7% cap to the maximum rent increase for existing tenants in 2023/24.

The report then demonstrates the impact on the baseline position by applying two separate alternative scenarios which are proposed in the proposed rent policy:

1. Adopting a policy of re-letting vacant properties at the formula rent
2. Further adopting the use of rent flexibility

These scenarios are intended to illustrate potential changes to the baseline, which may flow from policy decisions. They do not constitute a full stress test of the authority's position but demonstrate how changes to income changes affordability, balances and debt repayment positions.

2. Baseline projections

2.1. Baseline assumptions

The baseline assumptions reflect the revised 2022/23 revenue budget, draft 2023/24 budget and medium-term projections for capital and revenue. Other information and assumptions that have been used in preparing this baseline projection include:

- The authority's medium term HRA capital programme
- Updated information on the authority's programme for developing and acquiring new dwellings over the medium term
- Data from the right to buy pooling returns that the authority submits to DLUHC
- An assumption that the authority sells 23 homes a year under the right to buy
- The authority aims to maintain a minimum HRA balance of £1.000m, adjusted for inflation
- Any sums generated by the HRA that are in excess of the minimum balance are made available to pay for the capital programme or to repay debt
- Actual rents increase up to the maximum rate currently permitted by the rent standard. Due to the rent cap, the maximum rent increase for existing tenants in 2023/24 has been set at 7% for general needs housing. Under the current policy statement an increase of CPI +1% is expected to apply until 2024/25. The government plans to consult separately on rent increases from 2025/26. While the Council awaits this consultation a prudent assumption that rent increases will be limited to a CPI uplift from April 2025 has been applied.
- Formula rents increase at CPI +1% in 2023/24 and 2024/25, in line with the rent standard and government policy statement. As for actual rent increases, it has been assumed that formula rents increase in line with CPI from 2025/26, pending consultation by government.
- In 2022/23 the authority re-lets 5.5% of its social rent stock (277 units in 2023/24) at formula rent, with future relets in the same proportion.
- Depreciation costs have been estimated in line with the authority's budget, uplifted for inflation at RPI.
- Inflation has been applied as follows:
    - Underlying inflation for 2023/24 is linked to the inflation rates for September 2022, as published by the Office for National Statistics, and the house price index published by HM Land Registry for August 2022.
    - CPI at 5.2% in the final quarter of 2023, based on projections prepared by the Bank of England and published in the November 2022 monetary policy report. This rate has been used to reflect underlying inflation for 2024/25. From 2025/26 onwards it is assumed CPI runs at 2% pa.
    - RPI tracks at CPI +1%
    - General management and special management cost increase by 5% and 7% respectively for 2023/2, then reflect underlying CPI.
    - Building costs increase by 25% over the three years to 2025/26 (after allowing for inflation already built into the authority's budgets), then continue to increase at RPI. This affects spending projection for day to day repairs and maintenance, major works to existing homes and the provision or acquisition of new homes.
    - Other costs in the capital programme have been inflated by CPI.
- Major works and component replacements are treated as 100% variable from 2025/26. These costs have an element that flexes to reflect increases and reductions in the housing stock.

- At the start of the planning period HRA debt includes internal borrowing from the Council of £5.874m. It is assumed the HRA would make repayments from this debt until 2024/25, in line with its medium term financial plan. From 2025/26 onwards it is assumed that the authority would not reduce this internal debt further.
- The projections assume an interest rate of 3.8% would be charged on all new external loans, with 0. 5% interest payable on internal borrowing

In preparing this projection it is assumed that the HRA would attempt to repay any additional external borrowing that it undertakes as quickly as possible. Our reason for making this assumption is that it gives a clearer indication of how well the HRA can service and repay any borrowing that is required to deliver its long term capital programme. Any actual borrowing undertaken by the authority would be subject to the prevailing market conditions and guidance received from the authority's treasury advisors.

2.2. Gaps in the data and potential risks

There are gaps in the data available to the authority, which have required us to make assumptions about future expenditure in key areas. The two principal gaps identified relate to:

- The profile of component replacements required for the existing stock
- the scale of EPC-C and decarbonisation works required to the existing stock

The profile of component replacements required for the existing stock is normally generated from a stock condition survey. A full stock condition survey is underway with a target completion of January 2024.

At the moment, every authority's assessment of the decarbonisation works required to its existing stock is a developing area, and estimated costs can vary substantially as the specific requirements emerge. In estimating costs data from the authority's Greener Housing Strategy work has been used, which currently represents the best available information. However, these assumptions will be updated in due course as the Greener Housing Delivery Manager progresses their work to identify a programme for EPC-C and decarbonisation works.

Other key risks include:

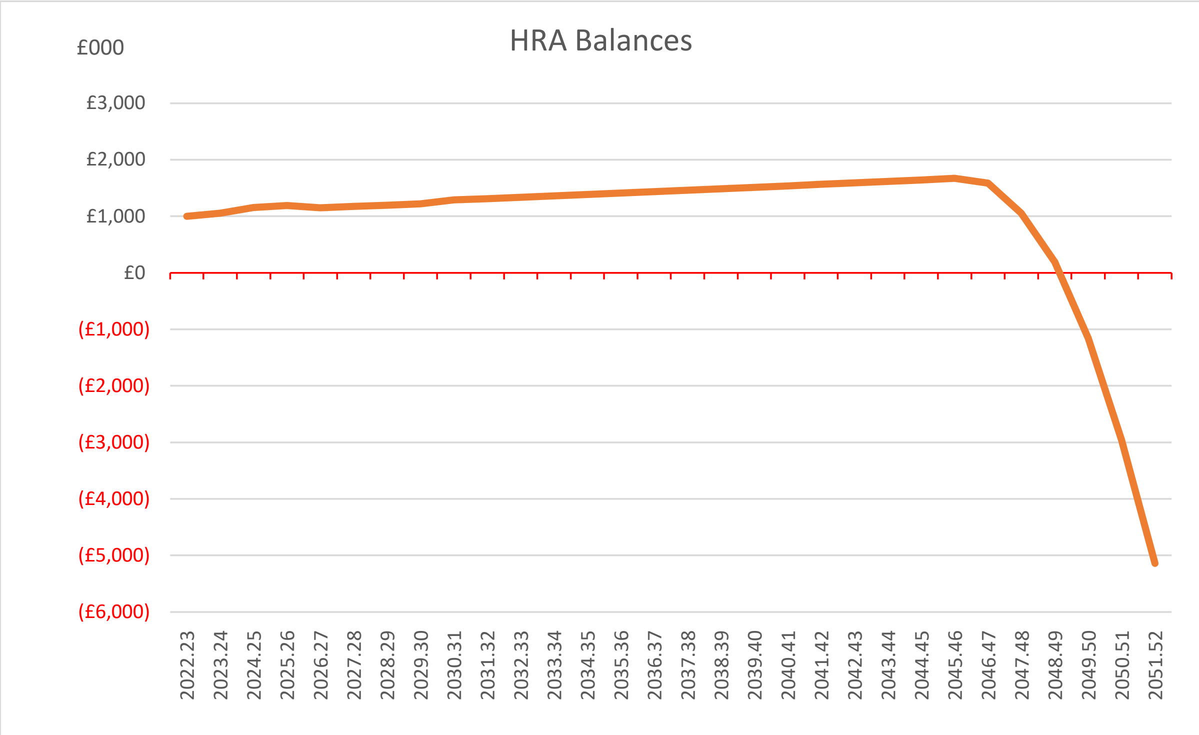
- fluctuations in the underlying rate of inflation, which can impact on both costs and income
- further constraint imposed on rent increases by government, or by the authority itself
- increases in the costs of works and services that are not matched by increases in income
- changes to underlying interest rates
- absence of compiled information on stock condition and future component replacements

The effects of the baseline assumptions are shown in the following sections.

2.3. Baseline - revenue position

In the chart below the orange line projects the cumulative HRA balance at the end of each year.

The chart therefore shows the authority's ability to maintain a minimum level of balances during the 30 year period covered by the baseline projection:



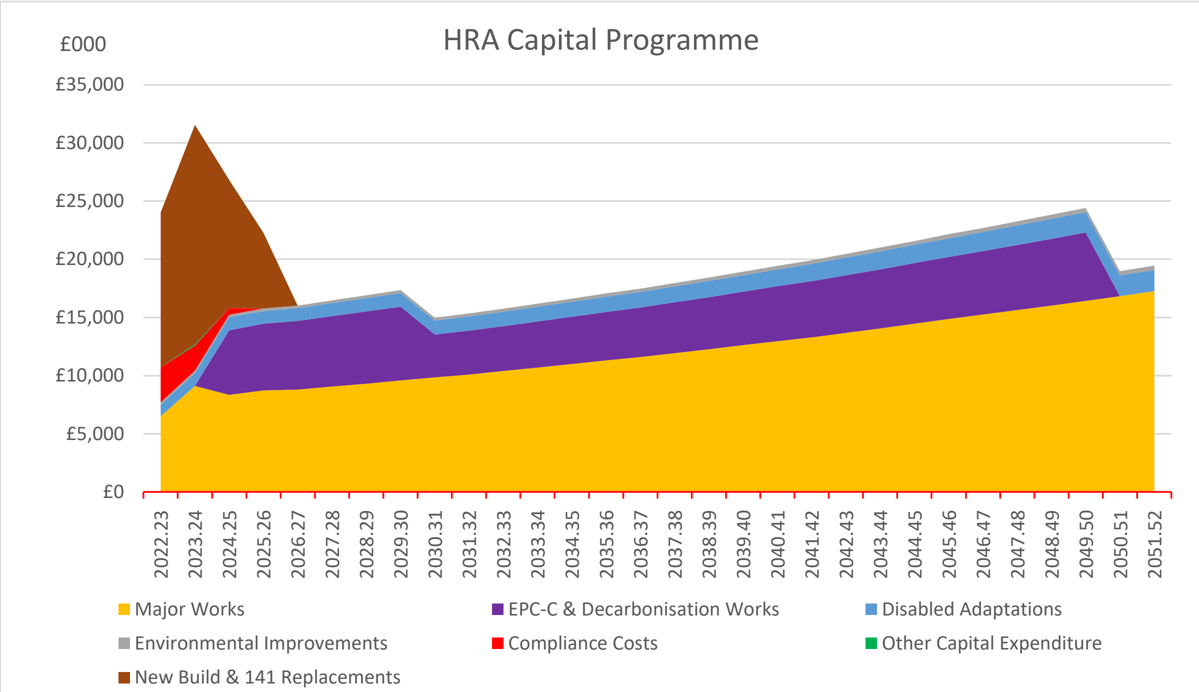
In this chart the orange line projects the cumulative HRA balance at the end of each year.

The authority maintains its minimum HRA balance of £1.000m (plus inflation) until 2045/46. During this period, any "spare" rents generated are used to pay for capital projects or to repay debt. Without further mitigating actions from 2046/47, spending pressures on the HRA prevent it from maintaining the minimum balance and the position deteriorates, causing the HRA to fall into deficit from 2049/50. By the end of the period the deficit grows to £5.140m.

It would be unlawful for the authority to budget for a deficit on its HRA. This chart indicates that the baseline assumptions require action to mitigate the situation to ensure a financially sustainable HRA over the long term.

2.4. Baseline -capital programme

The next chart shows the scale and composition of the authority's projected capital programme:



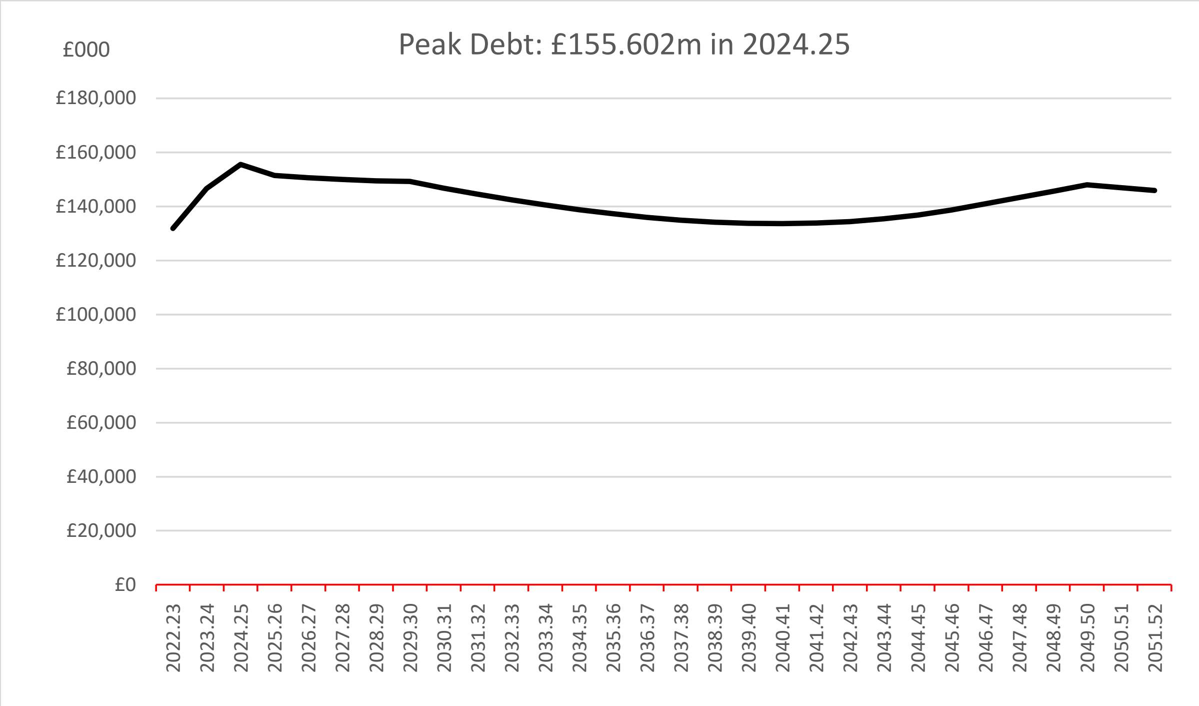
This programme includes projects for new build and stock purchase that produce 188 new properties between 2022/23 and 2025/26 (brown area) to meet the Council's commitment to deliver 600 units of social housing.

The yellow area allows for investment required on stock condition, based on projected expenditure levels in 2024/25. The purple area shows an allowance for improving energy efficiency of existing homes to EPC level C standard by 2030, plus wider decarbonisation works by 2050. The total amount of investment in the above chart steps down in 2030/31 and in 2050/51, at the conclusion of the EPC-C and wiser decarbonisation programmes.

The average annual cost of major works at current prices, averages £1,203 per existing unit over 30 years (excluding EPC-C and decarbonisation works). While this is consistent with the "rule of thumb" range of between £1,200 and £1,300 per unit that some other authorities have used, this is not based on a detailed assessment of stock condition. As a result, the projections do not allow for the profiling of any future, and amended, planned component replacement programmes Which will be updated once projections are established from the Stock Condition Survey programme.

2.5. Baseline – debt

The next chart projects movements in the level of HRA debt during the planning period:



On these assumptions, the authority is unable to finance its capital programme entirely from its Major Repairs Reserve, revenue surpluses generated by the HRA and projected right to buy receipts. This causes the HRA to rely on borrowing to part-finance the HRA capital programme until the decarbonisation programme ends in 2049/50.

HRA-related debt is projected to rise to a peak of £155.602m in 2024/25, which is the year after peak delivery for the current development programme. From 2025/26 onwards HRA-related debt gradually reduces until it reaches £133.660m 2040/41. However, from 2041/42 the authority needs to resume borrowing to deliver its capital programme, with total debt climbing back to £148.027m in 2049/50, which coincides with the end of the decarbonisation programme. Over the last two years the requirement for debt finance reduces, with debt falling slightly, to £145.927m by the end of 2051/52.

The HRA can repay little of the peak debt required to deliver the authority's baseline capital programme by the end of the projections. This is caused by the combined effects of additional spending pressure (through the effects of cost inflation) and constraint on rents (due to the 2023/24 rent cap and an expectation that increase from 2025/26 would reflect CPI, instead of CPI +1%).

2.6. Baseline – summary

The baseline assumptions produce a position that looks affordable over the medium term, but deteriorates from mid-plan. The HRA can use borrowing to increase the number of units over the medium term, but it is unable to service and repay that debt over the long term, unless further corrective action is taken.

The projections also indicate some potential risks, which the authority needs to manage. These include:

- Additional costs projected by the stock condition data.
- Assumptions around the costs of decarbonisation works are based on partial information and will be influenced by a developing market. Consequently, there is a risk that the authority could be understating the levels of investment required in these areas, which in turn could affect the affordability of future plans.
- While prudent assumptions about future government policy on social rents have been made, we currently await details of the approach that will be taken from 2025/26. Any reduction in future rent levels would have an adverse impact on the financial capacity of the authority's HRA.
- Failure on the part of the Council to maximise rental income or minimise the costs that are charged to the HRA would impact negatively on the financial health of the HRA

The baseline HRA projections suggest that the authority retains insufficient "wriggle room" to respond to emerging risks and pressures over the long term. The Council will need to take action to minimise its exposure to these risks. Where possible, spending pressures should be contained within the levels of income growth the authority can achieve from rents and other charges.

3. Scenarios

3.1. Scenarios tested

The alternative income scenarios proposed and their respective impact on the baseline position are outlined below.

Scenario 1 – re-letting vacant dwellings at the formula rent

The authority currently re-lets dwellings at the rent paid by the previous tenant, and that the rent most tenants currently pay is at or near the formula rent for their home.

The government's updated policy statement for rent increases from 2023/24 means that rents for existing general needs tenants will subject to a maximum increase of 7% in April 2023, and that the formula rent for a dwelling will not be subject to a cap and would increase by 11.1%, which is in line with CPI. This means that formula rents for 2023/24 will increase by much more than the actual rent a tenant pays, and that most tenants will be paying less than the formula rent.

The government policy statement on social rents expects authorities to relet homes for social rent at the formula rent set for that dwelling. If it were to do so, the authority would be able to recover some of the rent lost by the application of the 7% cap on rent increases in 2023/24 as dwellings are re-let in future years. Scenario 1 indicates the effects of making this change to the authority's rent policy.

For Scenario 1 it is assumed that 5.5% of the social rent stock would be re-let at the formula rent in 2023/24 (277 units), with the same proportion of dwellings below the formula rent being re-let in each subsequent year.

Scenario 2 – adopting the use of rent flexibility

Rent flexibility is available to the authority under the government's policy statement and the rent standard. It permits a social landlord to charge up to 5% more than the formula rent for a general needs social rent property (or up to 10% more for supported housing). In order to apply rent flexibility, the authority must have a rationale for doing so, which takes into account local circumstances and is affordable to tenants. It also needs to consult with tenants.

Scenario 2 takes Scenario 1 a step further and models the impact of adding rent flexibility to a policy of re-letting units at the formula rent. For the purposes of this exercise, Scenario 2 assumes that rent flexibility of 5% is applied to all new social rent dwellings delivered, plus 9% of re-lets where the Council has invested over £40,000 to repair the property or where the property has been part of decarbonisation upgrade programmes.

3.2. Further testing

The scenarios tested are simply designed to provide an indication on key policy decisions that the authority may wish to make during its forthcoming budget-setting process.

The Council will need to regularly review its assumptions on inflation and interest rates, while updating expenditure assumptions to reflect its in-year monitoring of budgets and programmes.

Adopting a rigorous approach to stress testing the authority's HRA will help it to identify the effects of potential risks at an early stage, test its response and take appropriate action to eliminate or mitigate the risk.

3.3. Scenario results

The table below summarises the effects of each scenario on the health of the HRA Balance at 10 year intervals during the projections. These are shown alongside the results produced by the baseline position:

Scenario/ Sensitivity	HRA Balance			
	2022.23 £000	2031.32 £000	2041.42 £000	2051.52 £000
Baseline	£1,001	£1,310	£1,564	-£5,140
Relet at Formula Rent	£1,001	£1,324	£1,597	£1,986
Relet at Formula Rent + Rent Flexibility	£1,001	£1,326	£1,602	£1,994

Reletting vacant dwellings at the formula rent (Scenario 1) improves the operating surplus and allows the authority to maintain a minimum balance on its HRA for the duration of the 30 year projections. If we add rent flexibility (Scenario 2), the authority uses the additional income generated to repay debt and continues to maintain balances at the minimum level.

Our next table shows the impact of each scenario on the level of HRA-related debt:

Scenario/ Sensitivity	HRA CFR			
	2022.23 £000	2031.32 £000	2041.42 £000	2051.52 £000
Baseline	£131,882	£144,522	£133,848	£145,927
Relet at Formula Rent	£131,882	£141,007	£118,225	£114,146
Relet at Formula Rent + Rent Flexibility	£131,882	£140,340	£115,656	£108,039

Both scenarios increase the rental income available to the HRA, which improves the ability to repay debt. As a result, the authority has more revenue resource available, which means it is better able to part-finance its capital programme using revenue contributions. When it does have to borrow to finance the capital programme, it needs to borrow less, and the additional revenue resource available means that it can repay the debt more quickly.

If the authority adopts a policy of re-letting units at the formula rent (Scenario 1), its debt after 30 years drops to £114.146m, which is £31.780m lower than the baseline position. If 5% rent flexibility is also added to applicable re-let rents (Scenario 2), the authority can repay more of its external HRA debt within 30 years and is left with HRA related debt of £108.039m.

The following table shows the impact of each scenario on the interest cover performance of the HRA:

Scenario/ Sensitivity	Interest cover ratio			
	2022.23 %	2031.32 %	2041.42 %	2051.52 %
Baseline	172.59%	178.30%	158.11%	102.75%
Relet at Formula Rent	172.59%	193.60%	201.42%	166.52%
Relet at Formula Rent + Rent Flexibility	172.59%	196.33%	209.13%	180.69%

Our final table shows the full impact on the finances of the HRA over 30 years, based on the combined movement in the HRA balance and HRA debt:

Impact over 30 years (Compared with Baseline)	Movement in HRA Balance £000	Increase in HRA Debt £000	Combined Impact £000
Relet at Formula Rent	£7,126	-£31,780	-£38,906
Relet at Formula Rent + Rent Flexibility	£7,134	-£37,888	-£45,022

Both scenarios have a strong positive impact on the HRA over 30 years. If the authority re-lets units at the affordable rent (Scenario 1), the combined benefit of increased balances and reduced debt comes to £38.906m at the end of the period. Adding rent flexibility to re-let units increases this benefit by a further £6.116m after 30 years (a combined positive impact of £45.022m, compared with the baseline).

It is clear from this table that differences the ability to generate additional rental income has a potentially substantial cumulative impact over 30 years. Accordingly, it would be in the financial interests of the HRA to maximise the income it generates from rent each year (while ensuring compliance with the government policy statement), as this maximises the resources available to improve existing homes and deliver new council housing.

3.4. Scenarios – summary

Both of the scenarios improve on the position set by the baseline assumptions. It is clear that increasing the income generated by rents:

- Reduce the authority's reliance on debt finance; while
- increasing the ability to repay debt.

The scenarios presented do not represent a full stress test of the authority's HRA. Stress testing a wide range of potential risks would allow the authority to identify the effects of emerging situations at an early stage, test its response and take appropriate action to eliminate or mitigate the risk.

It is important that the authority takes steps to ensure that it protects the capacity of its HRA to deliver the investment required over the medium and long terms. The two scenarios presented show how it can do this by maximising the rental income it generates. Other steps to consider include:

- Ensuring that service charges are sufficient to cover the costs of the services provided
- Committing to a medium term efficiency programme to maintain downward pressure on operating costs
- Generating additional capital receipts from disposal of appropriate assets on the open market
- Seeking additional external funding (e.g. for decarbonisation investment)
- A combination of the above measures