30 Year HRA Business Plan Briefing

1. Introduction

This note has been prepared by Housing Finance Associates, using information supplied by officers at New Forest District Council about the authority's housing revenue account (HRA). It presents a baseline position plus two alternative development scenarios, which have been prepared using working papers and assumptions agreed with the authority using figures available during its budget-setting process in late 2024.

The projections summarise expenditure, investment, capital financing and borrowing in respect of council housing over a 30 year period, starting in 2024/25. We have presented a baseline position that reflects the authority's best available data and assumptions. The baseline allows for inflationary pressures to impact on budgets and programmes from 2025/26 onwards. It also assumes that National rent policy will permit maximum rent increases of CPI +1% until 2030/31, which is in line with a current consultation by government. Alongside this baseline we have also shown the effects of two separate alternative scenarios for future development:

1. Extending the current development programme by a further four years until 2038/39.
2. Continuing to replace dwellings sold under the Right to Buy for the full thirty-year period.

Note that our scenarios are intended to illustrate potential changes to the baseline, which could flow from policy decisions on the part from the council. They are not decisions made, nor do they constitute a full stress test of the authority's position. We recommend that the authority reviews the risks facing its HRA regularly, with a view to identify the effects of emerging situations at an early stage, testing its response and taking appropriate action to eliminate or mitigate the risk.

The first part of this note focuses on the baseline projections.

NB Since the publication of this briefing document there are some additional corporate costs proposed to be borne by the HRA in the HRA Budget 25/56 report which will require factoring in to long term projections.

2. Baseline projections

2.1. Baseline assumptions

The baseline assumptions reflect the revised 2024/25 revenue budget, draft 2025/26 budget and medium term projections for capital and revenue prepared by the authority's finance team. These update the approved budgets that were reported to Cabinet in the annual budget-setting report from February 2024. Other information and assumptions we have used in preparing this baseline projection include:

- 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 MHCLG
- We have assumed that the authority sells 25 homes under the right to buy in 2024/25 and 40 homes in 2025/26, while it processes an influx of applications that followed publication in October 2024 of the government's plans to reform the Right to Buy and reduce discount levels. From 2026/27 onwards we have allowed for 10 to 11 sales pa.
- The authority aims to maintain a minimum HRA balance of £1.000m, adjusted for inflation
- Any sums generated by the HRA that exceed the minimum balance are made available to finance the capital programme or to repay debt.
- Actual rents increase at the maximum rate currently permitted by the rent standard. The maximum rent increase for existing tenants in 2025/26 has been set at 2.7%. Under the policy statement recently issued by government for consultation an increase of CPI +1% is expected to apply until 2030/31. We have made the prudent assumption that rent increases will be limited to a CPI uplift from April 2031.
- Formula rents increase at CPI +1% until 2030/31, in line with the government's policy statement consultation. From 2031/32 onwards we have assumed that formula rents increase in line with CPI.
- In 2024/25 the authority re-lets 5.5% of its social rent stock (282 units) at formula rent, with future relets in the same proportion. A small number of these dwellings (6 pa) are also re-let with an additional 5% rent flexibility charge, which is permitted under the rent standard.
- Depreciation costs have been estimated in line with the authority's budget, uplifted for inflation at CPI.
- Inflation has been applied as follows:
    - Underlying inflation for 2025/26 is linked to the CPI inflation rate of 1.7% for September 2024, as published by the Office for National Statistics. House prices for 2025/26 are assumed to have reduced b1.0%, in line with the house price index published for the New Forest by HM Land Registry for August 2024.
    - CPI at 2.25% in the final quarter of 2025 and 1.5% in the final quarter of 2026, based on projections prepared by the Bank of England and published in the August 2024 monetary policy report. These rates have been used to reflect underlying inflation for 2026/27 and 2027/28 respectively. From 2028/29 onwards we have assumed CPI runs at 2% pa.
    - RPI tracks at CPI +1%
    - General management and special management costs increase by underlying CPI.
    - Building costs increase at RPI. This affects spending projections 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.

- The baseline allows for the HRA to develop or acquire approximately 464 new homes between 2024/25 and 2034/35.
- Major works and component replacements are treated as 100% variable from 2027/28. 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 £9.812m.
- The projections assume a pooled interest rate of 4.8% would apply to new loans in 2024/25 and 2025/25, reducing to 4.2% for 2026+/27 and 2027/28, then a rate of 3.8% from 2028/29 onwards.

In preparing this projection we have 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

Note that 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 we have identified relate to:

- The cost of unforeseen works that may be required when investing in the authority's existing housing stock. We have included a contingency to allow for such works.
- Lack of certainty around future National policies impacting on the Right to Buy, decarbonisation of the housing stock and associated funding. We have made prudent assumptions to accommodate these risks.

The profile of component replacements required for the existing stock is generated from the authority's stock condition data. We recommend continuing to update the modelling assumptions to accommodate new information from the stock condition data, as soon as it becomes available.

Other key risks include:

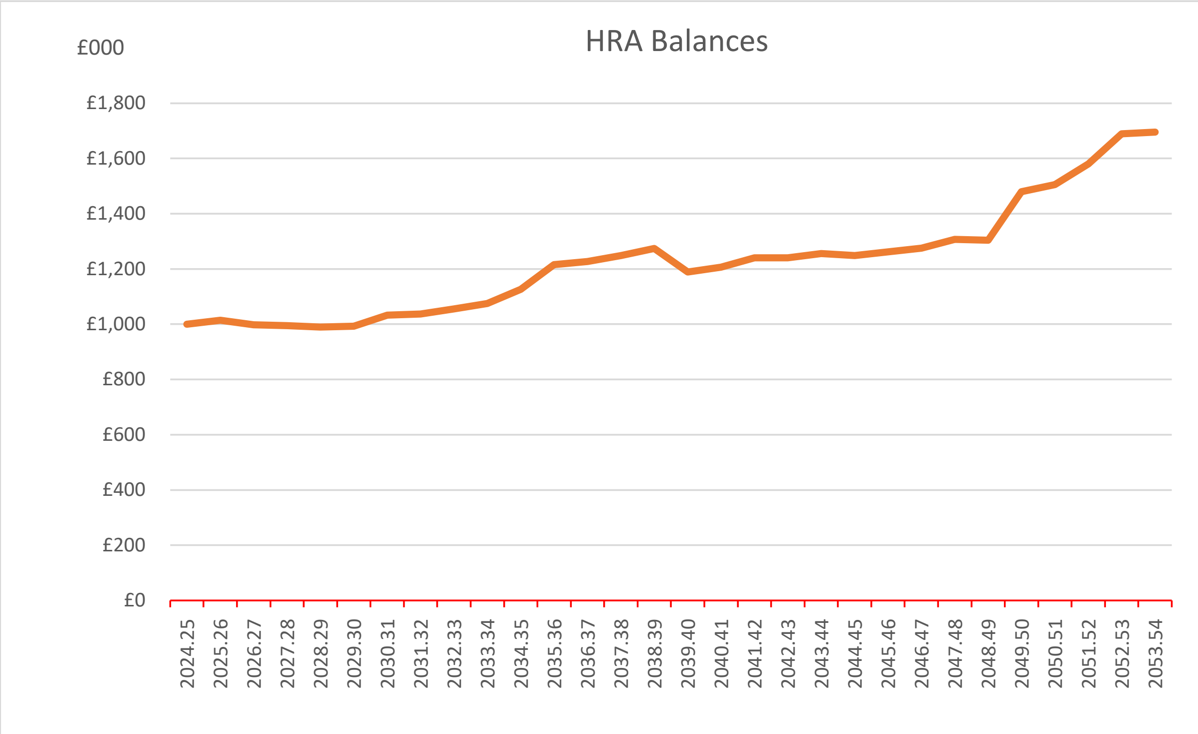
- fluctuations in the underlying rate of inflation, which can impact on both costs and income
- further constraint imposed on rent increases, whether by government or the authority itself
- increases in the costs of works and services that are not matched by increases in income
- changes to underlying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

We recommend that the authority reviews the potential HRA impact of these risks regularly, as part of its early warning system. This will enable it to identify the effects of emerging situations at an early stage, test its response and take appropriate action to eliminate or mitigate the risk.

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

2.3. Baseline - revenue position

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

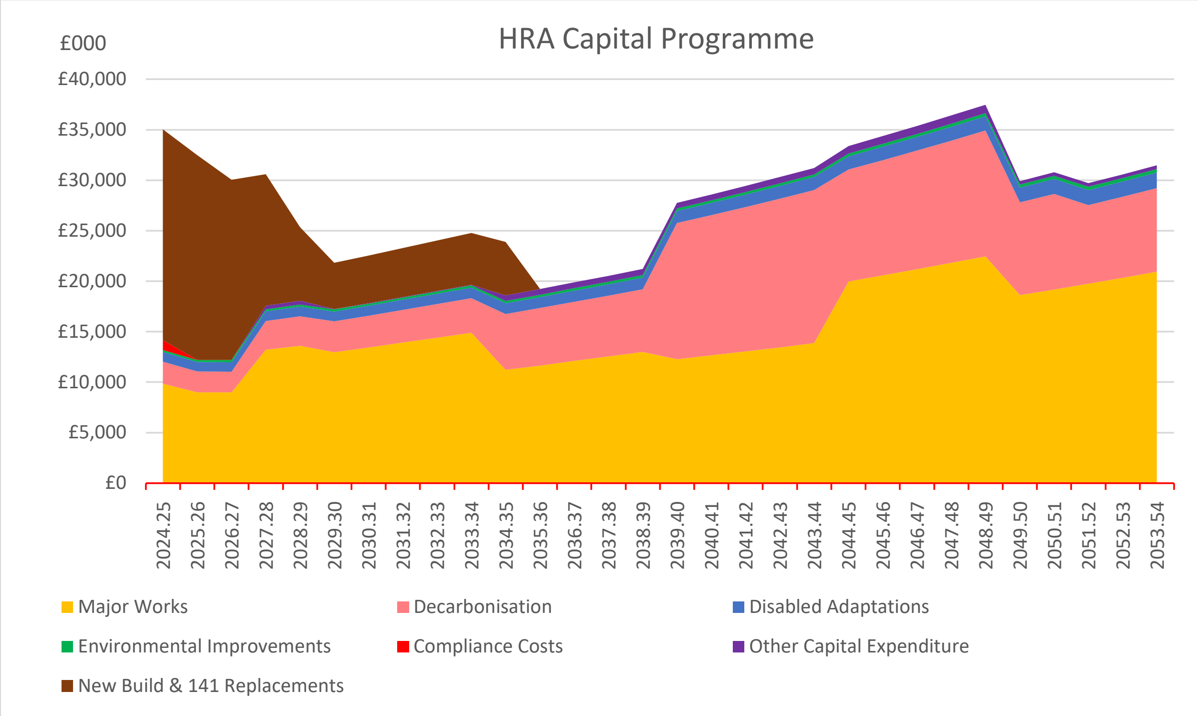


In this chart the orange line projects the cumulative HRA balance at the end of each year.

The authority maintains its minimum HRA balance of £1.000m (plus inflation) throughout the projections. During this period, any "spare" rents generated are used to pay for capital projects or to repay debt.

2.4. Baseline -capital programme

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



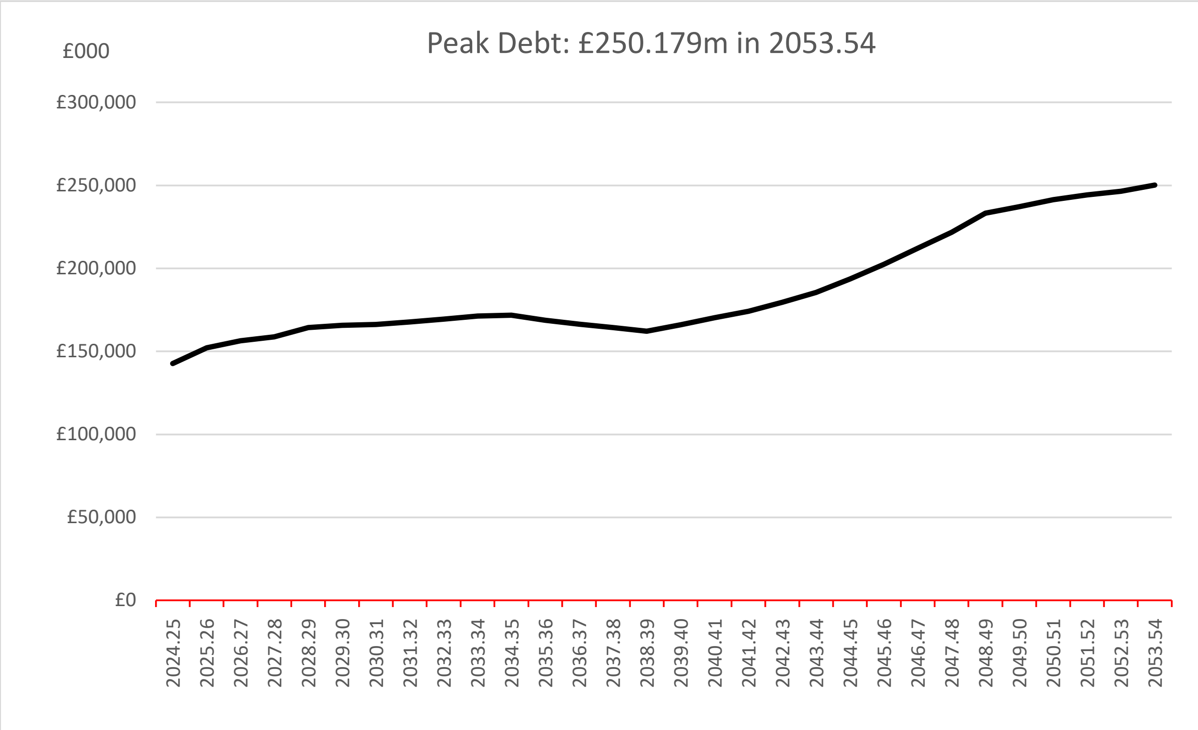
This projection includes a cautious 10 year programme for new build and stock purchase that produces 464 new properties between 2024/25 and 2034/35 (brown area). This reasonably represents the authority's commitment to increasing its housing stock over the medium term.

The amber area allows for investment required on stock condition, based on the existing capital programme and stock condition data, with a contingency for (as yet) unidentified additional stock investment. The pink area shows an allowance for improving energy efficiency of existing homes to EPC level C standard by 2030, plus wider decarbonisation works. This allowance is based on the existing capital programme and stock condition data, with a contingency for additional decarbonisation works. The total amount of decarbonisation investment in the above chart is consistent with representative levels assumed by other local authorities.

The average cost of major works at current prices, £50,190 per dwelling (excluding decarbonisation works). The allowance for decarbonisation comes to £25,015 per dwelling at current prices over the same period. These allowances are consistent with representative levels of investment in other authorities.

2.5. Baseline – debt

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



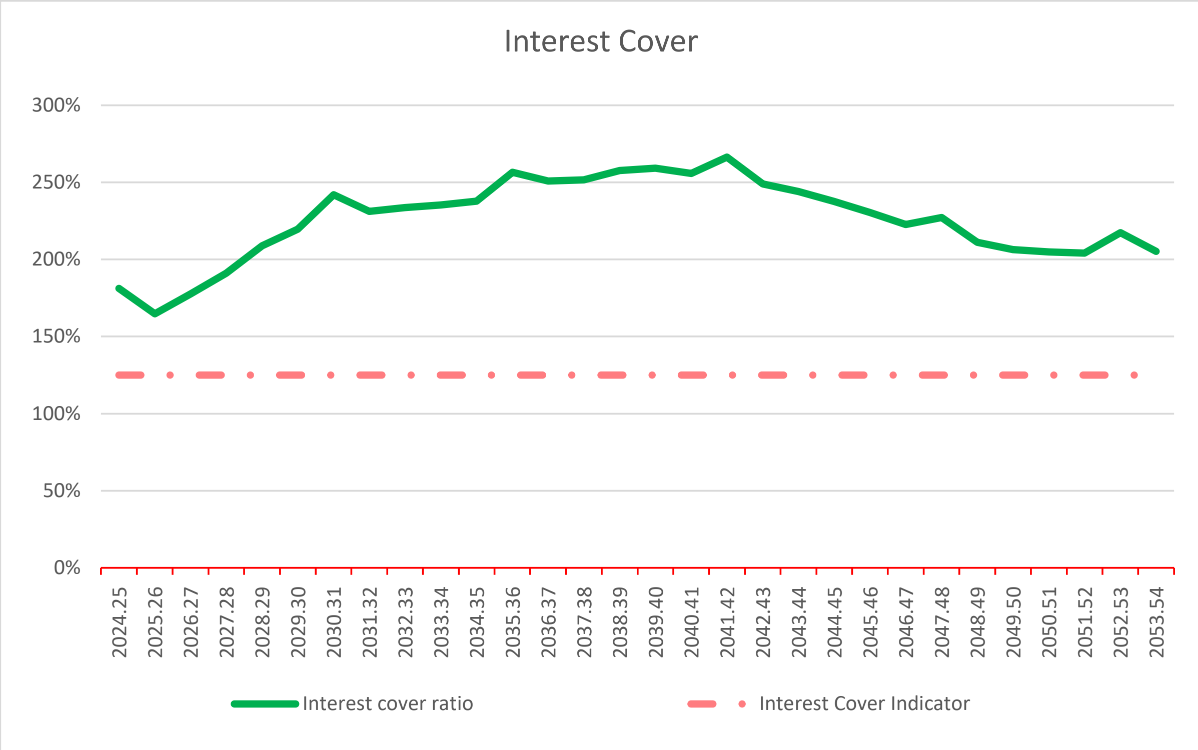
On these assumptions, the authority is unable to finance its capital programme entirely from its Major Repairs Reserve, revenue surpluses generated by the HRA and projected right to buy receipts. This causes the HRA to rely on borrowing to part-finance its HRA capital programme throughout the thirty year period.

HRA-related debt is projected to rise in most years, reaching a peak of £250.179m in 2053/54 – the final year of the projections. It is noticeable that the authority is able to repay some debt between 2035/36 and 2038/39 although this remains a choice due to the capacity to service debt and the potential future pooling of HRAs under Local Government Reorganisation, which follows the end of the medium term development programme and precedes an expected increase in decarbonisation investment. From 2039/40 onwards the HRA needs to borrow more to finance its capital programme than it can afford to repay from the available resources, causing debt to rise for the remainder of the period.

Debt is at its peak level in 2053/54 and continuing to rise. This means that the authority would be exposed to potential fluctuations in interest rates over the long term. It will therefore be important to continue reviewing the authority's options as the underlying economic circumstances evolve.

2.6. Baseline – affordability

Alongside our projection of the ability of the HRA to repay the debt required to finance the assumed capital programme, the chart below compares the level of operational surplus it generates with a standard indicator used by other landlords:



The green line in this chart shows the number of times the revenue HRA surplus is able to cover the assumed interest charges on its debt. When the green line goes down the authority's HRA is either making smaller surpluses or paying more in interest charges and the reverse is true when the green line goes up. The static dashed pink line suggests a minimum level of 125%, below which the authority would be at risk of being unable to cover its interest costs from its operating surplus.

This chart shows reasonable levels of interest cover throughout the projections, which implies that the authority would be able to afford the level of borrowing required under the baseline assumptions. It is noticeable that performance against this metric deteriorates in the latter half of the planning period. This reflects an expectation that some costs will rise at a faster rate than income over the long term, as well as increases in borrowing to deliver the 30 year capital investment requirement. If debt continues to rise at the projected rate, it would eventually reach a level that is unaffordable to the HRA.

Any further increase in costs or loss of income would cause the drop in performance under this metric to accelerate, unless the authority is able to make cost savings or generate additional income to compensate. The types of additional cost that the authority could encounter might result from higher inflation, increases in interest charges, commitments to spend more on providing additional or improved services, or additional costs to secure compliance with regulatory requirements. Any constraint on rent levels (whether imposed by government, or by a local decision to set rents at a lower level) would have a similar negative impact on interest cover performance.

Note that the requirement for borrowing is very sensitive to assumptions relating to cost levels, income from rents and other sources, plus interest rates. Initial sensitivity testing of these assumptions indicates that the authority should continuously seek to minimise costs and maximise income as a way of keeping debt levels down and minimising the associated risks.

2.7. Baseline – summary

The baseline assumptions produce a position that looks affordable but starts to weaken over the long term. The HRA can use borrowing to increase the number of units over the medium term, but to protect the long term financial health of the HRA the authority needs to be cautious about future commitments, potentially forecasting in 5 year rolling periods. It will be important to continue to minimise costs, while maximising income and resources. Where possible, spending pressures should be contained within the levels of income growth the authority can achieve from rents and other charges.

3. Development Scenarios

3.1. Scenarios tested

The alternative scenarios we have tested for the authority are designed to indicate the potential impact of less cautious development programmes on the financial health of the authority's HRA.

Scenario 1 – development programme extended to deliver 524 new homes by 2038/39

Under Scenario 1 the authority would extend its development plans by a further 4 years, to 2038/39. This increases the number of new homes from the baseline assumption of approximately 464 dwellings by 2034/35, to approximately 524 new homes by 2038/39. All homes would be let at a social rent.

Scenario 2 –replace all RTB disposals for 30 years, delivering 673 new homes

Scenario 2 allows for the authority to replace dwellings sold under the right to buy over 30 years. This increases the new homes delivered from the baseline assumption of approx. 464 dwellings by 2034/35, to approx. 673 new homes by 2053/54. Again, all new homes would be let at a social rent.

3.2. Use of scenarios

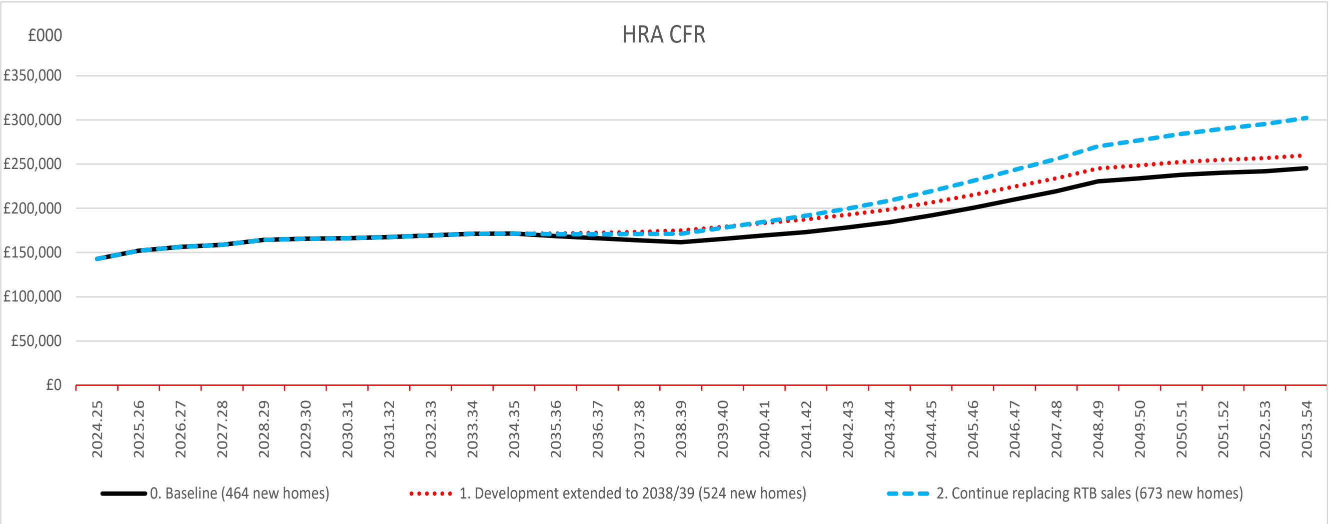
We recommend that the authority routinely reviews its HRA assumptions and tests the potential impact of different decisions, evolving economic circumstances and changes in government policy. In particular, it should regularly review its assumptions on inflation and interest rates, while updating expenditure 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 key financial metrics for the HRA. These are shown alongside the results produced by the baseline position.

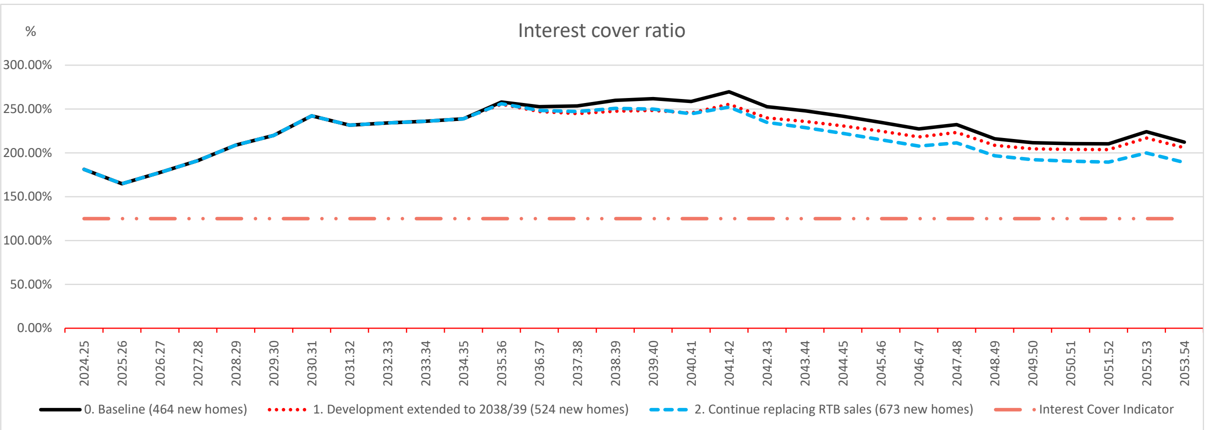
Our first chart shows the impact of the two different levels of development on the baseline debt projection:



In this chart the black line shows the baseline position (464 homes by 2034/35), as presented in section 2.5 of this briefing. The red dotted line shows Scenario 1 (524 homes by 2038/39) and the blue dashed line represents Scenario 2 – a 30 year programme of replacing RTB sales (673 homes by 2053/44). As might be expected, both of the scenarios require the authority to borrow more from 2035/36 onwards. Under Scenario 2, the authority needs to borrow at higher levels and debt continues to grow at a faster rate by the end of the period.

The authority's exposure to interest rate risk increases under both scenarios and is significantly higher under Scenario 2.

Our next chart shows the impact of each scenario on the affordability of HRA-related debt:



The black line in this chart shows the baseline position (464 homes by 2034/35), as presented in section 2.6 of this briefing. The red dotted line shows Scenario 1 (524 homes by 2038/39) and the blue dashed line represents Scenario 2 – a 30 year programme of replacing RTB sales (673 homes by 2053/44).

Under each scenario the higher debt level required means that the authority must pay more in interest charges than it generates from additional rents. As a result, the authority has less revenue resource available than under the baseline. Each scenario becomes less affordable than the baseline, as they have less available to spend on stock investment and the management and maintenance of its existing homes.

Under either of these scenarios the authority would need to consider mitigating action to help improve the financial health of its HRA over the long term. These actions might include:

- Reviewing service charges to ensure that they remain sufficient to cover the costs of the services provided
- Considering its choice of tenures when developing or acquiring new homes
- Committing to a medium term cost reduction programme that maintains downward pressure on the costs of housing management and repairs
- 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

3.4. Scenarios – summary

Both of the scenarios weaken the position set by the baseline assumptions. It is clear that increasing the scale of the development programme:

- Increases the authority's reliance on debt finance; while
- Raising the associated costs of interest charges; and
- Reducing its ability to repay debt.

The HRA needs to operate as a business and many recent activities within the service demonstrate this transition, including service charge changes, new rent setting policy, receipt of grant funding, mini restructures, voids and rents improvement projects in place, the journey to meet consumer standards and business systems transformation including self-serve will reduce transactional costs and improve efficiency . Costs are only affordable while they are covered by the rents that tenants pay.

It is important that the authority continuously monitors the situation and takes steps to ensure that it protects the capacity of its HRA to deliver the investment required over the medium and long terms. There may also be further financial changes proposed by the national government following recent consultations to consider in due course. However, steps it might consider include:

- Ensuring that service charges are sufficient to cover the costs of the services provided
- Considering its choice of tenures when developing or acquiring new homes
- 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
- A combination of the above measures