Appendix 1

# EPPING FOREST DISTRICT COUNCIL - HRA FINANCIAL OPTIONS REVIEW – STAGE 1

**FEBRUARY 2017**

SD SMITH CONSULTANCY LTD

## CONTENTS

# 1. INTRODUCTION AND BACKGROUND

1.1 SD Smith Consultancy Ltd has been appointed to support the Council with regular updates of the HRA Business Plan for Epping Forest. This review is to identify options open to the Council as a way of moving forward, given that we have a little more certainty for 2017.18 in terms of Government Policy, following recent announcements and the publication of the Housing White Paper.

1.2 Following the Autumn Statement (November 2016), it was announced that the proposals for the introduction of a High Value Voids Levy have now been put back until 2018.19 at the earliest. There was also little reference to the Levy in the recently published Housing White Paper.

1.3 In addition the news that the 'Pay to Stay' initiative will no longer be introduced on a compulsory basis, in terms of HRA planning may result in right to buy applications declining on account of this.

1.4 The Council, based on financial modelling last October and concerns about extending or taking on additional borrowing, have placed a moratorium on the new build programme so that Phases 1 to 3 of the Council Housebuilding Programme and the acquisition of s106 properties at Barnfield are considered part of the current programme, with Phases 4 to 6 not progressing for the time being.

1.5 As part of this decision it has been necessary for the Council to start passing '1-4-1' right to buy receipts to the Government from September last year and into the foreseeable future as, due to the moratorium, there is an inability to spend them on additional affordable homes without a Housebuilding Programme.

1.6 Therefore in order to progress with investment decisions for the HRA moving forward the Council's Housing Portfolio Holder has taken the decision to split this further HRA Financial Options Review into two:

Stage 1: Based on what the Council knows now – to help members to make decisions on the future of the Council House Building Programme (Phases 4 to 6) and if they wish to reduce investment in the existing stock from the Council's Modern Homes Standard back to the Decent Homes Standard

Stage 2: If and when a decision is made with regards to the High Value Voids Levy – the implications will be then modelled to identify the required actions to mitigate the known financial impact at that time.

1.7 Therefore, this report covers the review of Stage 1 by analysing the HRA projections under four options by identifying the impact of:

Option 1 – Continuing with the full Housing Building Programme (at least until the completion of Phase 6) and with a Modern Homes Standard for existing Council homes (the Council's current policy)

Option 2 – Continuing with the full Housing Building Programme and reverting to the Decent Homes Standard for existing Council homes

Option 3 – Ceasing the current Housing Building Programme and maintaining a Modern Homes Standard for existing Council homes

Option 4 – Ceasing the current Housing Building Programme and reverting to the Decent Homes Standard for existing Council homes

1.8 The last review of the HRA Business Plan was in October 2016 which was modelled on the basis of delivering the Full House Building Programme (i.e. at least until Phase 6) and maintaining the Council's Modern Homes Standard for the existing stock.

1.9 In summary, that review identified that, based on the level of investment required for Option 1 above, there would be a shortfall of capital funding of £23.236million (£27.486million inflated) without extending existing, or taking on additional, borrowing. However, the review also identified that the HRA could afford to extend or increase its borrowing, with all existing and new loans paid within the 30-year period of the HRA Financial Plan.

Three alternative funding scenarios were modelled to mitigate this:

- Reprofile some of the capital expenditure from years 3 to 7 to years 8 to 13, so that each year could be fully funded; or
- Refinance the Council's first £31.8m loan due in year 7 and repay this in year 13, which then resulted in a shortfall of £0.257million which could be caught up in the following year; or
- Borrow a total of £28.724million over a period of 5 years with repayments scheduled in year 14

1.10 Prior to this a paper from us reviewing the financing of the Council House Building Programme identified risks in terms of meeting spend requirements in order to retain '1-4-1' right to buy receipts. At that stage, the Council therefore decided not to take up the grant funding from the HCA for Phase 2 and finance the development using '1-4-1' receipts instead, in order to avoid paying '1-4-1' receipts to the DCLG with interest that were derived from sales in early 2014.

1.11 In November 2016 the Council decided to place a moratorium on the new build programme for Phases 4 to 6 on account of concerns over the need to extend existing borrowing required to meet the programme and with a view to the greater uncertainty then around the introduction of the High Value Void Levy.

1.12 Therefore the Council's Cabinet concluded it prudent to pay over to the Government an element of receipts, £312,000 from the 2016.17 Quarter 1 right to buy sales and all of the £1,363,695 from Quarter 2 sales as, due to the moratorium, there was no certainty of the match spend required in the next three years and interest would have been payable at 4% above base rate if returned at a later date. Since then, a further £1,744,000 of 1-4-1 receipts have been paid to Government for Quarter 3, in line with the same Cabinet decision. Therefore, a total of around £3.4million has been paid to Government over the first three quarters of the current financial year.

<u>The Council's Modern Home Standard and the Decent Home Standard</u>

1.13 The options in this review refer to the national Decent Homes Standard and the Council's current own Modern Homes Standard. Therefore, it is important to explain the difference between the two standards.

1.14 The Decent Home Standard was introduced by the Government in 2000 to "ensure that all social housing meets standards of decency by 2010". For a home to meet the Decent Home Standard, it must meet the following criteria:

- It must provide a safe and healthy environment for any potential occupier or visitor;
- It must be in a reasonable state of repair, whereby either:
    - No <u>key</u> building components are old and, because of their condition, need replacing or major repairs: or
    - No more than one other building component is old and because of its condition needs replacing or major repair;
- It must have reasonable modern facilities and services, whereby it does not lack three or more of the following:
    - A reasonably modern kitchen (less than 20 years old)
    - A kitchen with adequate space and layout
    - A reasonably modern bathroom (30 years old or less)
    - An appropriately located bathroom and WC
    - Adequate insulation against external noise (where external noise is a problem)
    - Adequate size and layout of common areas for blocks of flats.
- It must provide a reasonable degree of thermal comfort, in terms of both effective insulation and efficient heating.

1.15 The Council met the Government's target to have 100% decent homes in 2010, and has continued to meet this target ever since. However, following the introduction of self-financing for the HRA in 2012, when significant additional financial resources became available to the HRA, the Council introduced its own Modern Home Standard. The Modern Home Standard is achieved through the Council planning its 30-Year Maintenance Programme to ensure that none of its housing stock has any building components that fail or lack any reasonable modern facilities or services. In reality, this is achieved by planning to renew building components based on shorter industry standard average life cycles, instead of extended life cycles.

1.16 The following table compares the planned life cycles under the Modern Homes Standard with the life cycles under the Decent Homes Standard

| | Decent Homes Standard Element Life-cycle (Years); | Modern Homes Standard Element Life-cycle (Years); |
|---|---|---|
| Flat roof covering | 20 | 16 |
| Pitched roof covering | 48 | 40 |
| Rewiring | 40 | 32 |
| Front entrance door replacement | 32 | 24 |
| PVCU window replacement | 40 | 24 |
| Heating and boiler replacement | 24 | 16 |
| Kitchen replacement | 28 | 16 |
| Balcony resurfacing | 40 | 40 |
| Door entry security | 20 | 16 |
| Bathroom replacement | 32 | 24 |
| Communal water tank replacement | 40 | 28 |
| Lift improvements | 24 | 24 |

## 2. THE CURRENT FINANCIAL STATUS

2.1 The financial modelling in this report is launched from 2015.16 to keep the analysis consistent with the previous reviews undertaken in the latter part of last year.

2.2 However, the modelling has been updated to take account of:

- The latest HRA and capital forecasts for 2016.17
- The proposed HRA and capital budgets for 2017.18
- The right to buy sales for Quarter 3 and revised estimates for the coming quarters
- The latest cash forecasts for Phases 1 to 3 and the s106 and market purchase acquisitions

2.3 The key changes between the 2017.18 position that was forecast in October and this review are:

- Rental Income is forecast to be lower on account of new build properties for Phases 1 and 2 not coming on stream as quickly as expected and the higher number of right to buys that have occurred/projected
- Management Costs are higher – but these increases are matched with reduced expenditure to the repairs account (as a result of past erroneous coding)
- Repairs Forecast Costs have been increased for voids and planned improvements

- Interest Charges are lower on account of reductions in the base rate, rather than increases that were previously modelled
- Interest Received is lower on account of percentage rates used for the calculations reducing from over 1% to 0.3% - based on latest performance and estimates

2.4 The latest cashflows for the Council House Build Programme have identified that, due to the slippage, there will be lower expenditure than anticipated by March 2017. As recently reported by officers to the Cabinet, this will result in a payment to Government of '1-4-1' receipts of an estimated £343,000 plus interest for Quarter 4 of 2016/17. We have analysed the '1-4-1' position for now and the future in the "Other Items" section below. It should be noted that if the full Council Housebuilding Programme were reinstated then this figure would reduce as some eligible expenditure has occurred on Phase 4 and would be allowable if this phase were to continue.

2.5 It is important to note that no assumptions have been made in terms of how much could be payable under the High Value Voids Levy and is therefore excluded from any of the following options analysis.

2.6 The Council Housebuilding Programme cash flow for all phases is continually being reviewed in terms of current build programmes but also those in a feasibility or planning stage. In terms of the latest forecasts and assumptions we have explained these in more detail within each of the options below.

## 3. FINANCIAL ANALYSIS – OPTION 1 - CONTINUING WITH THE FULL HOUSEBUILDING PROGRAMME AND WITH THE MODERN HOMES STANDARD FOR EXISTING COUNCIL HOMES (THE COUNCIL'S CURRENT POLICY)

3.1 This option delivers the highest number of affordable housing, whilst maintaining the existing stock at a good standard, higher than that prescribed by Government as a minimum but also ensures that the Council maximises the 1-4-1 receipts it has and will gain as a result of increased right to buy sales, without paying any to the government.

3.2 The investment levels remain as per the last review with some fine-tuning in respect of the capital expenditure predicted for 2016.17.

3.3 Along with the changes to the budget which affect the baseline position projected forward there have been some updates to the cashflow expenditure for Phases 4 to 6 as part of the full Council Housebuilding Programme which is currently held in moratorium.

3.4 The total expenditure from 2016.17 for Phases 4 to 6 amounted to a total £22.531million in the October 2016 Business Plan review.

3.5 The latest cashflow forecasts anticipate new build expenditure at £24.411million. This is an increase of £1.880million. There are a number of factors that explain the difference and are as follows:

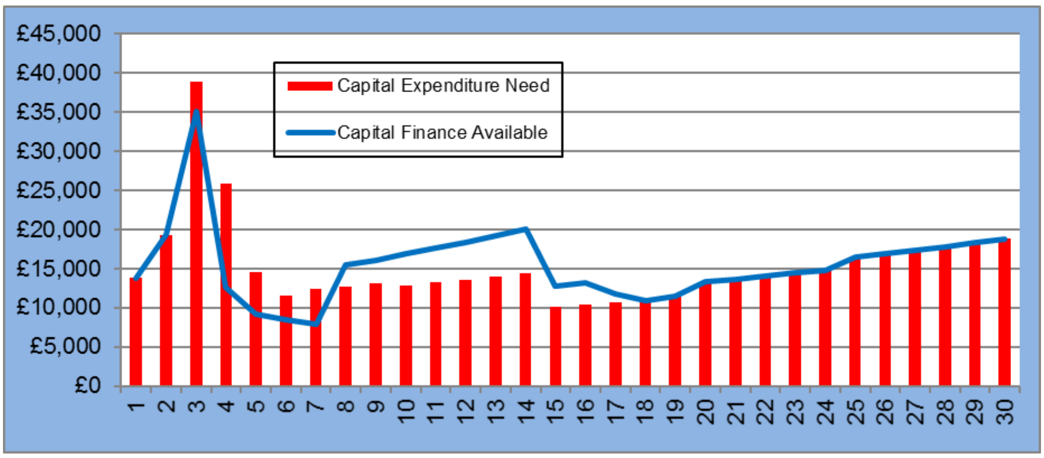
- Update on the required expenditure for Phases 4 to 5 based on latest feasibility studies, planning applications and benchmarked costs from the tenders for Phase 3
- With regards to Phase 6 there has been a revisit to the cash flow forecasts on the basis that some of the sites have not been successful with their planning applications, thus reducing the number of affordable units by a small margin.

3.6 As before we have assumed to assess the baseline position that;

- No additional borrowing is undertaken
- The £31.8million loan that matures in 2021.22 (year 7) is repaid through sufficient contributions made to the Self-Financing Reserve from 2018.19 onwards
- The HRA minimum balance remains at £2million
- The Council fully utilises the '1-4-1' receipts retained to date and projected in the future to use towards the full Council Housebuilding Programme, with the exception of a reduced return of receipts estimated at £0.159million (as expenditure incurred already on Phase 4 can be included). In addition, we have assumed recovery of receipts already paid to Government of £1.676million, which we understand may be possible up to June 2017 (provided Government does not re-allocate them), on account of having the relevant forecast expenditure needed. Also, the receipts from Q3 (December) 2016 totalling £1.744million will also not be paid to the Government on this basis.
- No S106 affordable housing financial contributions are used, although it should be noted that committed S106 receipts of around £3.5million are expected to be received over the next few years from signed 106 Agreements.

3.7 Given that the HRA must maintain its minimum balance and the debt portfolio remain as is it is the projected capital funding position that will dictate the shortfalls and this is demonstrated in the graph below

3.8 Capital Financing Position – Option 1 – Full CHP and Modern Standard £'000



3.9 The required capital expenditure inclusive of the new build expenditure is represented by the vertical red columns with the financing available shown by the horizontal blue line.

3.10 The key points are that in years 3 (2017.18) to 7 (2021.22) the capital expenditure is higher than the resources available to the HRA. From year 8 the resources are greater than programmed expenditure, so in effect the modelling is showing the 'catch-up' position. The capital shortfall over this period is £30.016million.

3.11 In order to mitigate this shortfall, if this option were selected by the Council, there are three possible ways to finance this:

3.11.1 Re-profile the Capital Expenditure

In order to ensure that the HRA remains viable the following reductions would have to be made from the proposed investment of stock (excluding inflation):

| | |
|---|---|
| 2017.18 | £3.864million |
| 2018.19 | £13.269million |
| 2019.20 | £5.382million |
| 2020.21 | £3.081million |
| 2021.22 | £4.420million |
| Total | £30.016million |

The 2018.19 reduction of £13.269million, would not be possible given that investment in stock for that year is estimated at £12.968million. Therefore, the required combined saving for 2018.19 and 2019.20 of £18.651million would have to be split more equally over these two years. However, Council officers have advised that to reduce stock investment by over £9million per annum for two years would be extremely difficult and would affect the continuity of works contracts, that could also incur penalties.

In the following ten years, the above expenditure could be added to the programmed expenditure to, in effect, reprofile the expenditure. The reductions would equate to approximately 47.4% of the original expenditure. Inflation is added where the expenditure occurs later in the plan, which equates to £6.097million cumulatively until the re-profiling is complete, resulting in a total £36.113million.

3.11.2 Refinance the £31.800million Loan Repayable in Year 7

The changes to new build expenditure and budgets used for a baseline to project forward mean that the HRA cannot fully finance its capital expenditure even with re-financing in year 7 and utilising the balances from the Self-Financing Reserve. We estimate that there would still be still be a capital shortfall of £2.412million or £2.529million inflated. This would then leave two options:

1. To reprofile the capital expenditure by reducing it in years 4 & 5 and increasing it in years 6 to 7 to compensate.
2. To borrow short-term in year 4 and repay the loan in year 7

In either instance the refinancing of the loan in year 7 would mean taking out a new 8-year loan for a slightly reduced value of £31.300million with repayment in 2031.32 (year 17) or a series of smaller loans repaying gradually over the same period.

3.11.3 Take out additional Short-Term Borrowing

We assessed that a total of £33.460million of loans could be taken out over years 3 to 7 and comfortably repaid by year 18. The amount borrowed is higher than the £29.299million due to the fact that interest needs to be applied of which we have applied a prudent rate of 3%.

The loan drawdowns would be as follows:

| **Drawdown** | **Amount** | **Repayment** |
|---|---|---|
| 2017.18 | £6.370m | 2027.28 |
| 2018.19 | £6.550m | 2029.30 |
| 2018.19 | £6.550m | 2032.33 |
| 2019.20 | £5.370m | 2028.29 |
| 2020.21 | £3.180m | 2023.24 |
| 2021.22 | £5.440m | 2025.26 |

3.12 Whatever the option financed the HRA's debt would then remain on course for repayment by year 27 with HRA balances increasing from year 17, which could be used to finance service improvements beyond that date as discussed in section 8.

Sub-Option 1a – Purchase of Affordable Units from the Pyrles Lane Nursery Development

3.13 In addition to Phases 4 to 6 there is the potential to purchase affordable units from the proposed Pyrles Lane Nursery site.

3.14 This sub-option assumes the purchase of 14 affordable units from the Council's selected developer at an assumed value of £175,000 per unit, with the ability to use '1-4-1' receipts (total £2.450million).

3.15 Using the same scenarios for ensuring funding for the scheme, the table below shows the impact of adding these properties to the Council Housebuilding Programme:

| | Base | With Pyrles Lane |
|---|---|---|
| Re-Profile of Capital Expenditure | Shortfall: £30.016m (£36.113m Inflated) | Shortfall: £31.554m (£38.073m Inflated) |
| Refinance Year 7 Loan of £31.8m | £31.300m – year 17 Capital S/F £2.412m | £32.640m – year 17 Capital S/F £3.511m |
| Short-Term Loan | £33.460m – year 18 | £35.030m – year 15 |

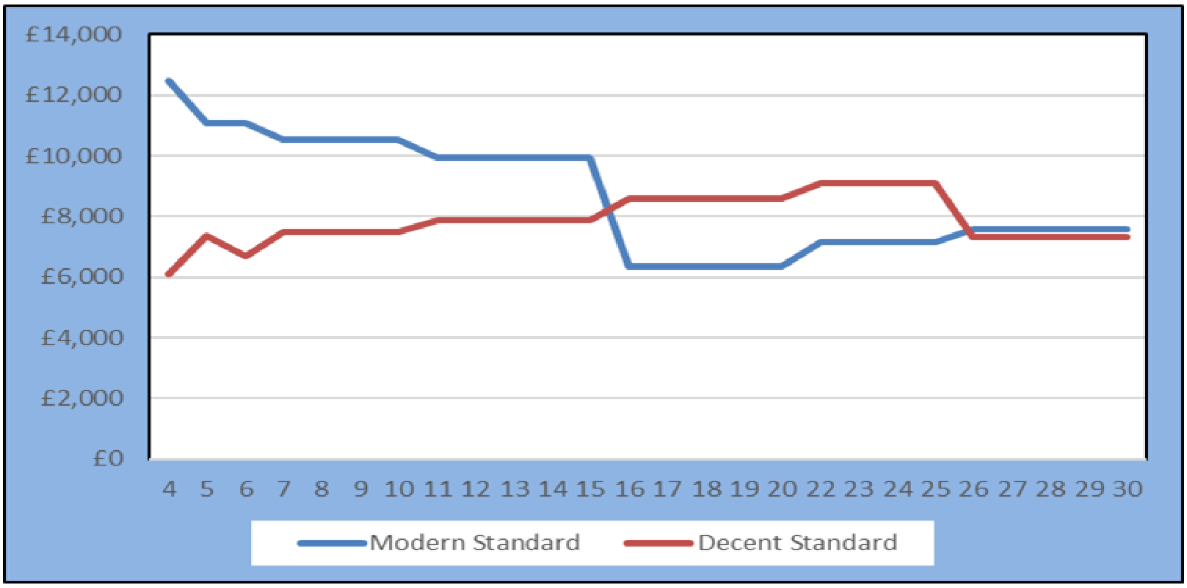
3.16 Given the additional net expenditure for the assumed purchase of the affordable units at Pyrles Lane, the capital shortfalls, or borrowing requirement extends. Whilst not demonstrated in the above table, the scheme would be 30% funded from available '1-4-1' receipts, saving a potential £0.735million being paid to Government.

## 4. FINANCIAL ANALYSIS – OPTION 2 - CONTINUING WITH THE FULL HOUSEBUILDING PROGRAMME AND REVERTING TO THE DECENT HOMES STANDARD FOR EXISTING COUNCIL HOMES

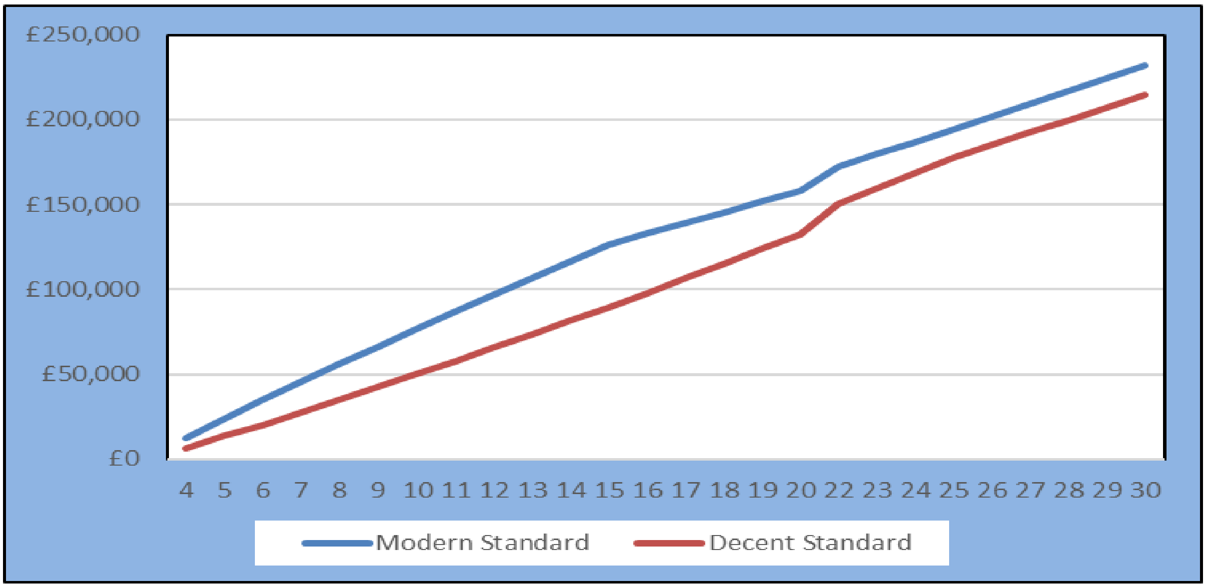
4.1 This option seeks to deliver the highest number of affordable housing on identified sites, but in order to assist funding the full Council Housebuilding Programme the level of investment on existing stock drops from the Modern Standard to the Government's minimum Decent Homes Standard.

4.2 The differences in the required levels of expenditure is shown in the graphs below:

The first graph shows the annual (uninflated) expenditure per year from year 4. The reader should note that, from year 7, the outputs from the stock condition database are produced in 5-year bands, hence the flat lines in expenditure for 5 year periods.



The following graph shows the **cumulative** expenditure for each of the two standards from year 4. In monetary terms (without inflation) the overall expenditure is £231.7million for the Modern Homes Standard, in comparison to £214.3million for the Decent Homes Standard, a difference of £17.4million over 27 years.

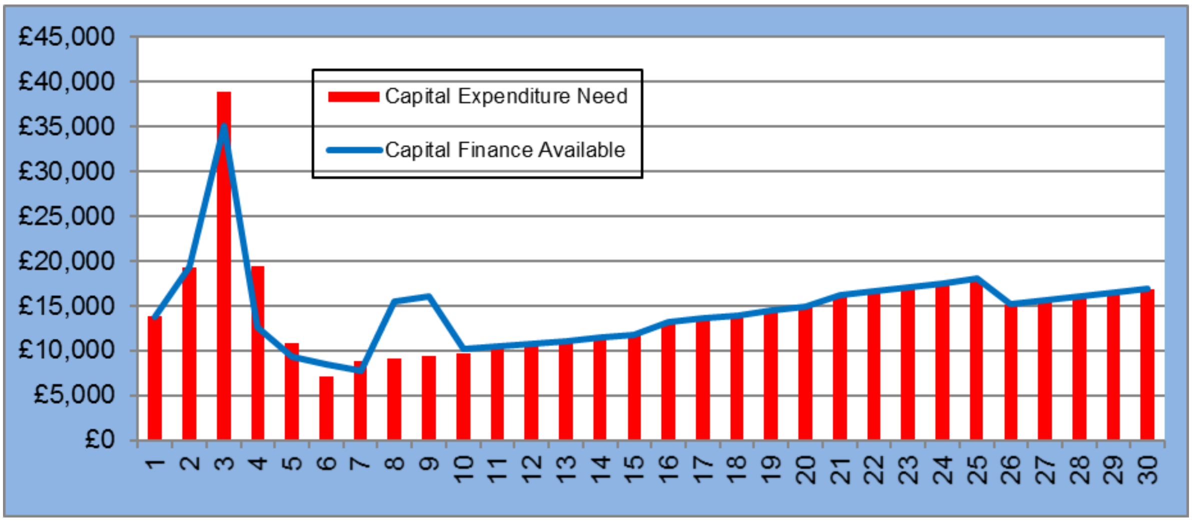



4.3 The key benefit for reducing to the Decent Homes Standard is in the reduction of required expenditure in the earlier years (i.e. years 4 to 15). All the other aspects in the capital programme for 2017.18 remains.

4.4 The main differences between the two standards are that major components such as kitchens, bathrooms, roofing and heating have their life-cycles extended. Therefore, items that would have been replaced in the early years are then replaced at a later stage.

4.5 The results of reducing the programme is demonstrated in the graph below

4.6 <u>Capital Financing Position – Option 2 – Full CHP and Decent Homes Standard £'000</u>



4.7 Although the reduction in investment expenditure is still insufficient in the early years to prevent a shortfall in capital funding, it is far less than for Option 1. The shortfalls occur between years 3 & 5 and amount to £12.213million.

4.8 Again to mitigate this shortfall, if this option were selected by the Council, there are three possible ways to finance this:

4.9.1 <u>Re-profile the Capital Expenditure</u>

In order to ensure that the HRA remains viable the following reductions would have to be made from the proposed investment of stock (excluding inflation):

| | |
|---|---|
| 2017.18 | £3.864million |
| 2018.19 | £6.836million |
| 2019.20 | £1.513million |
| Total | £12.213million |

The 2018.19 reduction of £6.836million, would only just be possible given that investment in stock for that year is estimated at £6.535million. Therefore, we suggest the required combined saving for 2018.19 and 2019.20 of £8.349million would have to be split more equally over these two years.

In the following five years, the above expenditure would be added to the programmed expenditure to in effect reprofile the expenditure. The reductions would equate to approximately 41.9% of the original expenditure. Inflation is added where the expenditure occurs later in the plan, which equates to £1.473million cumulatively until the re-profiling is complete, resulting in a total £13.686million. Again, this would cause issues with the current procurement of the capital programme.

However, in discussion with officers, it is clear that such a further significant reduction in expenditure would be unsustainable, after already reverting to the Decent Homes Standard, which is generally seen as the national basic minimum standard for social housing.

4.9.2 <u>Refinance the £31.8million Loan Repayable in Year 7</u>

With not contributing as much to the Self-Financing Reserve in the earlier years the HRA can sustain the level of expenditure. In year 7 though it would need to refinance £12.940million of the £31.800million loan repayment. In addition, we project that there would be a capital shortfall still of £0.659million that would either have to be financed (perhaps through S106 financial contributions that come to fruition) or expenditure reprofiled ahead of year 7 with an inflated cost of £0.683million.

We estimate that this refinanced loan of £12.940million could be repaid within just three years (2024.25), based again on an interest rate of 3%.

4.9.3 Take out additional Short-Term Borrowing

We assessed that a total of £12.330million of loans could be taken out over years 3 to 5 and comfortably repaid by year 10. Furthermore the £31.8million loan could not be fully repaid leaving £1.220million that would need to be refinanced resulting in a total net borrowing of £13.550million.

The loan drawdowns would be as follows:

| **Drawdown** | **Amount** | **Repayment** |
|---|---|---|
| 2017.18 | £3.870m | 2022.23 |
| 2018.19 | £6.830m | 2023.24 |
| 2019.20 | £1.630m | 2022.23 |
| 2021.22 | £1.220m | 2024.25 |

4.10 Again, the future HRA balances generated are assessed in section 8 in terms of the service improvements that can be generated. The projected HRA balances are shown in section 7.

Sub-Option 2a – Purchase of Affordable Units from the Pyrles Lane Nursery Development

4.11 This sub-option again assumes the purchase of 14 affordable units at an assumed value of £175,000 per unit, with the ability to use '1-4-1' receipts (total £2.450million).

4.12 Using the same scenarios for ensuring funding for the scheme the table below shows the impact of adding these properties to the Council Housebuilding Programme:

| | **Base** | **With Pyrles Lane** |
|---|---|---|
| Re-Profile of Capital Expenditure | Shortfall:<br>£12.213m<br>(£13.686m Inflated yr 10) | Shortfall:<br>£13.840m<br>(£15.545m Inflated yr 11) |
| Refinance Year 7 Loan of £31.8m | £12.940m – year 10<br>Capital S/F £0.659m | £14.360m – year 10<br>Capital S/F £0.647m |
| Short-Term Loan | £13.550m – year 10 | £15.180m – year 10 |

4.13 As before with sub-option 1a, the additional net expenditure for the assumed purchase of the affordable units at Pyrles Lane, the capital shortfalls, or borrowing requirement extends. Whilst not demonstrated in the above table, the scheme would be 30% funded from available '1-4-1' receipts, saving a potential £0.735million being paid to Government.

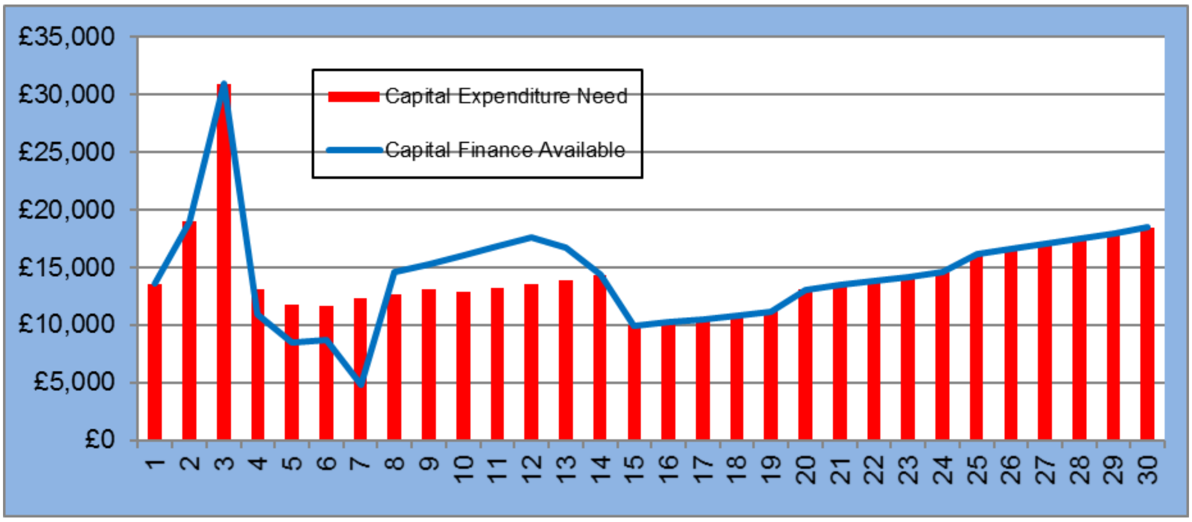
# 5. FINANCIAL ANALYSIS – OPTION 3 - CEASING THE CURRENT HOUSEBUILDING PROGRAMME AND MAINTAINING THE MODERN HOMES STANDARD FOR EXISTING COUNCIL HOMES

5.1 This option maintains stock investment in line with current plans but continues with the moratorium of no further Council Housebuilding Programme and short to medium term capital budgets.

5.2 We have maximised the use of '1-4-1' right to buy receipts, though it is inevitable that without the required levels of expenditure through the Housebuilding Programme these receipts will in future need to be paid to the Government. For clarity, we have shown in Section 7 a table that shows anticipated receipts and those that will need to be paid to the DCLG under both this and Option 4.

5.3 With the removal of £24.411million of expenditure on the full Council Housebuilding Programme the capital financing forecasts are as follows:

5.4 Capital Financing Position – Option 3 – Cease CHP and Modern Standard £'000




5.5 The graph demonstrates that despite the withdrawal of the full Council Housebuilding Programme there will still be a shortfall projected in years 4 to 7. This totals £15.918million and is higher than might have been expected based on the levels of expenditure withdrawn, but is mainly due to the ability to fully use the Council's '1-4-1' receipts.

5.6 As before, to mitigate this shortfall, if this option were selected by the Council, there are three possible ways to finance this:

5.7.1 Re-profile the Capital Expenditure

In order to ensure that the HRA remains viable the following reductions would have to be made from the proposed investment of stock (excluding inflation):

| | |
|---|---|
| 2018.19 | £2.178million |
| 2019.20 | £3.231million |
| 2020.21 | £2.935million |
| 2021.22 | £7.574million |
| Total | £15.918million |

In the following six years, the above expenditure would be added to the programmed expenditure to in effect reprofile the expenditure. The reductions would equate to approximately 32.8% of the original expenditure. Inflation is added where the expenditure occurs later in the plan, which equates to £1.989million cumulatively until the re-profiling is complete, resulting in a total £17.907million.

However, it should be noted that if this option was chosen and these reductions made, it would not be possible to maintain the full Modern Home Standard, since there would be insufficient funding.

5.7.2 Refinance the £31.8million Loan Repayable in Year 7

With not contributing as much to the Self-Financing Reserve in the earlier years the HRA can sustain the level of expenditure. In year 7 though it would need to refinance £16.810million of the £31.800million loan repayment.

We estimate that this new loan of £16.810million could be repaid within six years (2027.28), based again on an interest rate of 3%.

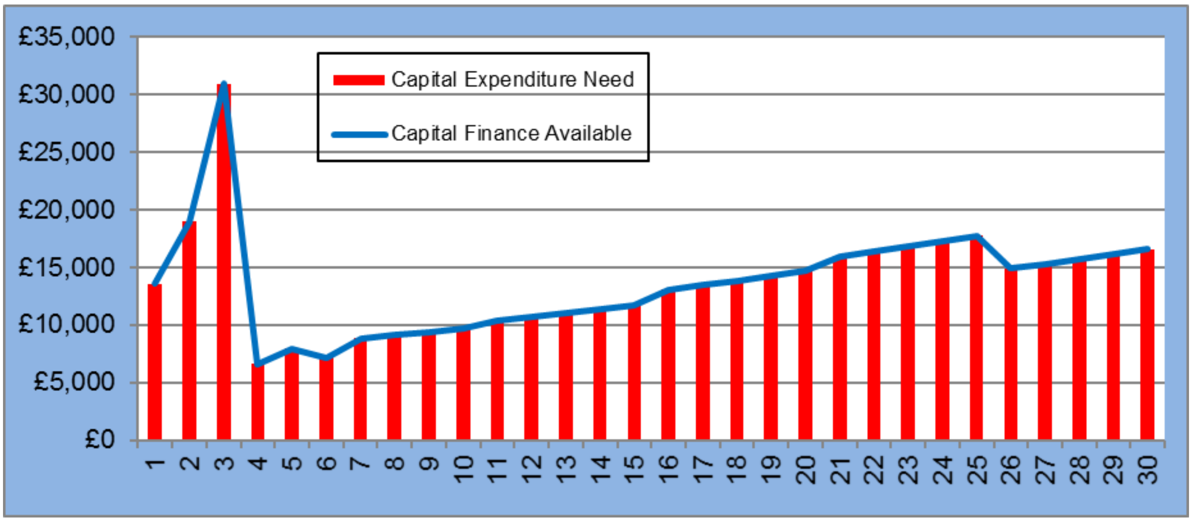
5.7.3 Take out additional Short-Term Borrowing

We assessed that by matching the contributions to the Self-Financing Reserve based on affordability there is no capital shortfall until year 7 which mirrors the above position of having to refinance the year 7 loan, albeit at a lower level.

## 6. FINANCIAL ANALYSIS – OPTION 4 – CEASING THE CURRENT HOUSEBUILDING PROGRAMME AND REVERTING TO THE DECENT HOMES STANDARD FOR EXISTING COUNCIL HOMES

6.1 Finally, this option will reduce both expenditure on the new build programme and the capital financing.

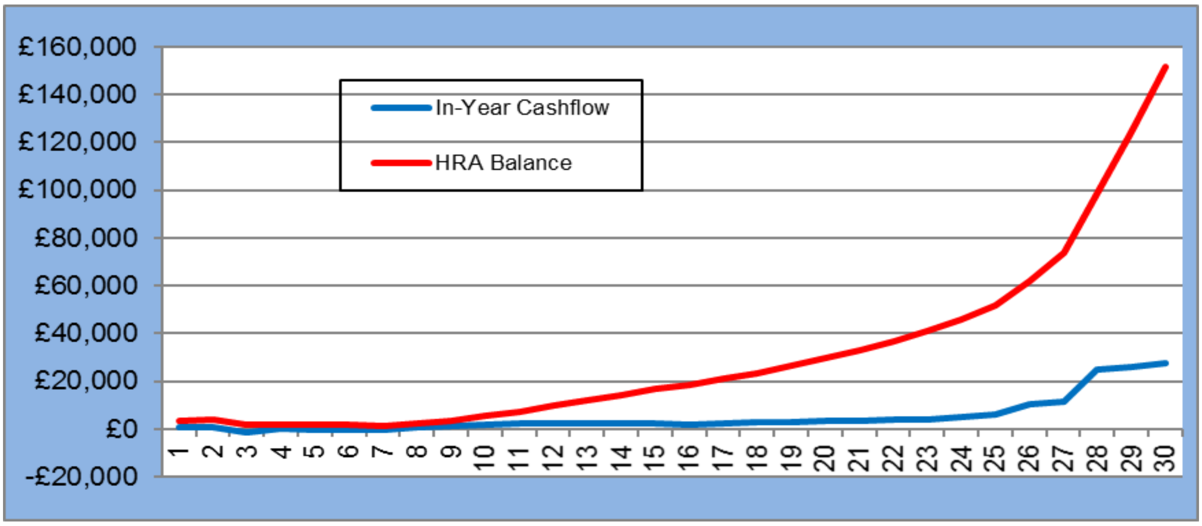
6.2 Capital Financing Position – Option 4 – Cease CHP and Modern Standard £'000




6.3 With this option there is no need for any additional borrowing, stock investment re-profiling or extending any loan repayment periods.

6.4 In fact projected HRA balances are demonstrated in the table below.

6.5 Projected HRA Balances – Option 4 – Current CHP and Modern Standard £'000




6.6 Again, this provides a very positive picture in that balances start building in the HRA from year 8 (2022.23) whilst sufficient provision is being made to repay all of the loans when they fall due, yet still resulting in HRA balances of around £150million in year 30.

6.7 The actual surpluses that this option creates is best demonstrated, in comparison with the other options, with projected HRA balances in section 7 and the service enhancements analysis in Section 8 below.

## 7. HRA BALANCES, SURPLUSES AND '1-4-1' RIGHT TO BUY RECEIPTS

'1-4-1' Receipts

7.1 As identified in this report the Council has already paid a total of £3.42million to the Government for the '1-4-1' receipts retained for Quarters 1 - 3 of this financial year. This was to avoid interest charges on account of not being able to spend the required 1-4-1 receipts within three years of the receipt occurring, due to the current moratorium on the Council House Building Programme and the possibility of Phases 4 to 6 not continuing.

7.2 The table below shows a conservative estimate of the predicted '1-4-1' receipts that could be available over the next few years, based on a weighted average of past values and anticipated sales. It then goes on to show the projected receipts that would have to be paid to the Government under the Options 1 and 2 (maintaining the current Council House Build Programme) and Options 2 and 3 (ceasing the Council House Building Programme). It also shows the position for Options 1a and 2a (the purchase of the S106 affordable units at the Pyrles Lane Nursery development).

| Quarter | No of Sales | '1-4-1' Receipts | Receipts Returned Options 1 & 2 Maintain CHP | Receipts Returned Options 3 & 4 Cease CHP | Receipts Returned Options 1a & 2a Maintain CHP |
|---|---|---|---|---|---|
| 2016.17 1-3 | 37 | £3.897m | £- | £3.420m | £- |
| 2016.17 – 4 | 9 | £0.615m | £- | £0.443m | £- |
| 2017.18 – 1 | 7 | £0.452m | £- | £0.379m | £- |
| 2017.18 – 2 | 8 | £0.547m | £- | £0.547m | £- |
| 2017.18 – 3 | 8 | £0.548m | £- | £0.548m | £- |
| 2017.18 – 4 | 7 | £0.454m | £- | £0.454m | £- |
| 2018.19 – 1 | 7 | £0.475m | £- | £0.475m | £- |
| 2018.19 – 2 | 8 | £0.578m | £- | £0.578m | £- |
| 2018.19 – 3 | 8 | £0.580m | £- | £0.580m | £- |
| 2018.19 – 4 | 7 | £0.483m | £0.348m | £0.483m | £0.096m |
| 2019.20 – 1 | 4 | £0.197m | £0.483m | £0.197m | £0.483m |
| 2019.20 – 2 | 4 | £0.205m | £0.205m | £0.205m | £0.205m |
| 2019.20 – 3 | 3 | £0.102m | £0.102m | £0.102m | £0.102m |
| 2019.20 – 4 | 3 | £0.103m | £0.103m | £0.103m | £0.103m |
| 2020.21 – 1 | 3 | £0.107m | £0.107m | £0.107m | £0.107m |
| 2020.21 – 2 | 3 | £0.114m | £0.114m | £0.114m | £0.114m |
| 2020.21 – 3 | 3 | £0.115m | £0.115m | £0.115m | £0.115m |
| 2020.21 – 4 | 3 | £0.115m | £0.115m | £0.115m | £0.115m |
| 2021.22 – 1 | 3 | £0.121m | £0.121m | £0.121m | £0.121m |
| 2021.22 – 2 | 3 | £0.127m | £0.127m | £0.127m | £0.127m |
| 2021.22 – 3 | 2 | £- | £- | £- | £- |
| 2021.22 – 4 | 2 | £- | £- | £- | £- |

| | | | | | |
|---|---|---|---|---|---|
| **TOTAL (6 years)** | **142** | **£9.935m** | **£2.137m** | **£9.213m** | **£1.688m** |

7.3 As can be seen, if the Council Housebuilding Programme is ceased (Options 3 or 4), between £7.076million and £7.525million will have to be paid to Government over a 6-year period, depending on the option chosen. As the receipts will have been paid after each quarter's return there will be no interest payable.

7.4 The sale number estimates are prudent, and there is a possibility that there will be a higher number of sales than estimated in the modelling. If this does materialise, then if the full Council Housebuilding Programme continues it is likely that less '1-4-1' receipts would need to be financed by loan or re-profiling of the stock investment programme, or a greater value of receipts would have to be paid to Government.

7.5 We estimate that if the current Council Housebuilding Programme moratorium continues, potentially only £0.722million of the future estimated £9.935million of '1-4-1' receipts could be utilised on Phases 1 to 3, with £9.213million having to be paid to Government. Conversely, the option of added Pyrles Lane to the current Council Housebuilding Programme results in the least amount of receipts being paid to Government.

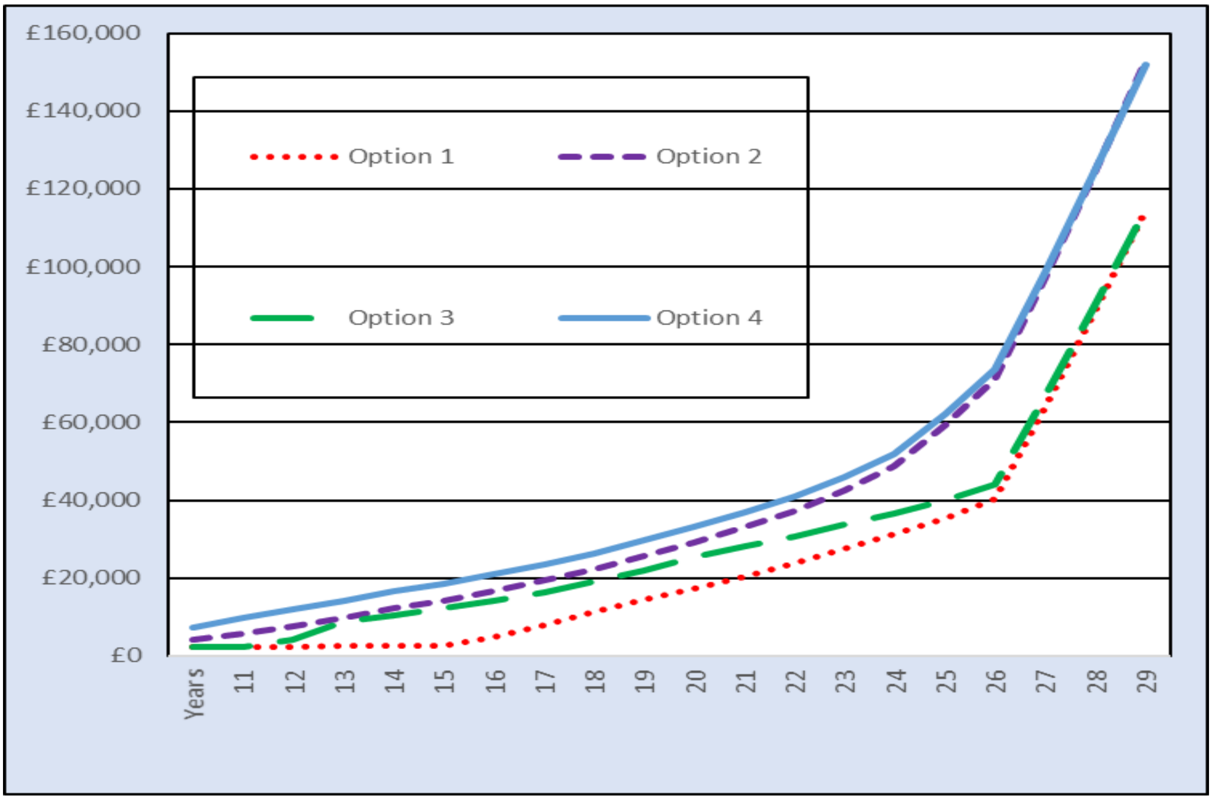
7.6 Officers have pursued various options to minimise the payment of 1-4-1 receipts to Government, which include investigating the provision of grants to housing associations funded by '1-4-1' receipts, instead of HCA grant but to date none have been able to progress.

<u>HRA Balances and Surpluses</u>

7.7 For all of the options the financial position improves once the £31.8million loan (refinanced or not) is repaid.

7.8 The following graph demonstrates the forecast HRA balances for each of the four main options.

7.9 Projected HRA Balances For All Four Options




7.10 For the above graph we have assumed the funding solution for shortfalls to be the one where capital expenditure is deferred by re-profiling rather than additional borrowing and the graph excludes the use of any service enhancements.

7.11 Options 2 & 4 (with the reversion to the Decent Homes Standard) have the greatest surpluses on account of the reduced investment in the stock.

7.12 What is most notable is that Options 1 & 3 have similar levels of HRA balances, as do Options 2 & 4, which demonstrates that over the period of the Plan, irrespective of whether or not the Decent Home or Modern Home Standard is adopted, if the Housebuilding Programme continues, the additional properties' net rental income (and the use of '1-4-1' receipts) pay for their construction over this period, resulting in the provision of additional affordable Council homes without any detrimental effect on the HRA.

7.13 In reality, it is likely that the balances over the set minimum balance of £2million (inflated) in later years can either be used to repay some of the HRA loans early or to identify potential service enhancements as referred to in Section 8 below.

# 8. OTHER ISSUES

Use of s106 Contributions

8.1 To date the Council Housing Programme has been part-funded with s106 contributions. To date there has been £2.326million used to fund the Council House Building Programme with an additional £0.510million budgeted in 2016.17. Currently there are no contributions modelled for 2017.18 and beyond in all options.

8.2 However, there is a potential £3.496million of further contributions that will be received through signed S106 Agreements over the next couple of years, when the developments reach specified trigger points, including two developments currently on site with required S106 contributions totalling in excess of £1.14million. In addition, based on past experience, it is likely that further S106 Agreements will be signed in the future requiring additional financial contributions for affordable housing in lieu of on-site provision. However, it is not possible to predict when this will happen and the amounts involved.

8.3 There is the potential to use such receipts to contribute to the funding of Phase 3 of the Council House Building Programme given that there is a net funding requirement of £4.586million after the application of '1-4-1' receipts.

8.4 Without a Council House Building Programme beyond Phase 3 the Council would have difficulty using these receipts should there be no affordable homes programme to put towards, although the Council could possibly purchase a smaller number of affordable rented homes on other S106 sites, in the same way as for Barnfield, Roydon, but 30% funded from 141 receipts and 70% funded from S106 financial contributions.

Service Improvements

8.5 In the October 2016 Business Plan Review it was identified that, subject to one of the options for funding the capital shortfalls being used, a total of £80million of service enhancements could be introduced from year 11 to 30.

8.6 With all of the options referred to in this report, the modelling demonstrates that the HRA is more than viable, with surpluses being generated generally from year 12 and earlier in Options 2 and 4.

8.7 The table below shows the potential funding for service improvements that can be provided, with the values exclusive of inflation, for each of the four options in five year periods over the life of the plan. The modelling ensures that the HRA maintains its minimum balance and that sufficient contributions are made to the Self-Financing Reserve in order to repay the loans taken out in March 2012.

8.8 Table of potential service enhancements for each option, without inflation

| £m | Option 1 Modern Std Maintain CHP | Option 2 Decent Std Maintain CHP | Option 3 Modern Std Cease CHP | Option 4 Decent Std Cease CHP |
|---|---|---|---|---|
| **Years 1-5** | £- | £- | £- | £- |
| **Years 6-10** | £- | £0.600m | £- | £4.075m |
| **Years 11-15** | £- | £6.325m | £5.900m | £6.125m |
| **Years 16-20** | £7.150m | £7.675m | £7.200m | £7.200m |
| **Years 21-25** | £8.450m | £11.150m | £5.850m | £10.375m |
| **Years 26-30** | £38.900m | £48.225m | £36.225m | £46.125m |
| **TOTAL** | **£54.500m** | **£73.975m** | **£55.175m** | **£73.900m** |

8.9 We have assumed the funding solution for shortfalls to be the one where capital expenditure is deferred by re-profiling rather than additional borrowing.

8.10 As identified in Section 7, Options 2 & 4 have the greatest surpluses available to finance service enhancements due to the lower spend requirements for the Decent Home Standard over the course of the Plan period. In addition, Options 1 & 3 allows for similar levels of service enhancement respectively. As explained in Section 7, this is due to the ongoing use of significant 1-4-1 receipts and the net additional rents collected from the additional Council homes over the period of the Plan.

<u>Alternative approach for Options 3 and 4</u>

8.12 If the Council decides to cease its Housebuilding Programme under Options 3 or 4, the main sub-option available for the Council to deal with the housebuilding sites that have received planning permission would be to sell the sites on the open market, with planning permission, with the Council receiving capital receipts totalling an estimated £8.165million. Under the pooling arrangements either 100% of the capital receipts can be retained, provided that they are used for affordable housing purposes (perhaps to purchase completed affordable rented homes from developers for S106 sites) or 50% (£4.083million) can be retained to be used for any other Council purpose, with the remaining 50% (£4.082million) having to be paid to the Government under the capital receipts pooling arrangements.

8.13 It would be possible to retain a greater percentage of the receipts if used for General Fund purposes if it could be proved that it was for “regeneration purposes” and accounting for it through a ‘Capital Allowance’ account.

8.14 We were commissioned separately by the Council to advise on the feasibility of a local housing company being established, and our report will be formally reported to the Council Housebuilding Cabinet Committee in due course, but the initial view is that this would not be an appropriate way forward for the Council.

<u>DCLG Housing White Paper – Fixing our Broken Market</u>

8.15 The Government has recently published its white paper on the future supply of housing. In the main the paper focuses on the thrust to quickly deliver homes where there is land and need which focuses on Council's planning departments and local plans.

8.16 There is no new or additional methods announced for local authorities to do the actual build, nor registered providers other the HCA funding programme. However, a 'delivery' test will be put in place to ensure local authorities will build within expectations with the threat of intervention. Therefore, any additional homes built will count within this test.

8.17 The only reference to the Government's policy to require local authorities to sell their higher value void properties, in order to fund a levy paid to Government, is that further consideration of this policy will wait until after the latest Government pilot schemes for giving housing association tenants the Right to Buy has been completed.

## 9. SUMMARY POSITION

9.1 In order to summarise the position the table below identifies the key facts for each of the options.

| | **Option 1 Modern Std Maintain CHP** | **Option 2 Decent Std Maintain CHP** | **Option 3 Modern Std Cease CHP** | **Option 4 Decent Std Cease CHP** |
|---|---|---|---|---|
| Number of Additional New Affordable Homes | 105 | 105 | - | - |
| Capital Investment in Existing Stock 5 Years (2018-2023) | £55.705m | £35.094m | £55.705m | £35.094m |
| Capital Expenditure Shortfall Projected | £30.016m<br><br>£31.554m (a) | £12.213m<br><br>£13.840m (a) | £15.918m | £- |
| If Capital Expenditure Reprofiled – the inflated cost and year of 'catch up' | £36.113m<br>Yr 17<br><br>£38.073m (a)<br>Yr 17 | £13.686m<br>Yr 10<br><br>£15.545m<br>Yr 11 | £17.907m<br>Yr 13 | N/A |
| If Short-Term Borrowing is Needed for Capital Shortfall instead – Amount & Year of Repayment | £33.460m<br>Yr 18<br><br>£35.030m (a)<br>Yr 18 | £13.550m<br>Yr 10<br><br>£15.180m (a)<br>Yr 10 | As Below | N/A |

| | | | | |
|---|---|---|---|---|
| If £31.8million due to be repaid in Year 7 is refinanced – What needs to be re-financed, what year could it be repaid and what additional borrowing would be required | £31.300m<br>Yr 17<br><br>£32.640m (a)<br>Yr17<br><br>£2.412m<br>£3.511m (a) | £12.940m<br>Yr 10<br><br>£14.360m (a)<br>Yr 10<br><br>£0.659m<br>£0.647m (a) | £16.810m<br>Yr 13<br><br>N/A | N/A |
| '1-4-1' Receipts paid to Government | £2.137m<br>£1.688m (a) | £2.137m<br>£1.688m (a) | £9.213m | £9.213m |
| Level of Service Enhancements Possible in later years | £54.500m | £73.975m | £55.175m | £73.900m |

9.2 The key considerations are that by re-implementing the full Council Housebuilding Programme the HRA will have greater resources in the longer-term and it prevents an estimated net £7.076million of receipts being paid to Government. However, whichever level of capital investment is chosen moving forward, there will be a short-term borrowing requirement of either £13.550million or £33.460million repayable over 7 to 15 years.

9.3 The reduction of investment from Modern to Decent Homes carries financial advantages, although this could be offset by increasing of revenue repairs or risk tenant dissatisfaction.

9.4 The re-profiling of the Modern Home Standard to meet available resources could be considered similar to that of the Decent Homes Standard, but the cost of doing so will be in inflated prices when the programme is delivered in later years. The cost of borrowing instead would be very similar to prevent any re-profiling.

9.5 If the Council wishes to avoid any additional or extension of existing borrowing, Option 4 with the decent home standard and the cessation of the Council Housebuilding Programme is the only solution. The disadvantages of this would be that an estimated £9.213million of receipts would have to be paid to the Government. The only upside could be that such reductions will generate surpluses into the mid-term of the plan, which are identified as service enhancements, which could be used to enhance slightly the Decent Homes Standard at that time.

## 10. APPENDIX – KEY FINANCIAL ASSUMPTIONS

1. All rents decreasing by 1% for 4 years commencing 2016.17
2. Rents increasing by CPI plus 1% after this period
3. 7% of tenancies (on a reducing balance) moving to formula rent
4. Void levels 0.9% throughout
5. Bad Debts Provision to match budgets then increase to 1% then reduce to 0.75%
6. Right to Buy levels at 30 per year for the next two years then gradually reduce
7. Un-pooled Right to Buy Receipt (up to Government cap) utilised by General Fund
8. 30% of the Assumed Debt element of receipt used to fund new homes
9. Service Charge income increasing by RPI only
10. Non Dwelling Rents (Garages) increasing by RPI only
11. Norway House Rents increasing by RPI only
12. Contributions from the General Fund (for service) increasing by RPI only
13. Management Costs increasing by RPI only
14. Repair Costs increasing by RPI only (after Repairs Fund adjustments)
15. Capital Improvement Costs increasing by RPI plus 0.25% from year 6
16. Base rate for variable interest calculations increasing from 0.5% to 2.0% by year 5