# Cheltenham Borough Council

## Cabinet – 9th February 2016

## Council – 12th February 2016

## Housing Revenue Account - Revised Forecast 2015/16 and Budget Proposals 2016/17

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| **Accountable member** | **Cabinet Member for Finance, John Rawson** |
| **Accountable officer** | **Section 151 Officer, Paul Jones** |
| **Ward(s) affected** | **All** |
| **Key Decision** | **Yes** |
| **Executive summary** | **This report summarises the Housing Revenue Account (HRA) revised forecast for 2015/16 and the Cabinet's budget proposals for 2016/17.** |
| **Recommendations** | **1. Note the revised HRA forecast for 2015/16.**<br>**2. Approve the HRA budget proposals for 2016/17 (Appendix 2) including a proposed rent decrease of 1% and changes to other rents and charges as detailed at Appendix 5.**<br>**3. Approve the proposed HRA capital programme for 2016/17 as shown at Appendix 3.** |

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| **Financial implications** | As contained in the report and appendices.<br>**Contact officer: Paul Jones.**<br>**E-mail: *paul.jones@cheltenham.gov.uk***<br>**Tel no: 01242 775154** |
| **Legal implications** | None specific arising from the report recommendations.<br>**Contact officer: Peter Lewis**<br>**E-mail: peter.lewis@tewkesbury.gov.uk**<br>**Tel no: 01684 272012** |
| **HR implications (including learning and organisational development)** | There are no direct HR implications for the Council arising from the report.<br>**Contact officer: Julie McCarthy**<br>**E-mail: julie.mccarthy@cheltenham.gov.uk**<br>**Tel no: 01242 264355** |
| **Key risks** | As outlined in Appendix 1 |

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| **Corporate and community plan Implications** | The aim of the budget proposals is to direct resources towards the key priorities identified in the Council's Corporate Business Plan. |
| **Environmental and climate change implications** | The budget contains proposals for improving the local environment particularly in addressing the issue of energy reduction in Council owned dwellings |

## 1. Introduction

There are no changes to the draft budget report presented to Cabinet on 15th December 2015.

## 2. Background Self-Financing and Changes to Social Rent Policy

2.1 In 2002 the Government introduced a rent convergence policy under which, over a ten year period, rents in social housing (local authority and housing association owned stock) were to be brought into alignment.

2.2 A rent formula was established with actual rents moving towards a national formula rent which took account of values of properties and local earnings relative to national earnings. A 'bedroom weighting' factor was also applied to try and ensure the resulting rents better reflected the perceived value of the properties being occupied. These formula rents were increased each year by the Retail Prices Index (RPI) + 0.5%.

2.3 Elected in 2010, the Coalition Government initially continued this rent setting process with a revised target convergence date for local authorities of 2015-16, subject to a maximum annual rent rise for an individual tenant of RPI + 0.5% + £2 per week. This policy formed a key assumption in the self- financing settlement in April 2012 and was used in the 30 year HRA Business Plan approved by Council in February 2012. This anticipated significant additional resources arising from the implementation of self-financing. CBC also approved a strategy to use these resources to finance a programme of new build, further improvements to existing stock and additional support services for tenants.

2.4 As part of the 2013 Spending Round the Government then announced that from 2015-16 social rents would rise by Consumer Prices Index plus 1 per cent each year for 10 years and that the policy of converging council and housing association rents was to be cut short. Following consultation the Government confirmed this policy change in May 2014. The financial projections in the HRA business plan were updated accordingly.

2.5 On 8 July 2015 (Summer Budget 2015) the Chancellor announced that rents in social housing would instead be reduced by 1% a year for four years resulting in a Government estimated 12% reduction in average rents by 2020-21. Nationally this measure is forecast to save the Exchequer £1.4bn by 2020-21, primarily in reduced Housing Benefit expenditure. Around 1.2m tenants not in receipt of Housing Benefit in the social rented sector are expected to benefit by up to £700 per year (current prices).

2.6 The scale of the impact of this proposal necessitates a fundamental review of the 30 year HRA Business Plan. The financial projections for 2016/17 to 2018/19 detailed in this report represent the start of a process which will produce a new long term business plan for Council approval in July 2016.

## 3. Impact of the Changes in Housing and Welfare Policy

3.1 The following significant changes in Government policy are being enabled through the Welfare Reform Bill 2015 and the Housing & Planning Bill 2015, both of which are currently passing through Parliament. The draft legislation sets the legal framework for the policy changes but much of the detail will follow in regulations to be published by the Secretary of State.

### 3.2 Rent Reduction

3.2.1 The current average rent for Council tenants is £82.38 per week. Prior to the budget the business plan assumed the average rent in 2019-20 would be £91.40 per week based on the CPI + 1% formula. It is now forecast that this will reduce to £79.16 per week, a reduction of 13.4% over the four year period when compared to the original forecast.

3.2.2 This will result in an estimated loss of rental income of £6.691m in the period to 31st March 2020. On the assumption that the Government will revert back to rent increases of CPI + 1% in April 2020, which is by no means certain, the cumulative loss of income over 30 years is estimated at £111m. This will produce a very significant reduction in the previously anticipated surpluses that were forecast in the long term HRA business plan.

### 3.3 Welfare Reform

There were also a number of changes to Welfare Benefits in the Summer Budget. Whilst a summary of these are noted below details of how these are to be implemented have not yet been issued by the Government and therefore the impact cannot be accurately forecasted:-

- The cap on benefits will be cut from £26,000 to £20,000 from April 2016.
- Working-age benefits will be frozen for four years, including tax credits and housing benefit; maternity payments will be excluded from the freeze.
- Working benefits will be removed from those who are not disabled and have no children, and will be withdrawn at a faster pace as claimants' earnings rise.
- Tax credit and universal credit support will be limited to the first two children from April 2017.
- Housing Benefit will be removed from young people aged 18-21, with some exceptions, from April 2017.
- Housing benefit will also be affected by removing the family premium for new children from April 2016.

These changes are in addition to the current roll out of Universal Credit.

CBH will need to monitor the impact of these changes as they are implemented with non-payment of rent being the ultimate risk to the HRA.

### 3.4 Extension of Right to Buy

3.4.1 The Government have committed to extending Right to Buy to tenants in Housing Associations, increasing discount rates, and decreasing qualifying periods. The Government intend to pay for the extension to Housing Association tenants, in part, by the sale of local authorities' most valuable (vacant) housing stock. The Government has said that the properties sold will be replaced on a one-for one basis.

3.4.2 Commentators questioned whether the rate of sales of vacant council stock would match the take-up rate of the extended RTB. It now appears that the Government is intending to address this issue by introducing a levy on local authorities, based on sales forecasts rather than actual sales. However there would still be a legal duty to consider sales.

3.4.3 The majority of HRA stock (97%) is valued below the regional 'high value cap' estimates published in the Conservative manifesto prior to the General Election. In total, only 122 units of stock would potentially be affected. However the properties affected are of two particular types – 2 bed houses in a high value area of the town and 50% (90 units) of 1 bed bungalows owned by the Council. The loss of these units would remove the limited social housing from one part of the town and significantly reduce the availability of single storey accommodation for the disabled and elderly.

3.3.4 The risk is that sales will be wholly random as to when and which properties become void and will have no regard for local housing need. This will produce further pepper-potting within Council owned housing which will make the much needed regeneration of social housing stock more complex and more costly.

Further detail is required from Government before we can make an estimate of this impact in the financial projections.

**3.5 Pay to Stay**

3.5.1 Following a consultation exercise in 2012 the Coalition Government gave social landlords in England the discretion to charge market or near market rents to tenants with an income of £60,000 or more a year. The scheme is known as 'pay to stay.' The challenges for local authorities (including Cheltenham) in implementing this scheme are:-

- administration - gathering information on and monitoring tenants' incomes;
- affordability – affected tenants could face substantial rent increases;
- the potential work disincentive effect; and
- residualisation of the housing stock as higher earners are incentivised to move out.

As part of the Summer Budget 2015 the Chancellor announced that the discretionary 'pay to stay' scheme would be made compulsory (in England) and that new, lower income thresholds would be introduced. These thresholds are expected to be £40,000 in London and £30,000 elsewhere. Local authorities will be expected to repay the additional rental income to the Exchequer, thus 'contributing to deficit reduction', while housing associations will be able to use the additional income to reinvest in new housing.

3.5.3 The move to a mandatory 'pay to stay' scheme will require primary legislation; the Government has recently published a consultation document seeking views on the implementation of the scheme which will commence in April 2017.

**4. 2015/16 Revised Forecast**

4.1 The forecast at Appendix 2 shows an increase in the surplus for the year of £1,024,500 compared to the original estimate. This increase, together with an increase of £1,297,300 in the balance brought forward from 2014/15, will give revenue reserves of £5,856,900 at 31st March 2016.

4.2 Significant variations within the 2015/16 revised forecast (>£30,000) have been identified in budget monitoring reports and are summarised below:-

| **Budget Heading** | **Change in resources** |
|---|---|
| | **£'000** |
| Repairs & Maintenance – decrease in forecast expenditure following reduced demand in year to date | 175 |
| Bad Debt Provision – lower arrears than anticipated reflect delay in implementation of welfare reform and allocation of additional resources to mitigate impact | 50 |
| Revenue contributions to fund capital programme – changes to programme and availability of funding options have reduced use of revenue resources | 754 |
| Other variations to expenditure | 21 |
| Other variations to income | 25 |
| **Net increase in Surplus for Year** | **1,025** |

## 5. Overview of HRA Business Plan

5.1 The recent changes in Government policy (in particular regarding rent reduction) have set all stock holding local authorities and private social landlords a significant challenge to produce a revised business plan that maintains service levels and retains viability.

5.2 Whilst CBH remain confident that the HRA can still deliver on the three key areas for investment within the existing Business Plan (further investment in new build, improvements to existing housing stock, and further investment in services), the timing, extent and scale of each will be significantly affected.

5.3 CBH will continue to review details of the changes to housing and welfare policy as they are released by the Government to determine whether further actions are required. The initial review of the HRA Business Plan has been guided by the following minimum targets:-

- Maintaining the recommended contingent balance of £1.5m in HRA reserves;
- Allocating sufficient resources to maintain the decent homes standard throughout the stock;
- Delivering the windows and doors improvement programme at a pace consistent with value for money;
- Ensuring that resources continue to be available to deliver the existing new build programme (i.e. those schemes currently being progressed and anticipated to complete by March 2018), but still subject to individual scheme evaluation;
- Ensuring the continuation of key service improvements initiated by Investment Pot 1;
- Seeking to protect existing levels of service and mitigating the impact on tenants and leaseholders;
- Retaining long term (30 years) viability. This will rely heavily on the Government's future social rent policy. We only have certainty until March 2020 – thereafter the link to CPI could be restored but there must be significant doubt as to whether rents will be allowed to increase above the prevailing rate of inflation.

5.4 The following work has been carried out in order to address the Budget impacts and to enable CBH to revise the financial projections in the HRA business plan.

- The HRA capital programme has been remodelled with particular emphasis on the next ten years.
- Potential impacts of the other changes in the July Budget have been identified with particular focus on benefit and tax credit changes. Further work is required to identify the actions needed by CBH to minimise these impacts for tenants and leaseholders.
- The key service improvements from Investment Pot 1 which need to be maintained have been identified and included in the base budget.
- CBH has revisited its goals for the next four years to ensure high quality core services will be maintained.
- CBH's medium term financial plan has been revised, identifying savings targets which will have to be achieved over the next four years.
- Long term viability has been reviewed using a range of assumptions for future rent increases, from CPI -1% to CPI +1% per annum.

5.5 The HRA budget proposals for 2016/17 form part of a four year plan put forward by CBH to mitigate the impact of rent reductions in the period to 31st March 2020 when the next review of the Government's social rent policy is anticipated. A summary of the plan is shown below:-

| **Category** | **£'000** | **£'000** |
|---|---|---|
| Efficiency savings in CBH management fee | 1,465 | |
| Service Improvements retained from Investment Pot 1 | -796 | |
| **Net reduction in management fee** | | **669** |
| | | |
| Efficiency savings in CBH maintenance service | | 1,026 |
| Re-alignment of the Capital Programme | | 2,707 |
| Use of HRA Reserves | | 2,208 |
| Reduction in the bad debt provision (arising from rent reduction) | | 128 |
| Reduction in interest receivable (lower reserves) | | -47 |
| **Total Savings** | | **6,691** |

5.6 Initial modelling of the potential impacts of future social rent policy post 2020 suggests:-

- Reversion back to a policy of annual increases above CPI should deliver increasing surpluses as anticipated in the original self-financing settlement, albeit delayed by the 4 year rent reductions. Within the long term plan existing debt of £45m could still be repaid leaving unallocated reserves of some £33m at year 30.
- Projections assuming future rent increases at the level of CPI (using 2% as the long term norm) show a further reduction of £87.5m in rent income compared to the figure identified in paragraph 3.2.2 above. This would be insufficient to accrue any significant reserves or repay debt. Further cost efficiencies would be required to retain long term viability and existing debt would need to be re-financed.
- An ongoing trend of rent increases below CPI would render the business plan unviable in the medium term without significant reductions to major repair expenditure and/or reduced levels of service.

## 6. 2016/17 Budget Proposal

6.1 The Government has confirmed proposals for social rent policy for the period April 2016 to March 2020. As detailed in paragraph 2 above rents will decrease by 1% in April 2016. The rent estimates assume a 1% void rate and 20 RTB sales in the year.

6.2 Estimates of service charge income currently assume no increase in grounds maintenance pending contract renewal. Charges for cleaning will rise by 2.8% whilst overall charges for power to communal areas are expected to be held at 2015/16 levels after a fixed tariff deal was agreed.

6.3 Following improvements to communal boilers and building insulation and the recent experience of milder winters it is proposed that fuel charges for communal gas heating will be reduced by 12.5% from April 2016.

6.4 The revenue impacts arising from new build expenditure have not yet been integrated into the budget but they will give a marginal benefit to resources in 2016/17.

6.5 Significant changes to the HRA (>£30,000) in 2016/17 as compared to the revised forecast for 2015/16 are itemised in the table below. There is a forecast surplus of £330,500 for the year which leaves revenue reserves at £6,187,400 at 31st March 2017.

| Budget Heading | Change in resources |
|---|---|
| | £'000 |
| | |
| Revenue contributions to fund capital programme – this increase reflects the impact of delayed expenditure in 2015/16 moving into the 2016/17 programme (see paragraph 8.1 below) | -1,247 |
| Increase in CBH management fee (see full detail in paragraph 7.5 below) | -57 |
| Increase in repairs and maintenance (demand adjusted from 2015/16) | -164 |
| Increase in bad debt provision – impact of welfare reform | -50 |
| Depreciation – inflation offset by stock loss | -70 |
| Decrease in rents (rent reduction & stock loss) | -293 |
| Other (net) | 11 |
| **Net decrease in resources** | **-1,870** |

## 7. Cheltenham Borough Homes (CBH)

7.1 The budget includes provision for the management fees and other charges payable to CBH. The company has submitted its own detailed budget and fee proposal for 2016/17, which show a breakeven position on services provided to the Council.

7.2 Prior to the July 2015 Budget the HRA Business Plan included forecast CBH management fees totalling £21.3m over the four years from April 2016. As part of the plan to mitigate the impact of rent reductions (see paragraph 5.5) the company is proposing to reduce this cost by £1.465m over the period to March 2020. This is after allowing for pay awards and anticipated increases in national insurance and pension costs and will be achieved through a phased approach as follows:-

1. Identify immediate vacant roles which will not be filled.
2. Review current management and other team structures to identify savings which can be implemented over the four year period.

3. Identify and implement efficiency savings as part of the service improvement programme already initiated by CBH. This will be achieved by streamlining business processes and improving related IT systems.

7.3 The three year period of service enhancements funded by the investment pot initiative ends in March 2016. In conjunction with CBC officers CBH has identified those that have achieved the greatest impact and should be absorbed into base budgets. These include:-

- Enhanced Benefit and Money Advice Service
- Additional Housing Revenues Officer
- Sheltered Hub & Activities Co-Ordinator
- Disability Hub
- Youth Café in St Pauls
- Expansion of Employment Initiatives Service
- Community Investment Grants

The total cost of these initiatives in 2016/17 is estimated at £205,000.

7.4 CBH budgets approved by their Board on 27th January 2016 show a net increase in management costs of £45,000 analysed as below:-

| | **£'000** |
|---|---|
| Pay award and increase in national insurance contributions | 99 |
| Investment Pot services absorbed into base (as detailed above) | 205 |
| Planned Savings | (259) |
| Increase in net management costs | 45 |

7.5 These additional costs are reflected in an increase in the HRA management fee of £57,000 (1%) over the current year, partially offset by a decrease of £12,000 in fees to the capital programme.

7.6 The overall cost of repairs and maintenance has reduced by 0.3% in comparison to the original budget for 2015/16 to £4,139,000, again as part of a four year plan to reduce costs by £1.026m in comparison to previous estimates. This will be achieved by reviewing staffing structures, leaner processes and renegotiation of supplier and sub contract rates.

7.7 The cost of delivering the estate cleaning contract has risen by 2.8% (£9,000) which reflects the anticipated cost of the pay award and additional national insurance contributions.

The fee submission for the main areas of activity is shown below and compared with 2015/16.

| | **2015/16** | **2016/17** |
|---|---|---|
| | £'000 | £'000 |
| Management Fee | 5,085 | 5,142 |
| Management of Capital Programme | 636 | 624 |
| Block Cleaning Service | 313 | 322 |

## 8. Capital Programme

8.1 The revised capital programme for 2015/16 reflects the completion of schemes carried forward from the previous year as previously reported to Cabinet and further variations identified during the year. The reduction in forecast spend primarily relates to tendering delays for the major window and door replacement programme. This is now anticipated to start on site in April 2016.

8.2 The detailed capital programme for 2016/17 and indicative programmes for the following two years are shown at Appendix 4. These reflect the investment requirements identified in stock condition surveys and the proposals in the updated asset management strategy.

8.3 The proposed funding of the capital programme, together with a statement of balances on the major repairs reserve, is shown at Appendix 3. The main sources of funding remain the major repairs reserve and contributions from the revenue account. The Government's policy to stimulate RTB has increased the availability of capital receipts. An element of those receipts, which is attributable to the debt held on each sold property, can be used for any HRA purpose and is used to finance capital expenditure on the existing stock.

8.4 Receipts from non RTB disposals and those retained through the one for one replacement agreement with the Government are held separately for investment in new affordable housing.

8.5 Appendix 4 also gives estimates of new build expenditure and funding assumptions for the period to 31st March 2019. The first new build scheme, Garage Sites 2a delivering 10 units of affordable housing, started on site in October 2015 following Council approval. A number of other schemes are being developed by CBH under the scrutiny of the Joint Programme Group and will be brought forward for individual Council approval as necessary.

8.6 New build schemes will be financed from a combination of funding sources namely:-

| **Funding Source** | **Estimated Available 2015/16** |
|---|---|
| | £'000 |
| | |
| Borrowing up to HRA debt cap | 8,112 |
| Right to Buy (RTB) retention receipts | 1,716 |
| Non RTB receipts from market disposals | 2,331 |
| Revenue contributions (through new build reserve) | 1,903 |
| | |
| **Total** | **14,062** |

8.7 The annual funding plans for new build expenditure will be determined by the Section 151 Officer ensuring maximum benefit and cost efficiency.

## 9. Reserves

9.1 The recommended minimum revenue balance to cover contingencies is £1.5m. This figure was determined in 2012 at the start of the self-financing regime and equates to approximately £330 per unit of stock which is very much in line with the sector norm. Key risks other than significant changes to Government policy primarily relate to property damage. The stock is insured for fire damage with the Council self-insuring against other perils. The three year projections forecast a reserve balance of £3.243m at 31st March 2019.

## 10. Conclusion

10.1 The potential benefits of the self-financing settlement have been significantly eroded by the change in the Government's social rent policy. It remains unclear whether the additional operating surpluses forecast in the previous 30 year business plan will be restored after 2020. Until there is more certainty about future rent levels it is recommended that focus should be concentrated on the medium term, ensuring that:-

- existing stock is maintained at the decent homes standard
- the improved level of tenant and leaseholder services is retained
- the Council can take advantage of opportunities to build new stock

CBH has brought forward a four year plan which will deliver these key objectives despite the significant reduction in forecast rent income.

## 11. Consultation process

11.1 The budget proposals have been endorsed by the Board of Cheltenham Borough Homes Ltd and presented to the Tenant Scrutiny Improvement Panel with no specific concerns being raised. No other responses have been received during the period of consultation.

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| **Appendices** | 1. Risk Assessment<br>2 HRA Operating Account<br>3 Major Repairs Reserve and HRA Capital Programme (summary)<br>4 HRA Capital Programme (detail)<br>5 HRA Rents and Charges |
| **Background information** | 1. HRA 30 year Business Plan<br>2. CBH Budgets and Plans 2016/17 |

## Risk Assessment - Interim HRA budget 2016/17 Appendix 1

| The risk | | | | Original risk score (impact x likelihood) | | | Managing risk | | | | |
|---|---|---|---|---|---|---|---|---|---|---|---|
| Risk ref. | Risk description | Risk Owner | Date raised | I | L | Score | Control | Action | Deadline | Responsible officer | Transferred to risk register |
| 1.01 | If CBH are unable to deliver savings to offset lower income as a consequence of 4 year rent reductions | Pat Pratley | December 2015 | 5 | 3 | 15 | R | Implementation of savings plan will be closely monitored by CBH with periodic reports on progress being submitted to Council officers | Mar 2020 | CBH through management agreement | |
| 1.02 | If there is a further change to the Government's social rent policy that reduces anticipated rent income | Pat Pratley | December 2015 | 4 | 3 | 12 | R | Any additional loss of income will need to be mitigated by further savings | Mar 2020 | CBH through management agreement | |
| 1.03 | If welfare reforms have a greater impact on tenants than anticipated and planned for, it may increase the level of debt or impact on vulnerable families | Pat Pratley | December 2012 | 3 | 4 | 12 | R | The HRA budget includes specific resources to control rent arrears | Mar 2018 | CBH through management agreement | |
| 1.04 | If the compulsory sale of high value properties depletes significant numbers and specific types of stock | Pat Pratley | December 2015 | 4 | 3 | 12 | R | Further detail is awaited from Government on the implementation of this new initiative. It may be possible to apply for certain properties to be exempted. | Mar 2017 | CBH through management agreement | |
| 1.05 | If supporting people contracts are not renewed it could impact on the tenants in sheltered accommodation | Pat Pratley | December 2012 | 3 | 3 | 9 | R | A transitional contract has been agreed with the County Council until October 2016. An evaluation of alternative service and funding options is in progress as part of the overall review of service delivery in this area | Oct 2016 | Lead Commissioner Housing | |

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| 1.06 | If void rent loss is higher than estimated it will impact on assumed rent income in the HRA | Pat Pratley | December 2012 | 3 | 2 | 6 | R | Demand for social housing remains high with significant waiting list. Quality of accommodation needs to be maintained and changes in tenancy termination rates monitored | Mar 2017 | CBH through management agreement | |
| 1.07 | If the demand for reactive repairs increases there may be insufficient budget to meet demand | Pat Pratley | December 2012 | 4 | 3 | 12 | R | Maintain robust stock condition data. Major peril to the stock is fire which is covered by appropriate insurance. HRA reserves are maintained at a level considered sufficient for uninsured stock damage | Mar 2017 | CBH through management agreement | |
| 1.08 | If there is insufficient capacity to deliver the ambitious programme of building works then the programme may not be deliverable | Pat Pratley | December 2012 | 2 | 3 | 6 | R | The HRA budget includes specific resources to address capital programme works | Mar 2017 | CBH through management agreement | |
| 1.09 | If the capital receipts held from RTB sales under the retention agreement with DCLG are not used within 3 years of receipt they are repayable with interest to the Government | Pat Pratley | December 2013 | 3 | 2 | 6 | R | New build programme has commenced on site, officers are monitoring spend against that required to retain receipts. Cabinet has approved an alternative strategy of acquiring property to eliminate potential repayment | Mar 2018 | CBC/CBH via the Joint Programme Group | |