AGENDA ITEM NO 5

REPORT NO 71/17

ANGUS COUNCIL

COMMUNITIES COMMITTEE – 14 FEBRUARY 2017

REVIEW OF HOUSING REVENUE ACCOUNT BUSINESS PLAN

REPORT BY HEAD OF PLANNING AND PLACE

ABSTRACT

This report provides members with the outcome of a review into the Housing Revenue Account (HRA) 30 year Business Plan, including future investment proposals and its affordability.

1. RECOMMENDATIONS

It is recommended that the Committee:

(i) Note the key assumptions underpinning the affordability analysis in this report

(ii) Approve the HRA 30 year Business Plan, including the proposal to almost double the Capital Investment Programme to £90M over the next 5 years.

(iii) Note that based on the assumptions made and the affordability analysis undertaken, the 2017/2022 Housing Revenue Account Financial Plan is considered to be affordable, prudent and sustainable as required by the Prudential Code.

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

2.1 This report contributes to the following local outcome contained within the Angus Community Plan and Single Outcome Agreement 2013-2016:

- We have a sustainable economy with good employment opportunities
- Our communities are developed in a sustainable manner.

3. BACKGROUND

3.1 Over the last 5 years from 2011/12 the Council invested some £50M in its Capital Programme. Whilst this helped deliver over 180 new build homes, and achieved an overall improvement in the quality of the Council's homes (including meeting the Scottish Housing Quality Standard (SHQS), officers believe the HRA has the capacity and capability to grow its investment substantially.

3.2 Consequently, members will recall that Communities Committee recently provided approval for the 30 year HRA Business Plan to be reviewed (Report no.393/16 refers). The business plan sets out the critical income and expenditure criteria, borrowing parameters for the HRA, and guides the Council's investment capacity for building new homes and improving the existing housing stock for coming years.

3.3 Members will be aware that the Council must comply with the self-regulating Prudential Code, which requires the Council to consider the affordability and sustainability of its capital spending plans. This applies equally to the HRA capital plans as it does to the General Fund.

3.4 The 3 year time period requirement for Prudential Indicators, which measure affordability and sustainability, is considered insufficient to robustly assess the long term impact of capital investment decisions. The 30 year timespan of the Business Plan is considered a much more robust basis to evaluate the overall HRA Capital Affordability.

4 2017/18 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 9/2016 (of 15 December 2016) It 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 rental income received from tenants.

4.2 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. CURRENT POSITION

5.1 The Council's customers are involved in the planning of resources and investments through the Tenants Steering Group. An important role for the group is the rent setting consultation process, the outcome of which for the coming year (3.1% proposed average increase) members will be considering in a report also at this committee. The Tenants' group are consulted on all major proposals, and contribute to the prudent use of rental income through regular review and scrutiny. They also play an important role in agreeing standards and specifications for both new build and stock improvement projects. The group have been consulted on the proposed Business Plan and have given it their full support.

5.2 The Council's Capital programme and investment in new affordable homes should be considered in the context of the wider strategic role the Council has with its partners, the Scottish Government and Registered Social Landlords (RSLs), which is set out in the Consultative Draft Angus Local Housing Strategy 2017-22 (LHS) approved by members on January 17th 2017 (report 29/17 refers). This sets an ambitious target and programme across all social housing providers to deliver 620 new affordable homes in the period 2017-22.

5.3 The Council's new build activity forms a considerable part of this programme which is detailed in the Strategic Housing Investment Plan (SHIP), previously approved by members (Report 394/16 refers). The SHIP currently allocates Scottish Government funding to around 400 new homes, around half of which will be delivered by RSL partners, with a further 200 units identified as capable of being brought into the programme as further funding is made available. The Council's investment programme provides a clear statement of intent that increasing the supply of affordable housing is a strategic priority in Angus.

6. KEY PROPOSALS FOR THE BUSINESS PLAN AND FUTURE INVESTMENTS

6.1 The Business Plan has now been reviewed, and it is considered that a more ambitious investment programme can be delivered, whilst remaining affordable and sustainable, and staying within prudential financial parameters where overall loan charge costs should not exceed 25% of the projected rental income in any individual year.

6.2 **Capital Investment.** This means that the Council can almost double its HRA Capital Programme over the next 5 years, increasing from the previous average of £10M per year to £18M per year, taking the **total investment for the period 2017- 2022 to around £90M.** This will allow the Council to double its number of new homes being built, and expand the provision of affordable housing throughout our communities, whilst also investing heavily in existing stock so that all tenants can live in good quality energy efficient homes that they can be proud of, and which meet their aspirations. This will make our housing stock more efficient, more attractive, with fewer voids, leading to increased allocation rates and customer satisfaction.

6.3 **Improvements to Existing Stock.** As well as continuing to ensure all our properties meet the SHQS, a main priority for the Council is to reduce fuel poverty by ensuring all properties also meet the Energy Efficiency Standard for Social Housing (EESSH) by 2020. Work will take place across Angus, prioritised by property energy performance. We will therefore:

- Upgrade heating systems in approximately 450 properties every year. This will focus on changing old electric systems, either to gas or to high performance electric systems, as well as replacing older boilers with modern efficient models.
- Carry out external insulation and energy efficiency measures to 600 properties per year. Not only will this work improve energy performance, it will also help to improve the appearance of our estates. This type of work is proposed in Montrose, Brechin, Forfar and Arbroath.
- Alongside this programme the Council will continue to work in partnership with the Scottish Government to make use of external energy efficiency funding opportunities so that non-Council stock can also benefit from investment, especially solid wall and hard to treat construction types.

Our tenants have also told us that quality of facilities is very important to them. We therefore plan to replace 700 bathrooms in each of the next 10 years. This major replacement programme which will make a considerable improvement to 90% of the stock is starting in Friockheim and Letham. It is also important that we make our homes more accessible by adapting them to meet wider needs, so we can continue to help people stay in their own homes for longer as their needs change. We will therefore continue to invest over £500,000 per year in making our properties more usable for anyone in our community.

6.4 **New Build.** The increased investment will mean that The Council can make a much greater contribution to the building target set by the Scottish Government of 50,000 new affordable homes across Scotland within this term of government, making the most of higher grant funding allocations likely to become available, and favourable borrowing rates. These new houses not only increase the Council's stock of high quality energy efficient homes, they also have a multiplier effect, creating a chain of allocations for customers on the Housing waiting list. The new homes are offered to existing tenants, creating vacancies which are offered to other applicants in turn, and in this way doubling the number of offers to customers. This will result in:

- 70 new homes per year. 350 over 5 years
- 140 additional allocations per year

New homes are planned in all areas of Angus but with major projects in Arbroath, Brechin, Montrose, Forfar and Monifieth. Many of the projects will build on derelict and brownfield sites or will utilise surplus Council assets, so there will be a considerable regeneration benefit for our communities as we make better use of under-used land.

6.5 **Stimulating the economy, employment and training.** Every £1M spent on construction output can generate up to £2.84M in total economic activity, when both direct and indirect impacts are taken into account. Taking this as a basis, the proposed HRA Capital Programme over the next 5 years could:

- Generate an economic benefit of up to £256M to the Angus area
- Create or help sustain up to 1800 jobs.
- Sustain at least 12 Angus Shared Apprenticeship places

The beneficial impact of this investment cannot be over-emphasised, in terms of the extra confidence it brings to the strength of the local economy, which although on a positive trend, is still somewhat fragile. It will also help to retain skills in the local workforce, in construction trades, and in supportive disciplines, such as Design, Finance and Legal professions.

6.6 **Environment.** We aim to create places that people are proud to call home, so much of this increase in investment will be delivered as part of wider regeneration projects, and will not only improve the quality of our homes, it will also help improve the environment and neighbourhoods with better planning of places and infrastructure. We will take these opportunities to improve quality of amenity space and active travel connectivity, increasing safe routes to school, and cycling routes, to help improve health and wellbeing.

6.7 **Summary of key points**

- **£90M Capital Programme over 5 years**
- **£256M economic benefit to Angus**

- **Up to 1800 jobs**
- **70 new homes per year. 350 over 5 years**
- **700 bathrooms per year. 3500 over 5 years and 7000 over 10 years.**
- **450 new heating systems per year. 2250 over 5 years**
- **600 external insulation and energy efficiency measures per year. 3000 over 5 years.**

7 AFFORDABILITY ANALYSIS

7.1 Starting with an update of the 2016/17 position, the capital affordability analysis has projected the position over the 30 year period of the long term affordability model (i.e. 2017/18 to 2046/47) 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.

7.2 This involved using estimates and assumptions which may change over time, but the analysis is considered both robust and reasonable, based on known information at this time.

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

7.3.1 Loan Charges Costs. 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, much of which is focussed on delivering and maintaining the 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.

7.3.2 Existing Commitments. 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. The following interest rates have therefore been assumed:

- 4.80% for 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.

7.3.3 Capital Expenditure. The draft HRA 2016/2021 Financial Plan (appendix 1 to Report 70/17 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 in the context of ensuring that the SHQS continues to be met, and EEESH is achieved. To this end the following very broad levels of capital expenditure have been assumed beyond the current period of the Financial Plan:-

- £14.2m for 2021/22;
- £11.3m for 2022/23;
- £8.0m p.a. as an average thereafter

It should be noted that in the business plan developed for the 2016/17 rent setting process average capital expenditure beyond 2022/23 amounted to £8.1m which is comparable to the above position.

These levels of capital expenditure take account of the loan charges costs parameter set out at 7.3.1 above, but 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 housing stock condition surveys.

7.3.4 Projects Funded Under Prudential Borrowing. As noted at section 4, all revenue consequences from capital expenditure (including financing costs) are met from the HRA rental income stream, therefore all borrowing undertaken by the HRA is Prudential.

7.3.5 Capital Receipts. The Council generated reasonable capital receipts in the past from the sale of Council Houses, however, members will recall that Right to Buy was removed from 1 August 2016, so capital receipts will now be negligible. The balance of unallocated capital receipts from 2016/17 will however be utilised in 2017/18 to mitigate the initial effect of the abolition of Right to Buy. The affordability assessment assumes the following levels of capital receipts, and further detail is contained in Report 69/17 also on the agenda for this committee.

- £2,131,000 for 2017/18;
- Zero thereafter

7.3.6 Other Contributions. Other contributions 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, taking on board updated long term affordability assessments, capital requirements or grant conditions.

7.3.7 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 7.3.2 have also been applied in estimating the costs of new borrowing.

7.3.8 Net Income to CFCR. 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.

The Net Income applied in the model falls over the financial plan period, and thereafter (2021/22 onwards) averages around £6.000m per annum for the remainder of the 30 year period of the assessment. There continues to be a level of 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 a recent welcome change to the implementation process whereby housing benefit will now be paid directly to landlords, the council has nevertheless still been 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 programme 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 could be breached at various points through the period of the assessment.

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

7.3.10 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, 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.

8 AFFORDABILITY ANALYSIS - OVERALL SUMMARY POSITION

8.1 Table 1 summarises key figures for the current year (2016/17) and forward 2 years (2017/18 to 2018/19) and then, starting from financial year 2021/22, intervals of 5 years thereafter.

TABLE 1 – AFFORDABILITY ANALYSIS – SUMMARY POSITION

	16/17 £m	**17/18 £m**	18/19 £m	21/22 £m	26/27 £m	31/32 £m	36/37 £m	41/42 £m	46/47 £m
Capital Expenditure	**8.574**	**15.100**	**19.201**	**14.157**	**7.734**	**7.612**	**6.875**	**7.752**	**9.800**
Estimated Borrowing	**0**	**3.959**	**9.501**	**8.158**	**2.000**	**2.000**	**1.000**	**1.000**	**0.633**
Expenditure :-									
Housing Expenditure	**17.188**	**17.372**	17.664	18.371	19.201	20.047	20.917	21.732	22.524
(A) Loan Charges	2.198	2.338	3.113	5.862	6.647	7.149	7.619	7.611	6.174
(B) Total Expenditure	**19.386**	**19.710**	**20.777**	**24.233**	**25.848**	**27.196**	**28.536**	**29.343**	**28.698**
(C) Rental Income	26.276	26.458	26.966	28.941	30.291	31.817	33.420	35.104	36.874
Other Income	1.010	1,016	1.011	0.991	0.991	0.991	0.991	0.991	0.991
(D) Total Income	**27.286**	**27,474**	**27.977**	**29.932**	**31.282**	**32.808**	**34.411**	**36.095**	**37.865**
Net Income (D) – (B)	**7.900**	**7.764**	**7.200**	**5.699**	**5.434**	**5.612**	**5.875**	**6.752**	**9.167**
Affordability Check (A) / (C)	**9%**	**9%**	**12%**	**21%**	**23%**	**24%**	**24%**	**23%**	**18%**

Notes to Table 1. Paragraph 7.3.8 above notes that the net income is fully applied as CFCR in the affordability model, however in the case of 2016/17; the net income of £7.900m comprises both CFCR of £7.135m and the projected current year surplus of £0.765m.

8.2 Analysis of the overall Business Plan shows a projected peak in new borrowing levels in year 2023/24 which is largely the result of the borrowing projected to be required for new build properties in Arbroath, Forfar, Montrose, Kirriemuir, Carnoustie, Monifieth and energy efficiency measures and Bathroom Replacements to existing housing stock.

8.3 The analysis also confirms that the affordability check against the 25% parameter is not breached in any of the 30 years of the plan, meaning that the projected loan charges costs arising from the projected levels of borrowing are affordable.

9. FINANCIAL IMPLICATIONS

9.1 The affordability analysis on the 30 year Business Plan is 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.

9.2 Despite this risk, the Head of Corporate Improvement and Finance believes that the assumptions made are robust and reasonable for the purposes of informing the Council's decisions, and the analysis confirms that the HRA Business Plan can be regarded as affordable, prudent and sustainable.

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

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