AGENDA ITEM NO 5

REPORT NO 54/15

ANGUS COUNCIL

COMMUNITIES COMMITTEE (SPECIAL MEETING) – 10 FEBRUARY 2015

LONG TERM AFFORDABILITY OF THE HOUSING REVENUE ACCOUNT FINANCIAL PLAN

JOINT REPORT BY THE HEAD OF PLANNING AND PLACE AND THE HEAD OF CORPORATE IMPROVEMENT AND FINANCE

ABSTRACT

This report summarises the outcome from an assessment of the long term affordability of the Housing Revenue Account's 2014/2018 Financial Plan over a 30 year period.

1 RECOMMENDATIONS

It is recommended that the Committee:

1.1 Notes the contents of this report for its interest and in particular the key assumptions underpinning the affordability analysis;

1.2 Notes that based on the assumptions made and the affordability analysis undertaken, the 2014/2018 Housing Revenue Account Financial Plan is considered to be affordable, prudent and sustainable as required by the Prudential Code; and

1.3 Notes that the business plan and affordability assessment will be updated as necessary to assess the viability of future Housing Revenue Account capital project proposals.

1.4 Approves the Long Term Affordability Assessment as the basis for taking forward capital investment planning for the Housing Revenue Account.

2 ALIGNMENT TO THE ANGUS COMMUNITY PLAN / SINGLE OUTCOME AGREEMENT / CORPORATE PLAN.

This report contributes to the following local outcomes in the single outcome agreement:

2. Angus is a good place to live in, work in and visit
7. Our communities are safe, secure and vibrant
9. Individuals are supported in their own communities with good quality services
10. Our communities are developed in a sustainable manner

3 BACKGROUND

3.1 Members will be aware that the Council must comply with the self regulating Prudential Code when setting its capital budgets. The Prudential Code requires the Council to consider the affordability and sustainability of its capital spending plans. This applies equally to the Housing Revenue Account capital plans as it does to the General Fund.

3.2 Prudential Indicators which measure affordability, prudence and sustainability require to be set for 3 forward years as part of the annual budget setting process. This 3 year horizon is however considered insufficient to robustly assess the long term impact of capital investment decisions.

3.3 Members will note that a 30 year long term affordability model has been developed to evaluate the overall HRA Capital Affordability.

3.4 Members should also bear in mind when considering this report, that the Government has the power to limit capital borrowing at both a national and local level and this would apply across the Council, encompassing both HRA and General Fund. Whilst there has been no indication given that a limit is likely to be imposed in the near future, should such an eventuality arise, the HRA's capital spending plans would require to be reviewed and possibly scaled back.

4 2014/15 LOCAL GOVERNMENT FINANCE SETTLEMENT – CAPITAL FUNDING

4.1 Members are asked to note that, unlike the General Fund, the HRA does not receive any loan charges grant support or other capital support through the Finance Settlement details of which were announced in Finance Circular 9/2014 (of 11 December 2014).

4.2 The HRA is a ring-fenced and self financing service of the Council and all revenue consequences from capital expenditure must be met from within the HRA revenue budget funded by the rental income received from the tenants.

4.3 The HRA can however receive some Government capital support from specific funding that the Government may from time to time make available. Such funding must generally be bid for and has recently included Affordable Housing Grant funding. Any successful bids for such funding effectively reduces the net capital cost of projects to the HRA and as a result reduces the revenue consequences.

5 AFFORDABILITY ANALYSIS

5.1 Starting with an update of the 2014/15 position, the capital affordability analysis which has been undertaken has projected the position over the 30 year period of the long term affordability model (i.e. 2015/16 to 2045/46) for the following:

- future rent levels and taking consideration of the rent restructure exercise until 2017/18
- the HRA's existing loan charges commitments (unavoidable costs);
- estimated levels of HRA capital expenditure;
- estimated levels of capital receipts & other contributions; and
- estimated levels of borrowing.

5.2 This has involved using estimates and making assumptions which will no doubt change over time but the analysis is considered to be both robust and reasonable based on known information at this time.

5.3 <u>Key Assumptions</u>

As with any exercise of this nature the outcomes depend on a number of key assumptions and these are listed below:-

5.3.1 <u>Loan Charges Costs</u>

It is considered that overall loan charges costs should not exceed 25% of the projected rental income in any individual year. This reflects the capital intensive nature of the Housing service as much of the service is focussed on delivering and maintaining housing stock.

The bespoke long term affordability model continues to utilise the assumption implemented in the original business plan that the 25% parameter remains a sound basis of assessing affordability.

The affordability position is therefore based on the premise that this parameter will not be breached.

5.3.2 <u>Existing Commitments</u>

The cost of principal repayments on existing commitments is known with certainty from the Council's fixed asset management system.

Assumptions have to be made however in respect of future interest and debt management expenses rates in order to project forward the overall loan charges costs arising from past expenditure and borrowing as well as the anticipated future borrowing levels. In light of current interest rate expectations, it's assumed that after a couple of flat years the interest rate on the Consolidated Loans Fund will initially rise steadily but will rise more sharply in the later part of the 25 year period and the following interest rates have therefore been assumed:

- 4.80% for 2014/15;to 2016/17;
- 4.85% for 2017/18;
- 4.90% for 2018/19;
- 5.00% for 2019/20 to 2023/24;

- 5.25% for 2024/25 to 2028/29;
- 5.50% for 2029/30 to 2033/34; and
- 5.75% for each year thereafter.

In respect of debt management expenses, a rate of 0.08% has been applied in all years as this is in line with the average actual expenses rate in recent years.

These rates are considered reasonable and prudent at the present time.

5.3.3 Capital Expenditure

The draft HRA 2014/2018 Financial Plan (appendix 1 to Report 53/15 refers) was used as the starting point for making the long term affordability projections described in this report.

The affordability projection requires however to make specific assumptions regarding future capital expenditure and these assumptions need to be made in the context of ensuring that Scottish Housing Quality Standards (SHQS) are achieved and maintained. To this end the following very broad levels of capital expenditure have been assumed beyond the current period of the Financial Plan:-

- £9.6m for 2018/19;
- £9.3m for 2019/20; and
- £8.0m p.a. as an average thereafter.

It should be noted that it may be necessary to revisit the assumed levels of capital expenditure in future long term affordability assessments to take account of, amongst other things, the outcome of condition surveys of the housing stock.

Members are asked to note that in addition to addressing SHQS levels, these levels of capital expenditure take account of the loan charges costs parameter set out at 5.3.1 above.

5.3.4 Projects Funded Under Prudential Borrowing

As noted at section 4 above, all revenue consequences from capital expenditure (including financing costs) are met from the HRA rental income stream. In this regard, all borrowing undertaken by the HRA is Prudential Borrowing.

5.3.5 Capital Receipts

The Council has been reasonably successful in generating capital receipts from the sale of Council Houses over the last few years. Members have been updated regularly in this regard and it is considered that with the reducing numbers of sellable housing stock, combined with Right to Buy having already been removed for new tenancies and the impending complete removal of Right to Buy on 1 August 2016, the levels of capital receipts attainable in the future will reduce significantly and are expected to be negligible beyond 2017/18.

To this end the long term affordability assessment assumes that the following levels of capital receipts will be achieved. It should be noted however, that it’s not expected that all 2015/16 receipts will be utilised in funding the capital programme during 2015/16 but that a balance will be held as unallocated capital receipts and used in 2017/18 to mitigate the initial funding effect of the abolition of Right to Buy on 1 August 2016. Further detail is contained in Report 52/15 also on the agenda for this committee.

- £1.554m for 2014/15;
- £1.4m for 2015/16;
- £1.4m for 2016/17;
- £0.1m for 2017/18;
- Zero thereafter.

These capital receipts assumptions are considered to be prudent based on past performance. In the event that capital receipts exceed these estimated levels this will reduce the HRA’s need to borrow or can be used to increase capital expenditure.

5.3.6 Other Contributions

In respect of other contributions, these have only been included where already confirmed or where conditional approval has been received (e.g. Scottish Government Affordable Housing Grant or Affordable Housing Revenue Account). Should any additional "other" contributions be secured into the future, these will either be utilised to reduce borrowing or to enhance the capital programme as appropriate at the time, taking on board updated long term affordability assessments, capital requirements or grant conditions.

5.3.7 New Borrowing

As members will be aware it is the level of new borrowing required to fund capital expenditure which determines future commitments in relation to loan charges costs. The affordability projections therefore estimate the level of new borrowing required after taking into account all of the other assumptions about capital expenditure, capital receipts, etc. and this in turn has been used to calculate estimated loan charges costs into the future. These costs have been projected on an annuity basis and the interest rates detailed under Existing Commitments at paragraph 5.3.2 above have also been applied in estimating the costs of new borrowing.

5.3.8 Net Income to CFCR

Members will be aware that the HRA revenue budget habitually contains a significant budget to fund capital expenditure directly from revenue resources (CFCR). The long term affordability assessment starts from the premise that no CFCR is initially allowed for in the expenditure calculation which results in a significant net income position in each year within the model. This net income is then utilised as CFCR and fully applied to fund capital expenditure prior to determining borrowing requirement levels relative to the assumed capital expenditure levels.

For information, members are asked to note that the Net Income applied in the model rises over the financial plan period and thereafter (2018/19 onwards) averages around £6.000m per annum for the remainder of the 30 year period of the assessment. There continues to be significant risk to the Council's rental income stream from a number of welfare reform changes, the most important of which is the introduction of Universal Credit. Whilst there has been some delay in its introduction and implementation the council requires to be proactive in engaging with tenants to ensure that significant amounts of uncollectable arrears are not accumulated. If arrears were to increase significantly this would require a reappraisal of the delivery of the capital programme in terms of the long term affordability assessment.

It is also worth highlighting that the Net Income resources could if required be used to meet additional borrowing costs to fund a higher level of capital should this be a policy direction chosen. The use of CFCR in this way would however commit resources over the longer term and therefore only provide one-off boosts to expenditure at any one time. There is also a risk that were such an approach adopted, the key 25% affordability parameter (detailed at paragraph 4.3.1 above) could be breached at various points through the period of the assessment.

5.3.9 Expenditure Slippage

As expenditure slippage is not a capital funding source but merely affects the phasing of expenditure, no slippage assumptions have been included for the purposes of this affordability assessment.

5.3.10 Inflation

With the exception of the period of the Financial Plan (which is stated on an outturn basis), the affordability analysis does not make specific allowance for the effects of inflation, e.g. on capital expenditure on the basis that this is highly unpredictable over time. This will mean that the true purchasing power of the assumed capital expenditure total into future years will gradually be eroded.

5.3.11 Consultation

Members are also asked to note that the Tenants Movement continue to be fully involved and consulted on the operation of the Housing Service. In this regard the updated long term affordability will be utilised to assess the viability of any proposals which may arise from this consultation.

6 AFFORDABILITY ANALYSIS - OVERALL SUMMARY POSITION

6.1 The affordability analysis brings together a large volume of data and makes a number of assumptions. Table 1 below summarises the key figures in this regard for the current year (2013/14) and forward 3 years (2014/15 to 2016/17) and then, starting from financial year 2020/21, intervals of 5 years thereafter.

TABLE 1 – AFFORDABILITY ANALYSIS – SUMMARY POSITION

	14/15 £m	**15/16 £m**	16/17 £m	17/18 £m	21/22 £m	25/26 £m	30/31 £m	35/36 £m	40/41 £m
Capital Expenditure	**11.378**	**7.623**	**13.934**	**13.527**	**8.692**	**8.933**	**7.776**	**6.647**	**6.792**
Estimated Borrowing	**3.125**	**0.206**	**5.059**	**5.257**	**3.000**	**3.000**	**2.000**	**1.000**	**1.000**
Expenditure :-									
Housing Expenditure	**16.519**	**17.487**	17.236	17.543	18.390	19.183	20.313	21.624	23.158
(A) Loan Charges	2.284	2.516	2.578	2.926	4.879	4.972	5.475	5.843	5.793
(B) Total Expenditure	**18.803**	**20.003**	**19.814**	**20.469**	**23.269**	**24.155**	**25.788**	**27.467**	**28.951**
(C) Rental Income	23.348	23.725	24.834	25.715	26.759	27.845	29.266	30.758	32.327
Other Income	2.199	2.417	2.128	2.162	2.202	2.244	2.298	2.356	2.416
(D) Total Income	**25.547**	**26.142**	**26.962**	**27.877**	**28.961**	**30.089**	**31.564**	**33.114**	**34.743**
Net Income (D) – (B)	**6.744**	**6.139**	**7.148**	**7.408**	**5.692**	**5.934**	**5.776**	**5.647**	**5.792**
Affordability Check (A) / (C)	**10%**	**10%**	**10%**	**11%**	**18%**	**18%**	**19%**	**19%**	**18%**

Notes to Table 1

1. Paragraph 5.3.8 above notes that the net income is fully applied as CFCR in the affordability model, however members should note that in the case of 2014/15, the net income of £6.744m comprises both CFCR of £6.172m and the projected current year surplus of £0.572m.

6.2 The analysis shows a projected peak in new borrowing levels in the years 2016/17 and 2017/18 which is largely the result of the borrowing projected to be required in respect of new build properties in Arbroath, Forfar, Montrose, Kirriemuir, Carnoustie and Monifieth and Energy Efficiency measures to existing housing stock throughout the Angus area. .

6.3 The analysis also shows that the affordability check against the 25% parameter set at 4.3.1 above is not breached, meaning that the projected loan charges costs arising from the projected levels of borrowing are affordable. In this regard and in light of Table 1 not reflecting all 30 years of the analysis, it is confirmed that the model projects that the affordability check does not breach the 25% parameter in any of the 30 years. Members are asked to note that in fact the highest affordability check percentage reached is 21% once over the 30 Year period (2023/24).

6.4 Members are asked to note that after financial Year 2023/24, the currently projected affordability check percentages, suggest that there is further capacity and headroom to increase future years' capital expenditure programmes. Although the outcomes of the long term affordability model suggest that this headroom is only available after financial year 2023/24 in reality a portion of the headroom would in fact be available earlier if required. Future rent setting processes, including discussions with the tenants' group, will consider the timing and use of the headroom, however this in particular will be influenced by the availability of suitable land for new houses and projects for overall development. Options in this regard will however be reported to committee as and when suitable projects are identified and after taking account of the affordability assumptions and risks evident at the time.

7 OVERALL CONCLUSIONS FROM AFFORDABILITY ANALYSIS

7.1 A number of conclusions can be drawn from the affordability analysis which has been carried out. The affordability analysis is however based on a number of assumptions regarding future interest rates, capital expenditure, receipts levels and capital projects being delivered in line with expected timescales and costs. The analysis therefore carries some risk that some or all of these assumptions may prove to be inaccurate through time.

7.2 Despite this risk the Head of Corporate Improvement and Finance believes that the assumptions which have been made are robust, reasonable and prudent for the purposes of informing the Council's decisions. Critically the analysis confirms that the HRA capital spending plans can be regarded as affordable, prudent and sustainable in line with the requirements of the Prudential Code.

8 FINANCIAL IMPLICATIONS

8.1 There are no financial implications arising from this report beyond those outlined in the main body of the report.

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Background Papers :- No background papers, as defined by Section 50D of the Local Government (Scotland) Act 1973, (other than any containing confidential or exempt information), were relied on to any material extent in preparing this report.