

REPORT TITLE: HRA BUDGET BUSINESS PLAN AND BUDGET OPTIONS

16 DECEMBER 2020

REPORT OF CABINET MEMBER: CLLR KELSIE LEARNEY – CABINET MEMBER FOR HOUSING AND ASSET MANAGEMENT

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WARD(S): ALL

PURPOSE

The purpose of this report is to update members on the current HRA 30 year Business Plan, and upon the impact of any proposed budget options. It confirms that the proposed business plan is both sustainable and viable over the 30 year period.

It further proposes a change in future financing strategy to fully take advantage of the introduction of Prudential Borrowing as well as a change in the VFM hurdles that new investment proposals need to demonstrate.

The report also provides a number of budget options for members to consider and approve.

RECOMMENDATIONS:

That Cabinet:

1. Approve the HRA Business 30 year Plan for 2020-21 to 2049-50 as summarised in the Operating Account included as Appendix 4.
2. Support an increase in the projected capital programme of £173m subject to the approval of individual items below, and the proposed long term funding strategy that will see borrowing increase to £407m subject to the final detailed

HRA budget and the Capital Strategy being approved by Council in February 2021.

3. Note that the business plan is viable and sustainable and will support the council's ambitious delivery of 1,000 new affordable homes over the next ten years.
4. Approve the changes proposed to refresh and simplify the current financial viability hurdles to recognise the residual value of housing within the HRA and take full advantage of historically low borrowing rates.
5. Note that the calculation of the minimum HRA reserves will in future take account of both the scale of new build as well as the net operating expenditure within the HRA.
6. Approve the creation of an Energy Officer post to facilitate the council's carbon reduction agenda and embed it within the current and future housing stock subject to the final detailed HRA budget being approved by Council in February 2021.
7. Support the proposed increase in capital funding of £2.5m in retro fitting capital funding which will increase the funding from £10.7m to £13.2m subject to the final detailed HRA budget and the Capital Strategy being approved by Council in February 2021.
8. Support the proposal for a £10m investment in the purchase of a potential site for new housing development, as well as £0.5m for nitrate mitigation offset measures subject to the final detailed HRA budget and the Capital Strategy being approved by Council in February 2021.
9. Support the allocation of an additional £0.2m of investment as described at paragraph 17.2 of this report for sewage treatment works subject to the final detailed HRA budget and the Capital Strategy being approved by Council in February 2021.
10. Approve the increase in budgetary provision of £0.064m to support the increase in costs of the current 1 year Orchard contract and enable officers to procure a longer term 3 year contract subject to the final detailed HRA budget and the Capital Strategy being approved by Council in February 2021.

IMPLICATIONS:

1 COUNCIL PLAN OUTCOME

- 1.1 Providing good quality housing and new affordable homes is a strategic priority for the Council. Effective management of the resources available to the Council enable it to take advantage of new opportunities and ensure that satisfaction levels remain high amongst tenants in relation to their home and community. In particular
- 1.2 Tackling the Climate Emergency and Creating a Greener District
 - a) Carbon Neutrality measures will be implemented across existing housing stock and include within the design and construction of new properties, and feasibility considered in the purchase of any substitute properties
- 1.3 Homes for all
 - a) Assist with the increase of housing property stock across the Winchester district
- 1.4 Vibrant Local Economy
 - a) Deliver affordable accommodation that allows people to live and work in the community and contribute to the local economy.
- 1.5 Living Well
 - a) The wellbeing of residents are considered within the design of new properties and any substitute properties will be viewed accordingly.
- 1.6 Your Services, Your Voice
 - a) Housing tenants are directly involved in decisions regarding service provision, both through the work of TACT and through regular digital engagement processes. The service continues to review options to provide an improved customer experience, increase opportunities for digital engagement and to ensure satisfaction with services provided by the Council remains high.

2 FINANCIAL IMPLICATIONS

- 2.1 These are fully detailed in Section 10 of the report and the accompanying appendices.

3 LEGAL AND PROCUREMENT IMPLICATIONS

- 3.1 Under Part VI of the Local Government and Housing Act 1989 any local authority that owns housing stock is obliged to maintain a Housing Revenue Account. The HRA is a record of revenue expenditure and income in relation

to an authority's own housing stock. The items to be credited and debited to the HRA are prescribed by statute. It is a ring fenced account within the authority's General Fund, which means that local authorities have no general discretion to transfer sums into or out of the HRA.

- 3.2 The Council is required to prepare proposals each year relating to the income of the authority from rents and other charges, expenditure in respect of repair, maintenance, supervision and management of HRA property and other prescribed matters. The proposals should be made on the best assumptions and estimates available and designed to secure that the housing revenue account for the coming year does not show a debit balance. The report sets out information relevant to these considerations.
- 3.3 Section 76 Local Government and Housing Act 1989 places a duty on local housing authorities: (a) to produce, and make available for public inspection, an annual budget for their HRA which avoids a deficit; (b) to review and if necessary, revise that budget from time to time and (c) to take all reasonably practicable steps to avoid an end-of-year deficit.
- 3.4 The proposed HRA budget fulfils these requirements. The report also seeks approval for major investment estimates in relation to a variety of schemes. In compliance with Section 151 of the Local Government Act 1972, the Council has in place Financial Procedures which provide appropriate arrangements for the approval of major works estimates. The various major works schemes must be capable of being carried out within the Council's statutory powers. To the extent that the details of the schemes appear from the body of the report, it does appear that the proposed works meet this requirement. In particular the maintenance of dwellings may be considered consistent with the Council's repairing obligation under Section 11 of the Landlord and Tenant Act 1985.

4 WORKFORCE IMPLICATIONS

- 4.1 Some of the options for consideration for next year's budget will require an additional staffing resource. These options are detailed within Section 17 as relevant but in summary will include up the creation of new Energy officer post to help facilitate the retro fitting project.

5 PROPERTY AND ASSET IMPLICATIONS

- 5.1 In order to meet one of the key principles of the Council Strategy, the HRA is required to provide sufficient financial resources to both maintain existing stock to decent homes standard and to enable new affordable housing to be built to help meet local demands.

6 CONSULTATION AND COMMUNICATION

- 6.1 A draft of this report will be presented to Housing and Business Committee for their consideration on 1st December. A separate presentation was made to TACT members at a tenant briefing meeting on 25 November. Tenant

representatives will also be at Cabinet to give verbal feedback to Members on the report.

7 ENVIRONMENTAL CONSIDERATIONS

- 7.1 The Housing Service considers environmental factors when preparing and developing major projects e.g. working closely with Planning and Landscape Officers when considering new build developments to meet the required codes for sustainable housing.

8 EQUALITY IMPACT ASSESSEMENT

This document is part of the budget consultation process and the public sector equality duty is considered alongside any relevant budget options

9 DATA PROTECTION IMPACT ASSESSMENT

- 9.1 All projects set out in this report and the Capital Programme will be subject to individual data protection impact assessments.

10 RISK MANAGEMENT

Risk	Mitigation	Opportunities
<i>Property That Council owned dwellings fail to meet decent home standards</i>	An effective programme of future works and sound financial planning ensures that these standards are met and then maintained.	Self-Financing provides certainty around future resource allocations and facilitates better supply chain management
<i>Community Support Lack of consultation will affect tenant satisfaction and cause objections to planning applications for new build developments.</i>	Regular communication and consultation is maintained with tenants and leaseholders on a variety of housing issues. The Council consults with local residents and stakeholders on proposed new build schemes.	Positive consultation brings forward alternative options that may otherwise not have been considered.
<i>Timescales Delays to new build contracts may result in increased costs and lost</i>	New build contracts contain clauses to allow the Council to recover	

revenue.	damages if the project is delayed due to contractor actions.	
<p><i>Project capacity</i> The HRA can borrow funds in addition to utilising external receipts and reserves but it must be able to service the loan interest arising and repay debt in the future.</p> <p>Staffing resources (not always in Housing) reduce the ability to push forward new schemes at the required pace.</p>	<p>Regular monitoring of budgets and business plans, together with the use of financial assessment tools enables the Council to manage resources effectively.</p> <p>Staffing resources have been reviewed to support the delivery of the enhanced new build programme.</p>	<p>The Council monitor's government announcements on the use of RTB receipts and potential capital grant funding.</p> <p>Given the challenging nature of the delivery targets it may be necessary to review the resourcing requirements needed to successfully deliver this step change in anticipated activity</p>
<p><i>Financial / VFM</i> Risks, mitigation and opportunities are managed through regular project monitoring meetings</p>	<p>New build Schemes are financially evaluated and have to pass financial hurdles and demonstrate VFM.</p> <p>In addition Total Scheme Costs contain provision for 5% contingency on build and 10% on fees for new build developments that take account of potential residual development and sales risk.</p>	
<p><i>Legal</i> The provision of social housing is a statutory requirement. Changing Government priorities place a greater emphasis on social housing which must be monitored and considered within planning of future new build projects.</p>	<p>Government statutory requirements and policy changes are being monitored to identify any new risks or opportunities that they may bring.</p>	<p>To create new housing developments within new guidelines and drawing on innovative thinking.</p>
<p><i>Innovation</i> The creation of a Housing Company to support the new build programme is</p>	<p>External legal and business planning advice has been sought to ensure</p>	<p>A Housing Company has the potential to increase the available supply of</p>

<i>introduced without reference to existing rules and consents.</i>	the Council has the most appropriate and effective solution and that any developments are only undertaken if they are financially viable.	affordable housing to support our residents.
<i>Reputation Failure to complete major housing projects due to lack of resources would have a direct impact on both customer satisfaction and the Council's reputation.</i>	Business planning tools with regular updates are utilised to make sure resources are available to complete projects.	
<i>Other – None</i>		

11.0 BACKGROUND

- 11.1 The 2012 Self-Financing HRA reforms and settlement resulted in the City Council buying itself out of the previous tightly controlled national HRA subsidy system. This system which had operated since 1989 was widely discredited in that it sought to redistribute notional HRA surpluses and deficits and relied upon annual notifications of financial resources. This discouraged any council from growing or improving the efficiency of its local HRA.
- 11.2 When Self-Financing was implemented council's in deficit had debt paid off whilst council's in surplus took on new debt. Winchester City Council was a surplus subsidy council and bought itself out of the previous system by taking on an extra £156m of new debt. This enabled the council effectively to take back ownership of its HRA and of all future income streams. At this time, it was envisaged and hoped that this would lead to the unlocking of resources and to the development of a significant national number of new affordable homes and incentivise a real step change in Local Authority strategic ambition and delivery capacity.
- 11.3 However this aspiration was curtailed and constrained by the Government's reluctance to allow councils to borrow for HRA housing investment, with individual borrowing caps imposed upon all councils as part of the self-financing settlement. Nevertheless, after 2012 the HRA could effectively be run in a more business-like way, with varying degrees of control over its own assets and revenue streams.
- 11.4 The 30-year HRA business plan remains the annual measure of the viability and sustainability of the HRA. The Business Plan projects future HRA revenue and capital budgets based upon future assumptions on key variables such as interest rates, inflation and Social rent policy, proposed future capital investment plans and associated funding requirements. Essentially the 30-year

Business plan demonstrates to stakeholders the impact of future investment decisions upon the sustainability and viability of the HRA.

12. THE IMPACT OF PRUDENTIAL BORROWING

12.1 In October 2018 the Government removed the HRA borrowing cap replacing it with the same borrowing regime as applied to the General Fund, Prudential Borrowing. The key requirements of the Prudential Code are that capital investment plans are affordable, prudent and sustainable. On 12th March 2020 the Government further announced that HRA borrowing would now be available at a reduction of 0.8 basis points below other PWLB certainty borrowing rates. Current 50 year PWLB rates are at a historically low rate of under 1.8% In addition the HRA is not required to set aside any annual Minimum Revenue Provision (MRP) towards the outstanding debt as is the case in the GF. The LGA described the abolition of the debt cap as a game changing opportunity for local authorities.

12.2 Before this change, investment decisions were largely constrained by the availability of capital resources. Resources such as revenue funding, capital receipts, grants, and borrowing headroom up to the HRA Debt Cap. Now providing that the council's 30-year HRA business plan can cash flow the interest costs involved in undertaking new borrowing, and remains viable, it has significantly more funds available to make future investment decisions. Previously the borrowing cap constrained funds available for investment and this led to the sub-optimal solution of revenue funding being applied to fund long term investment. An example of the potential impact of this is where £1 of revenue previously funded £1 of capital investment, now £1 of revenue can effectively fund 50+ times as much capital investment as long as it remains affordable, prudent and sustainable.

13. THE NEED TO REVIEW & CHANGE BARRIERS TO FUTURE INVESTMENT

13.1 Although debt is often perceived as being a liability, in a business operating long term assets with an ongoing positive income stream that maintain and often increase their value, prudential borrowing is a mechanism for achieving sustainable and viable growth. Most normal investment decisions would be on the basis that the asset has little or no economic value past the period of the evaluation e.g. investment in machinery, vehicles or warehouses, apart from the residual valuation at the end of both the asset life and investment period. However in Housing, the assets are maintained and kept at decent homes standard, the demand for housing is greater than the supply and at the end of the investment, the council owns a working asset that has an often significant residual value in existing use.

13.2 The current suite of financial hurdles that must be passed in order to produce an investment that is considered viable are listed below, they have their origin in the Housing Association sector. Here commercial borrowers place covenants on the balance sheet to mitigate the risk of lending.

1. Investments must show a positive Net Present Value (NPV).
2. The payback period should be no more than 35 years.
3. Total scheme cost as a % of combined property market value is a maximum of 95%
4. Net operating income is a minimum of 105% of the annual interest cost.
5. All costs and expenses applicable to the scheme, internal or external, should be fully accounted for and charged to the scheme with no 'hidden' Subsidy.

Generally, for an investment to be considered viable and worth undertaking all of the above hurdles must be met, this can make potential investment opportunities appear unnecessarily unviable and not worth undertaking. The council has instead to meet the requirements of the prudential code on borrowing

- 13.3 The case can be made that with Prudential Borrowing being at historically very affordable levels that if the residual valuation were taken into account in determining future HRA Investments, that potentially more opportunities would be viable. A hypothetical illustration of the impact of taking the residual valuation into account is shown in Appendix 1. The effective hurdles would therefore be that:-

1. The Scheme was NPV+ taking account of the residual value of the asset
2. The HRA can fund the ongoing debt financing costs from net rental income
3. That the HRA Business Plan remained able to cash flow the investment

14.0 RISK AND THE MINIMUM REVENUE BALANCES

- 14.1 Building homes involves significant risks. This is why market developers and investors demand high returns in reward for that risk. It will rarely be possible to eliminate risk; however it can be assessed and managed. The council's corporate project and risk management processes will be used to mitigate detailed risk and ensure that projects are progressed in a logical sequence to ensure that the council is not overexposed to risk. The majority of risks can be managed through adequate monitoring, site investigations and ensuring developments meet housing need locally and are made available at an affordable rent. In terms of shared ownership sales risk the viability and assumptions over the demand and affordability of the proposed products need to be carefully assessed.
- 14.2 In terms of accounting for these residual risks at present all the viability assessments take into account a contingency provision of 10% on build and 5% on fees. This is then included in the project budget total scheme cost envelope. Where a project is deemed to have an unacceptable level of risk it would not be recommended for approval.

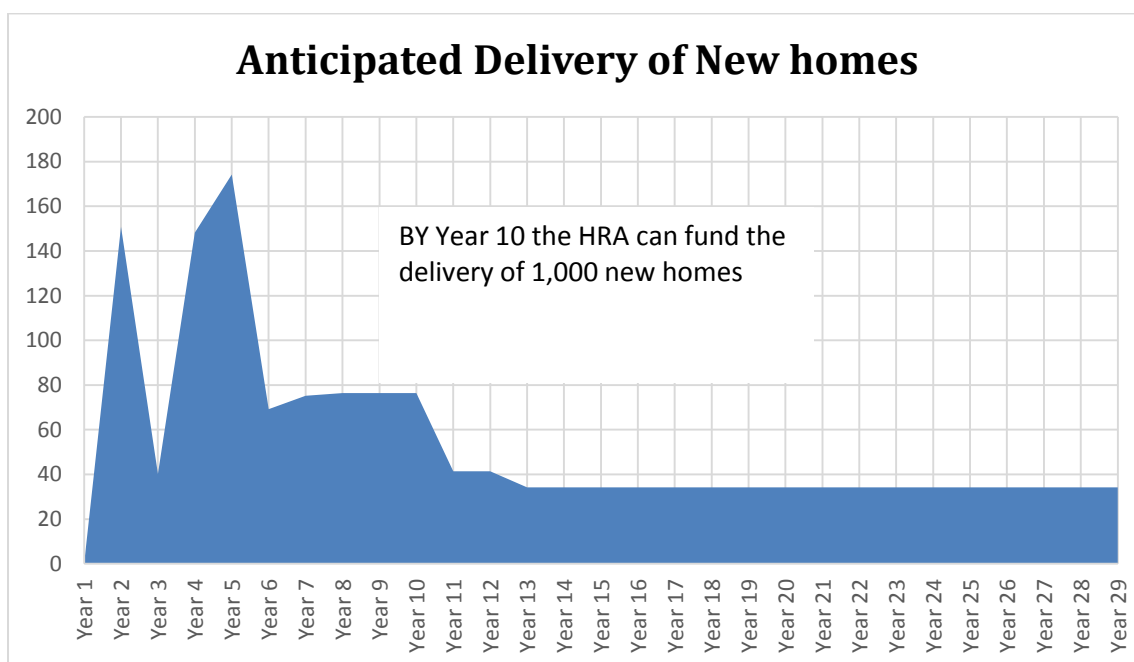
14.3 In addition it is normal practise to set a minimum level of working balances within the HRA, that reflect the risk of uncertainty, likely overspending and the inability of the HRA to budget for a deficit balance. It is recommended that in future this minimum balance is set with regard to both the revenue operating account and the scale of new build, with 10% set aside with regard to new build spend and 5% with regard to the operating account. See Appendix 2 for an exemplification.

15. THE PROPOSED 30 YEAR BUSINESS PLAN

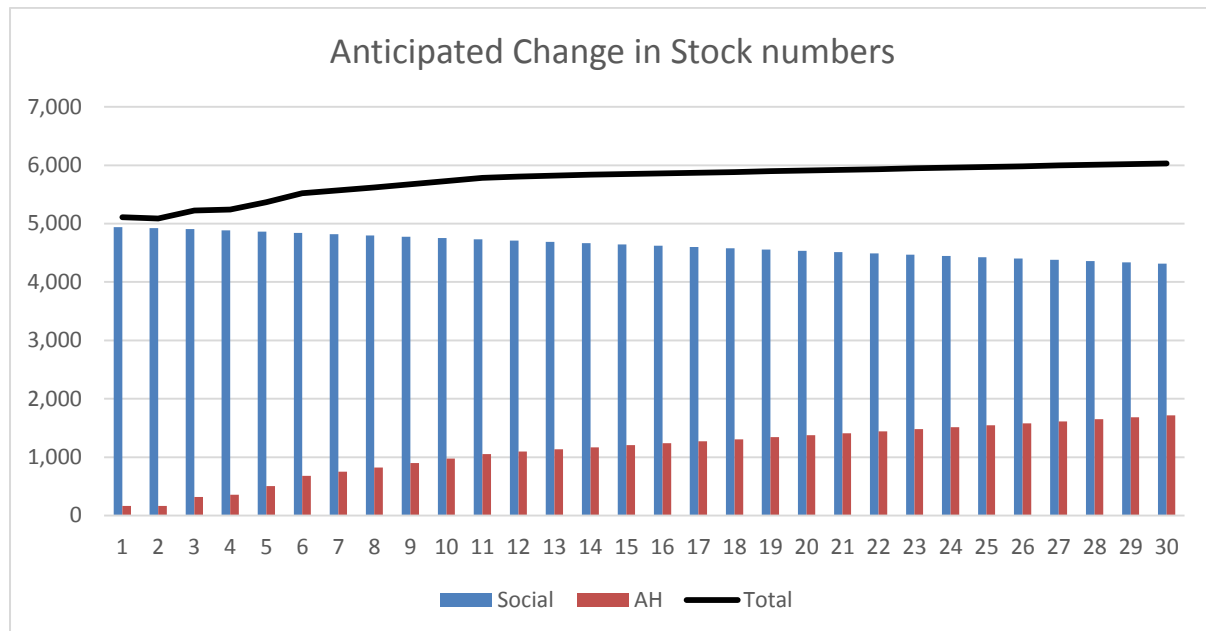
15.1 The general assumptions and forecasts used in the Plan have been reviewed and amended where considered necessary. The details of the key assumptions made are shown in Appendix 2. The current 30 Year Business Plan has been updated for changes in stock, actual average rent and service charges and projected HRA forecast outturn at period 5.

15.2 All of the identified current New Build Schemes have been individually reviewed by officers and the financial cash flow impact profiled in line with delivery expectations. The financial impact of this is now reflected within the proposed investment plans.

15.3 In addition, the council’s objective of delivering 1,000 new affordable homes is now fully recognised and funded within the current business plan, the increase in the overall costs of new build reflecting both these changes is anticipated to cost an extra £152m, which now also includes the future anticipated costs of new build major works. The profiled delivery of new homes is shown over the life of the business plan, with the target of 1,000 funded to be achieved within the first 10 years



- 15.4 The proposed business plan will see funding in place to deliver in total around 1,630 new affordable homes over the next 30 years including shared ownership of 279 units. The makeup of the stock, and forecast changes over time is shown below



16. RENT POLICY

- 16.1 The Rents for both social and affordable housing are now set in accordance with the guidance issued by the Regulator of Social Housing. The current policy framework applies to all registered social landlords, both local authorities and private registered providers (Housing Associations). This policy gives landlords a degree of certainty for 5 years from April 2020 that rents will be allowed to increase annually by a maximum of CPI+1% (based on CPI in September of the preceding year). The current year 2020-21 was the first year of this policy and followed 4 years of rent reduction under the Welfare Reform Act 2012.
- 16.2 The calculation of social rents is based upon a formulae of 70% relative earnings to 30% relative property value, applied to each individual properties value in January 1999, and then adjusted for bedroom size. This is then inflated by an index of applied annual rent increases to arrive at a current formula target rent for each property. There are also caps or limits on the maximum amount that can be charged by bed size. However as the government applied caps and limits to the permitted increases over a number of years it is possible that some tenants are paying less than the formula target rent. If a social rented property is re-let and the current actual rent is below the formula target, then the rent can be increased to the formula target rent. By contrast affordable rent is based on a maximum of 80% of certified market rent, and when affordable property is re-let the certified market value must be reassessed.

16.3 The current Business Plan assumes that the rents will continue to comply with this guidance and the increase will be in line with that allowed by Regulator. The September CPI was 0.5% so the proposed rent increase will be 1.5%. The impact of this in terms of weekly rents for Winchesters housing stock by type and bed size is shown over.

Type	No.	2020-21 Avg RENT per week	Min Rent per week	Max Rent per week	2021-22 Avg Rent per week	Min Rent per week	Max Rent per week
Affordable rent							
1	70	£133.94	£107.84	£150.78	£135.95	£109.46	£153.04
2	51	£162.16	£113.38	£185.51	£164.59	£115.08	£188.29
3	30	£182.66	£136.08	£240.00	£185.40	£138.12	£243.60
4	1	£219.83	£219.83	£219.83	£223.13	£223.13	£223.13
Affordable Total	152	£153.59	£107.84	£240.00	£155.89	£109.46	£243.60
Social rent							
B	80	£76.84	£71.45	£92.20	£77.99	£72.52	£93.58
1	1,561	£88.87	£63.52	£110.98	£90.20	£64.47	£112.64
2	1,624	£102.05	£83.15	£124.13	£103.58	£84.40	£125.99
3	1,509	£116.15	£96.89	£151.13	£117.89	£98.34	£153.40
4	66	£124.65	£89.99	£138.78	£126.52	£91.34	£140.86
5	1	£144.66	£144.66	£144.66	£146.83	£146.83	£146.83
6	1	£148.89	£148.89	£148.89	£151.12	£151.12	£151.12
Social rent Total	4,842	£102.10	£63.52	£151.13	£103.64	£64.47	£153.40
Grand Total	4,994	£103.67	£63.52	£240.00	£105.23	£64.47	£243.60

16.4 For information the Current and recent LHA rates for 1-4 bed properties in Winchester is shown below:-

Winchester Local Housing Allowance Weekly Rent Limits

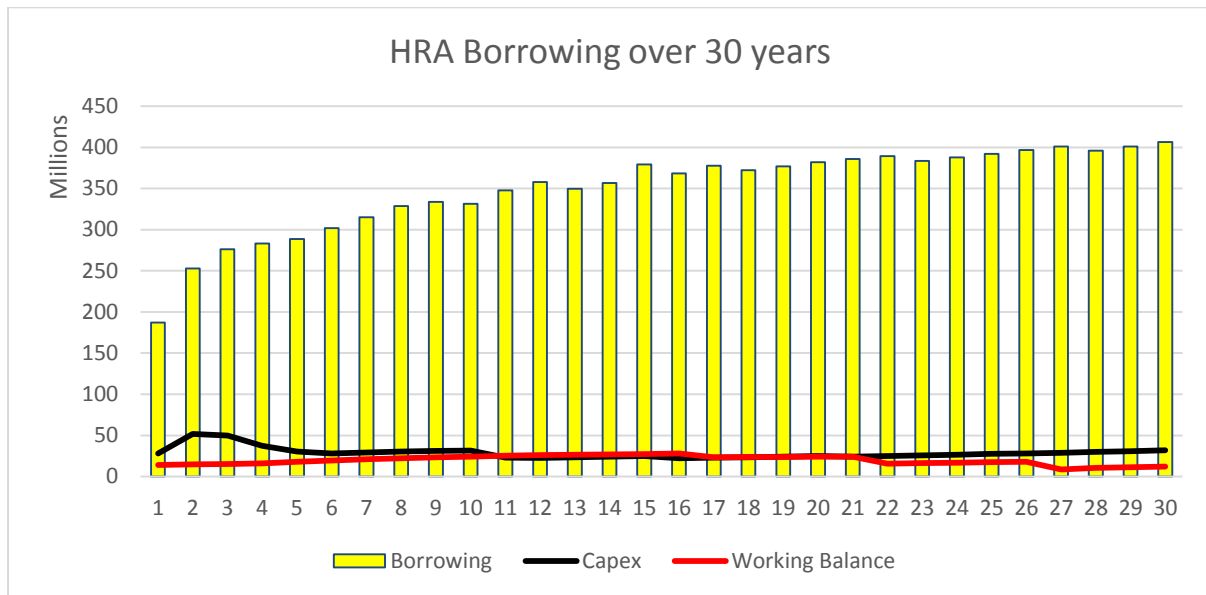
	Room(s)			
Year	1	2	3	4
LHA April 2018	£148.30	£182.45	£211.87	£312.77
LHA April 2019	£152.75	£182.45	£211.87	£322.15
LHA April 2020	£166.85	£197.92	£253.15	£368.22

17. HRA FUNDING STRATEGY

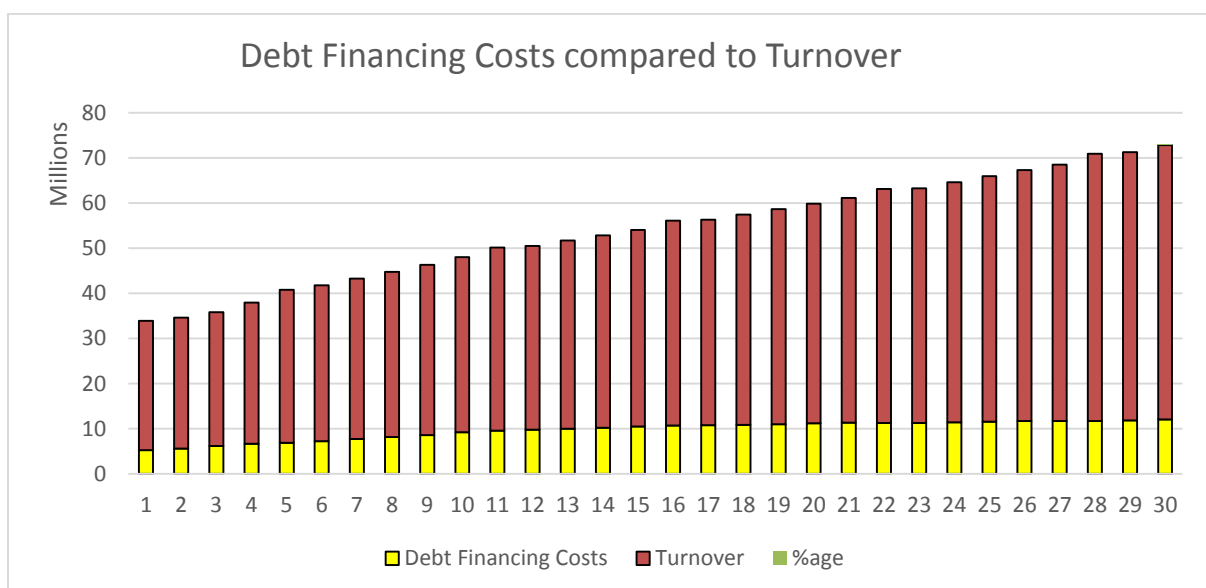
17.1 To facilitate the investment requirement needed to deliver the councils housing new build targets the HRA business plan external borrowing will need to increase from £156.7m to £406.7m, an increase of £250m over the life of the plan. This is necessary to deliver the step change in the anticipated delivery of new homes over the life of the plan. This will require over £136m of investment

in new homes over the next 5 years and take advantage of both the current historically low level of PWLB interest rates and the ability of the HRA to borrow prudentially.

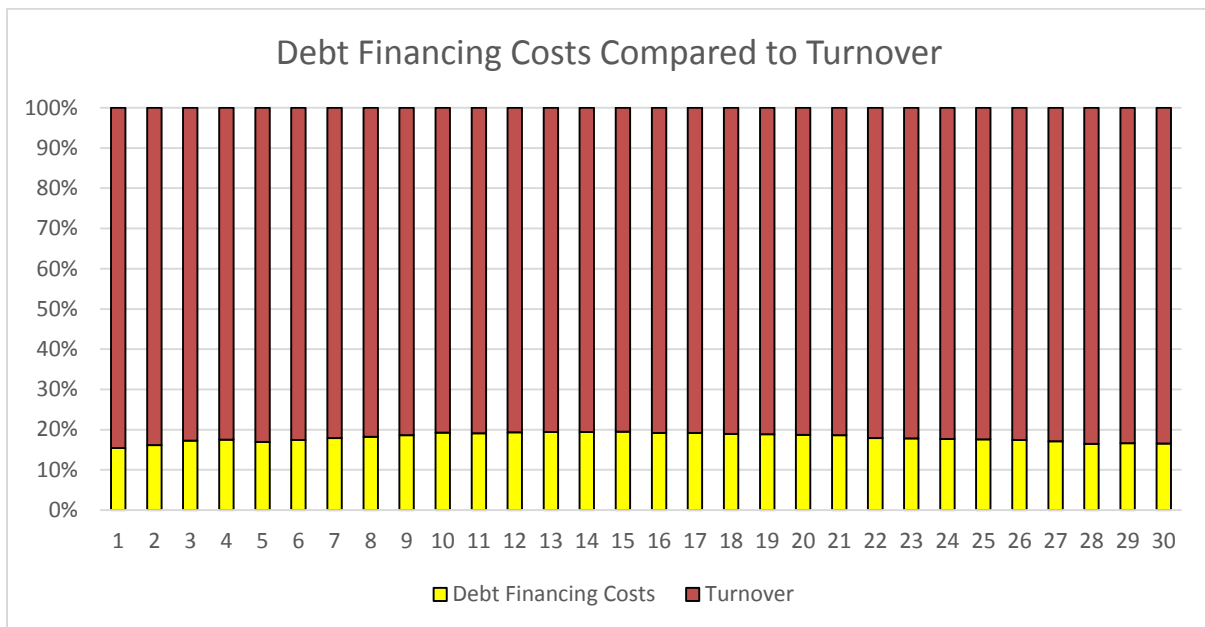
17.2 The interplay of capital investment, borrowing and the HRA working balance are shown over. The average amount of annual capital investment is £29m, and the projected HRA reserves at year 30 is £12m.



17.3 The projected increase in borrowing needs to be considered against the growth in both the asset base and the increase in turnover that this will facilitate. The increase in borrowing remains affordable as the interest costs can be funded from within the HRA and the associated increase in both the asset base and in turnover mean that the ratio of debt to income remains affordable



17.4 Looking at the relative relationship between the debt financing costs and turnover, the ratio of debt to turnover remains fairly constant at between 18%-24%.



17.5 In addition looking at the ratio of debt to asset cover, and the ratio of interest cover (interest compared to turnover) the ratios remain comparable over time and not dissimilar to the average for the major Housing Associations.

relevant Comparators	Debt to asset Cover	Interest Cover
Average for Housing Associations (2018-19)	44%	6.51
Housing Association Comparator Mixed	44%	6.51
Housing Association Comparator LSVT	48%	7.16
Housing Association Comparator Traditional	43%	5.16
Winchester HRA (2012-13)*	49%	4.60
Winchester HRA (2020-21)	38%	5.47
Forecast Winchester year (2049-50)	44%	5.06

* First year of HRA Self Financing

18. BUDGET OPTIONS

- 18.1 The proposed HRA Business plan is based upon the investment requirements from the asset management plan which in turn is informed by the component lifecycle replacement costs of maintaining both the current stock and importantly funding the long term maintenance costs of the new homes that are planned at the councils current decent homes standard plus.
- 18.2 In order to both maintain homes at decent homes and to fund the delivery of the new homes required, the HRA will need to undertake increased levels of prudential borrowing over both the medium and long term. A major part of the prudential assessment is having sufficient ongoing revenue funds to service the cost of borrowing undertaken. As identified previously the HRA does not have a legal requirement to set aside funds for the repayment of debt (MRP) as the assets held in the HRA are maintained as part of self- financing.
- 18.3 In order to further strengthen the capacity and capability of the HRA to facilitate and embed the carbon reduction agenda the plan allows for the further investment of £2.5m in the retro fitting programme on top of the current future allocation of £10.7m. In addition it allows for the creation of an energy officer post to support this important programme.
- 18.4 The ongoing investment requirements of the HRA sewage treatment works is currently being reviewed by officers with the aim of creating a robust future asset management strategy around these assets. In the meantime the plan allows for a minimum of £3.1m of investment over the next 30 years. An additional allocation of £200k is now required in 2021-22 to purchase & equip a new sewage vehicle, allow for the reinstatement of a collapsed sewer and to facilitate some minor urgent backlog investment.
- 18.5 The investment plan allows for an additional £10m investment in the purchase of a new site for new housing, as well as £500k for nitrate mitigation offset measures.
- 18.6 The costs of running the current housing management system Orchard have increased and the offering now includes a number of new modules that are required by the business. The increase in costs is approximately £64k and it proposed that future budgetary provision be allowed for this increase. This will allow officers to look at options to extend the current 1 year contract to 3 years.

19. OTHER OPTIONS CONSIDERED AND REJECTED

- 19.1 Indicative modelling has demonstrated that if the new housing delivery target is reduced by 1,112 units that the need to borrow would reduce from an extra £250m to only £26m over the life of the plan with debt at year 30 reduced to £200m. However the remaining level of new build would be insufficient to use all the expected RTB 1-4-1 receipts and c. £94m would need to be repaid to central government.

BACKGROUND DOCUMENTS:-

Previous Committee Reports:-

CAB3111 – HRA Budget 2019-20 & Business Plan 2019/49 – 30 Jan 2019

CAB3016 (HSG) – HRA Budget 2018/19 & Business Plan 2018/48 – 31 Jan 2018

Other Background Documents:-

Social Housing 5th Dec 2019 – special report on how housing associations finance compare to others - UK housing associations: audited accounts 2018/19 summary.

[Social Housing - Insight - Special report: how do housing associations' finances compare to others?](#)

APPENDICES:

APPENDIX 1 - EXAMPLE OF USING RESIDUAL ASSET VALUATION IN DETERMINING VIABILITY

APPENDIX 2 – HRA BUSINESS PLAN ASSUMPTIONS

APPENDIX 3 - CAPITAL INVESTMENT AND THE ASSET BASE

APPENDIX 4 - HRA OPERATING ACCOUNT 2020-21-2049-50

APPENDIX 1 EXAMPLE OF USING RESIDUAL ASSET VALUATION IN DETERMINING VIABILITY

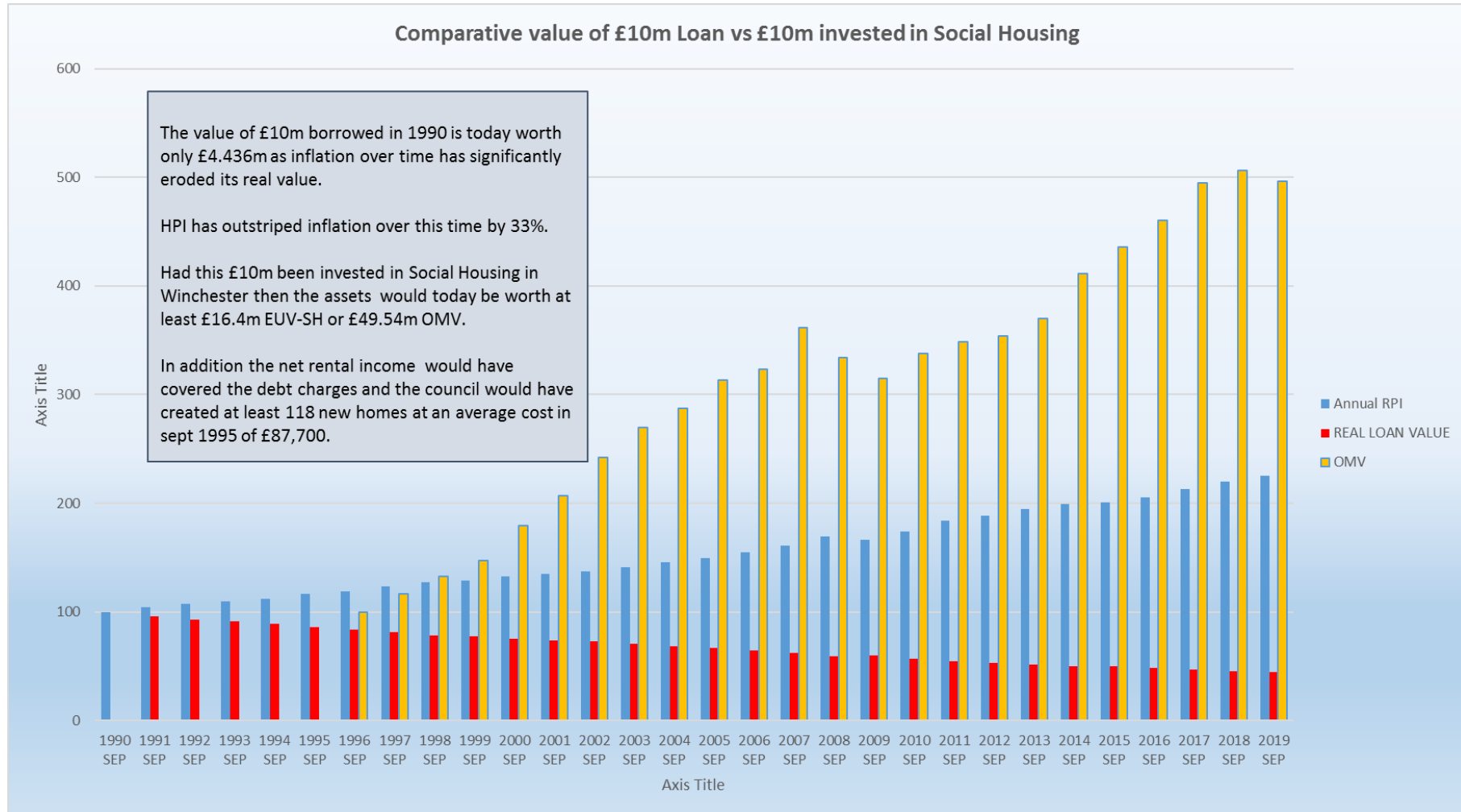
THE RESIDUAL VALUE OF AN INVESTMENT IN HOUSING

In the perspective where the HRA took on a fixed term loan (say a PWLB fixed rate long-term 50 year maturity loan) to invest in a viable housing project that resulted in an income generating asset, whose net rental income after costs covered the interest payments.

The value of this loan over time would be eroded by the impact of inflation whilst at the same time any investment where house price inflation over the long term performs better than inflation will lead to the investment generating an asset that has a material residual value that is potentially greater than the value of the loan at the end of the investment period.

- (1) This can be best illustrated by taking a hypothetical example shown on the next page based upon real inflation and house prices in Winchester over the period 1990-2019.
- (2) Here a hypothetical 30 year fixed term loan of £10m is borrowed at a coupon rate of 8.25% with interest at £825k a year. Had this been affordable to the HRA then it would have been sufficient to acquire c.118 properties at average cost at the time of £88k each. Had they increased in line with average house price inflation for Winchester (source Land registry), they would now be worth some £49.5m OMV or £16.4m EUV-SH. Whereas, the value of the £10m loan would have been eroded by the impact of inflation and in money terms the equivalent loan today would be worth £22.5m, therefore the loan has lost over half its value to inflation.
- (3) The council would therefore have had the social benefit of an extra 118 new homes over 30 years, the financial benefit of an increase in net assets with a residual value in existing use of £16.4m at the end of the loan period, and a £10m loan to refinance that in 1990 would at today's price base been worth £23m. This is largely because unlike other investments housing retains its residual value and its useful life is often in excess of over 60 years with major ongoing investment to keep it decent and replace key components.

APPENDIX 1 – HYPOTHETICAL EXAMPLE RESIDUAL ASSET VALUATION



APPENDIX 2 – HRA BUSINESS PLAN ASSUMPTIONS

There are a number of assumptions required for the 30 year HRA business plan. The key assumptions are detailed below.

Inflation

Year	RPI	CPI	Repairs
2021-22	1.10%	0.50%	1.60%
2022-23	2.50%	2.00%	3.00%
Thereafter	3.00%	2.00%	2.00%

NB RPI and CPI percentages for 2021-22 are based on September 2020 actual figures as published by the ONS. Repairs contracts are often linked to BMIS factors, produced by RICS.

Rent Increases

Year	Social & Affordable Rents	Shared Ownership Rents
2021-22	1.50%	2.10%
2022-23	CPI + 1%	RPI + 1%
2023-24	CPI + 1%	RPI + 1%
2024-25	CPI + 1%	RPI + 1%
Thereafter	CPI + 0%	RPI + 1%

NB Affordable rents have a requirement to “rebase” the rent level in relation to current market rents when a property is re-let. However, in business planning terms, it is assumed that market rent income will rise in line with CPI.

Voids and Bad Debts

Year	Voids			Bad Debts		
	Social	Affordable	Temp Acc.	Social	Affordable	Temp Acc.
2020-21	0.40%	0.15%	10.00%	1.60%	0.65%	12.60%
2021-22	0.40%	0.20%	10.00%	2.00%	0.80%	13.00%
2022-23	0.40%	0.20%	9.00%	4.40%	4.20%	14.00%
2023-24	0.40%	0.20%	9.00%	3.40%	3.20%	13.00%
2024-25	0.40%	0.20%	9.00%	2.20%	3.20%	3.00%
Thereafter	0.40%	0.20%	9.00%	4.00%	3.20%	4.00%

Appendix 2 (continued)

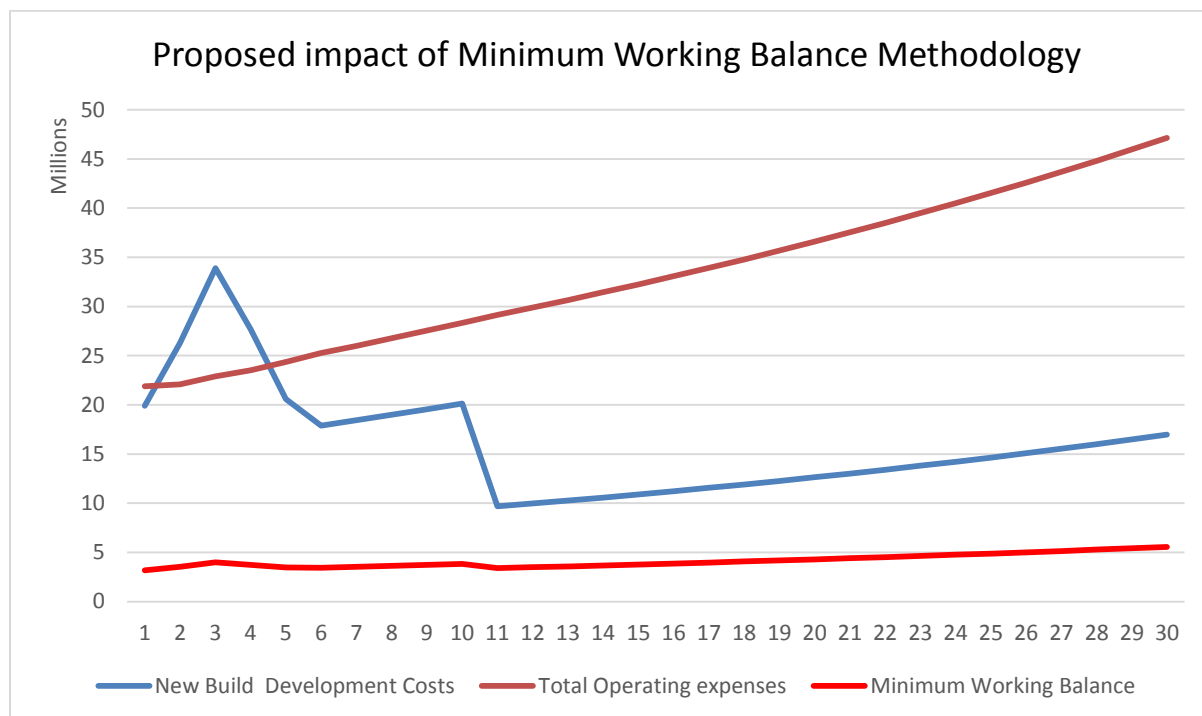
Right to Buy Sales

A review of the average number and value of RTB sales shows since the introduction of the reinvigorated RTB in 2012 that on average 22 sales have completed each year at a value in 2020-21 of £259k. The average discount that a tenant receives is currently £83,679, equivalent to 32% of the market value.

22 sales have been assumed for 2021-22 and all subsequent years.

HRA Working Balance

The minimum HRA working balance for 2020-21 has been reviewed in light of the challenging delivery and scale of investment required in new affordable housing with its inherent development/sales risks. It is now recommended that the minimum working balance should be set at 5% of the operating revenue expenditure and 10% of the annual new build programme. This will result in a minimum working balance shown below against the current budget for these two key activities. In 2021-22 this will be set at £3.5m.



Interest Rates and Borrowing

Internal

All internal transactions with the General Fund are determined by the Treasury Management Strategy approved by the Council and the statutory item 8Dr determination. All interest rates are variable and the current rates are set at 0% on both internal borrowings and credits in the HRA and reserves in light of the latest corporate guidance.

External

All current external borrowing was undertaken in March 2012 to fund the self-financing payment to DCLG. Loans outstanding were all for fixed terms and currently total £156.7m with interest rates ranging from 2.56% to 3.52% depending on the length of the loan. The current average cost of capital is 3.2%

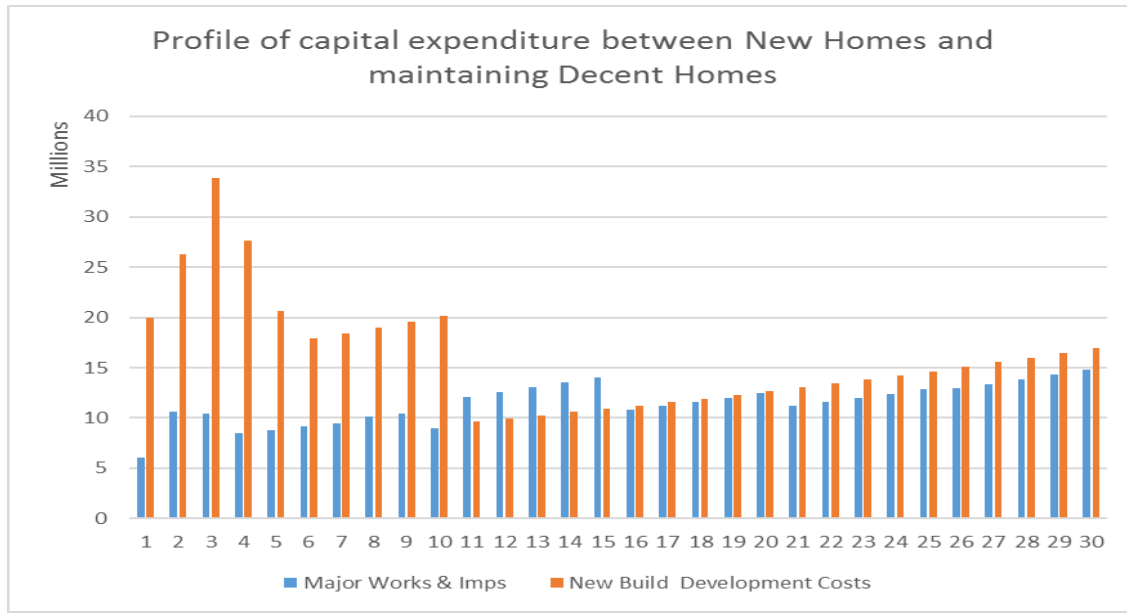
The latest business plan assumes that further external borrowing of £10m is undertaken in March 2021 at an interest rate of 1.8%. Thereafter the plan assumes that prudential borrowing is undertaken in order to finance capital expenditure, after the application of available RTB 1-4-1 funds, grants and Major Repairs Funding. The current HRA Capital Financing Requirement the (HRA CFR) increases over the life of the plan to £409.5m at year 30, an increase of £253m.

All current loans that expire during the plan are assumed to be refinanced. It is assumed that all new loans will bear an interest rate of 1.8% in the first 5 years and 3.5% thereafter. In the first 5 years £103m investment will be financed.

APPENDIX 3 CAPITAL INVESTMENT AND THE ASSET BASE

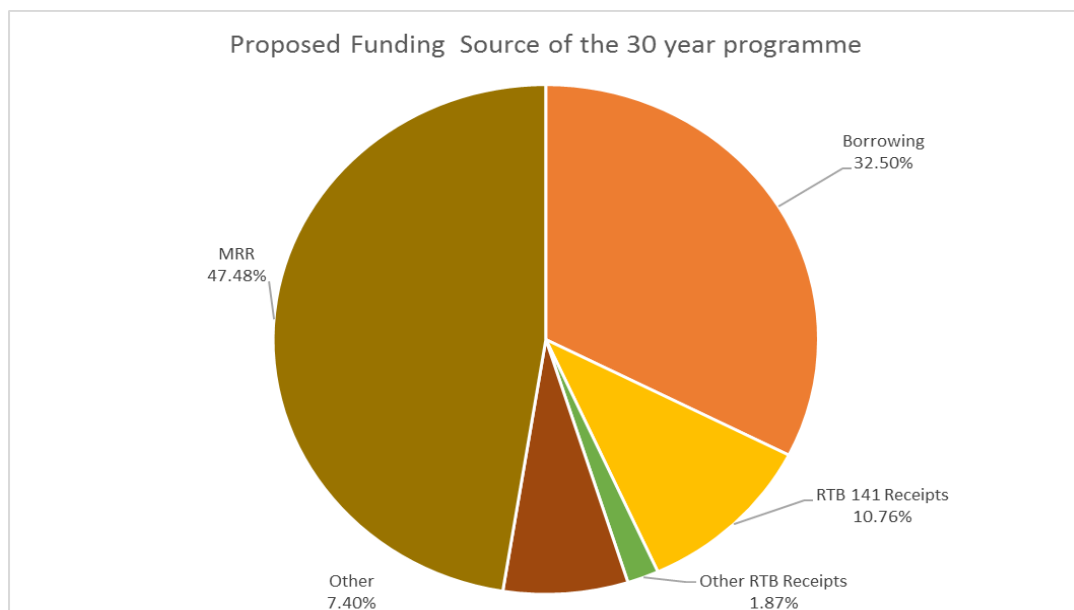
Capital Investment over the 30 year Plan

The Current plan allows for £345m of investment in maintaining Decent Homes standard+ which here includes investment in Climate change, estates improvement, disabled adaptations, sewage treatment works and Fire safety measures. At present the plan allows for £483m of new investment in affordable homes.

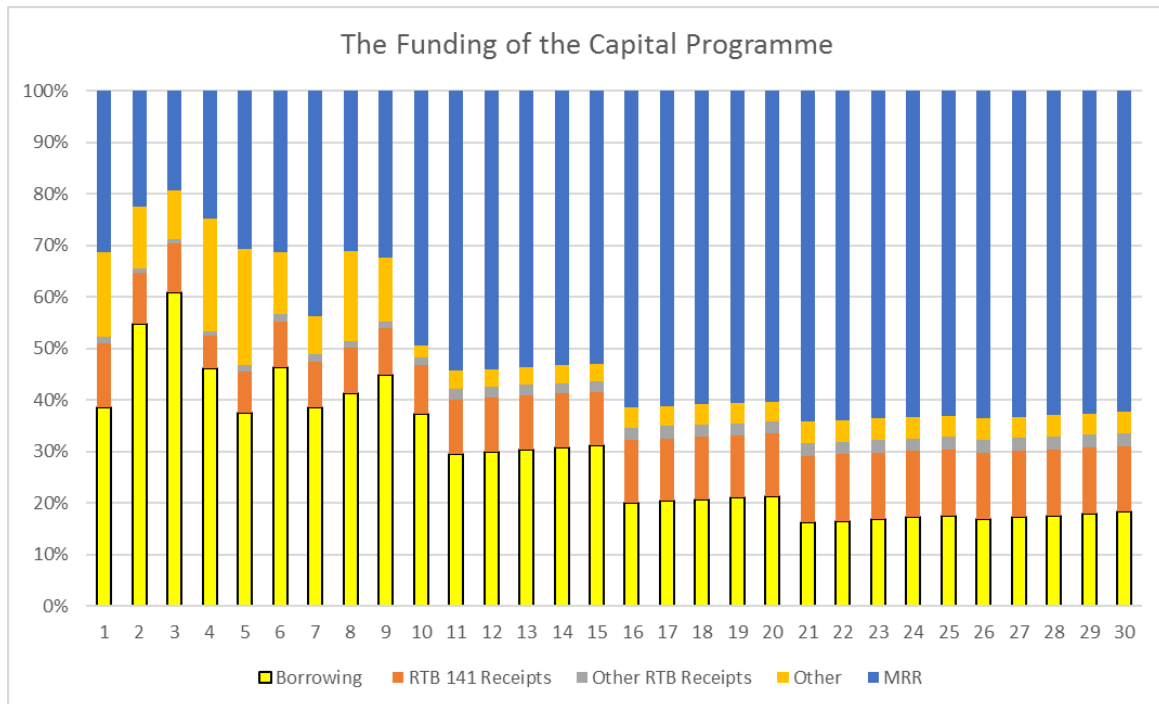


The funding of the Capital Programme

Based upon the funding strategy proposed the likely funding of the overall Capital Programme of £845m over the next 30 years is shown below.



The chart below shows the proposed funding profile by year over the 30 years.



APPENDIX 4 – The HRA OPERATING ACCOUNT 2020-21 to 2049-50

Winchester City Council
HRA Business Plan
Operating Account
(expressed in money terms)

Year	Year	Income			Expenditure					Net Operating (Expend) £,000
		Net rent Income £,000	Other income £,000	Total Income £,000	Managt. £,000	Depn £,000	Rev Repairs £,000	Total expenses £,000	Debt Financing Costs £,000	
1	2020.21	28,097	555	28,644	(9,848)	(8,193)	(4,237)	(22,278)	(5,239)	1,127
2	2021.22	28,475	565	29,029	(9,957)	(8,256)	(4,284)	(22,497)	(5,602)	930
3	2022.23	29,046	579	29,614	(10,206)	(8,678)	(4,418)	(23,302)	(6,194)	118
4	2023.24	30,728	593	31,310	(10,461)	(8,925)	(4,572)	(23,958)	(6,652)	699
5	2024.25	33,277	608	33,874	(10,722)	(9,361)	(4,741)	(24,824)	(6,917)	2,132
6	2025.26	33,921	623	34,532	(10,990)	(9,857)	(4,867)	(25,715)	(7,288)	1,530
7	2026.27	34,918	639	35,545	(11,265)	(10,187)	(4,996)	(26,449)	(7,748)	1,348
8	2027.28	35,957	655	36,599	(11,547)	(10,538)	(5,129)	(27,214)	(8,163)	1,221
9	2028.29	37,027	671	37,685	(11,835)	(10,903)	(5,266)	(28,004)	(8,630)	1,051
10	2029.30	38,126	688	38,801	(12,131)	(11,279)	(5,407)	(28,817)	(9,252)	732
11	2030.31	39,884	705	40,576	(12,435)	(11,667)	(5,535)	(29,636)	(9,562)	1,378
12	2031.32	40,037	723	40,746	(12,745)	(11,997)	(5,666)	(30,409)	(9,786)	551
13	2032.33	40,948	741	41,674	(13,064)	(12,337)	(5,800)	(31,201)	(10,024)	449
14	2033.34	41,862	759	42,606	(13,391)	(12,671)	(5,938)	(31,999)	(10,267)	340
15	2034.35	42,796	778	43,559	(13,725)	(13,014)	(6,079)	(32,818)	(10,524)	218
16	2035.36	44,593	798	45,376	(14,069)	(13,366)	(6,223)	(33,658)	(10,740)	977
17	2036.37	44,729	818	45,531	(14,420)	(13,728)	(6,371)	(34,520)	(10,802)	210
18	2037.38	45,728	838	46,551	(14,781)	(14,100)	(6,523)	(35,403)	(10,875)	272
19	2038.39	46,750	859	47,593	(15,150)	(14,481)	(6,678)	(36,310)	(11,038)	245
20	2039.40	47,796	881	48,659	(15,529)	(14,873)	(6,838)	(37,240)	(11,210)	209
21	2040.41	48,864	903	49,750	(15,917)	(15,275)	(7,001)	(38,194)	(11,361)	194
22	2041.42	50,918	925	51,825	(16,315)	(15,688)	(7,169)	(39,172)	(11,316)	1,337
23	2042.43	51,075	948	52,005	(16,723)	(16,113)	(7,341)	(40,176)	(11,277)	552
24	2043.44	52,218	972	53,171	(17,141)	(16,548)	(7,517)	(41,206)	(11,422)	544
25	2044.45	53,387	996	54,364	(17,570)	(16,996)	(7,697)	(42,263)	(11,575)	527
26	2045.46	54,583	1,021	55,584	(18,009)	(17,455)	(7,882)	(43,346)	(11,730)	508
27	2046.47	55,805	1,047	56,832	(18,459)	(17,927)	(8,072)	(44,458)	(11,713)	661
28	2047.48	58,153	1,073	59,205	(18,921)	(18,411)	(8,267)	(45,599)	(11,701)	1,905
29	2048.49	58,335	1,079	59,413	(19,394)	(18,908)	(8,467)	(46,769)	(11,878)	767
30	2049.50	59,643	1,106	60,748	(19,879)	(19,419)	(8,671)	(47,968)	(12,063)	716