APPENDIX B

Strategic financial direction for housing (30 year HRA Business Plan)

INTRODUCTION

1. This appendix to the main housing strategy report is concentrated on the HRA capital and revenue position in both the short and longer term. The HRA Business Plan financial model is the one instrument that combines both the capital and revenue projections and the links between them for the HRA. This appendix provides the financial context to the main housing strategy and allows a rounded informed direction of travel for the housing service.

2. It is recognised that there are areas outside the HRA which contribute and are part of the development of the housing strategy such as homelessness or the relationship with housing associations but this appendix solely considers the HRA financial position.

3. The strategic aim of the council is to provide a financially sustainable business plan which helps deliver affordable quality homes whilst at the same time maintaining the existing stock to a good standard. This may involve a change in the way the stock is managed and maintained and there may be a move towards alternative forms of funding, whether that is private sale to help cross-subsidise social rented stock, or other forms of tenure such as intermediate rents for key workers to provide additional rent income. The HRA business plan is key to help develop any change in strategy.

BACKGROUND INFORMATION

The 30 Year HRA Business Plan

4. In 2012/13 a new financial system came into operation called self-financing, which changed the way in which the HRA was funded. The government's aim at that time was to give councils more certainty and responsibility with regard to the landlord account. This was achieved through a redistribution of historical local authority housing debt between authorities and the removal of the HRA subsidy system. A self-financing valuation of each local housing authority's council housing stock was calculated using a discounted cashflow model. The assumptions used were based on the rental income and expenditure required to maintain each council's housing stock over 30 years. The calculated valuation was compared to the notional housing debt held by each authority.

5. Where the self-financing valuation for a local housing authority was greater than the notional debt then the authority had to pay to the government the amount by which the self-financing valuation exceeded the notional debt. There were 136 authorities that had to make a payment to the government compared with 33 authorities that received payments from the government. For LB Southwark the notional debt was higher than the self-financing

valuation and so the government made a payment to LB Southwark which reduced the council's borrowing from £774m to £577m (payment received of £197m).

6. The introduction of HRA self-financing was supposed to herald a more certain future for local authorities giving them more responsibility and to give them greater flexibility over their accounts. It was intended that authorities would also use self-financing as the opportunity to determine priorities with a more strategic longer-term view rather than on a year-to-year basis. This new approach as well as giving more responsibility to authorities also ensured that there was more risk for them. Spend and income for both capital and revenue had to be projected for in future years, treasury management and repayment of debt had to be accounted for, and the viability of the HRA had to be ensured.

7. At LB Southwark the key tool for ensuring a viable longer-term strategic approach is the 30 year HRA business plan; a sophisticated Excel spreadsheet model which is prepared and maintained by the Strategic Business Planning unit within Resident Services. The model incorporates both revenue and capital spend and income within the HRA over the short, medium and longer-term. For reporting purposes there is a base business plan which incorporates up-to-date realistic assumptions. Alternative scenarios are then used to test the robustness of the plan when set against possible future changes in assumptions.

8. All financial assumptions contained within the plan have been agreed by the Business Planning project group which comprises of officers from Resident Services, Asset Management, Finance & Regeneration.

9. The impact of Covid-19 has been severe and wide raging. The number of deaths in the UK related to the coronavirus has passed 42,500 and this is both sad and distressing. The wider implications of the virus have impacted on the movement of people during lockdown, which in turn has caused a severe economic downturn. Less commuters/travel has brought economic trouble for most sectors of the economy as varied as the hospitality, clothing, airline and sporting sectors.

10. There is also a knock-on impact on the council both in terms of service delivery and the financial consequences arising from the virus. A community hub has been set up and frequent contact with vulnerable tenants and residents has been a significant use of resources amongst other council initiatives. There will be areas where spend has increased (e.g. housing the homeless) but other areas where spend has decreased (e.g. repairs and new build spend). 2020/21 will mean budgets and spend have to be carefully monitored to gauge the financial impact of coronavirus which will help inform the 2021/22 budget process. It is uncertain what government financial support will be given to compensate councils or what the budget settlement will be for the next financial year

HRA Base Business Plan – Key General Assumptions

11. Rental Income. The average rent for all stock within the budget report is £101.57. This level of rent generates approximately £200m of gross rent to the HRA. Rent is the biggest income driver within the business plan and so future projections have a significant impact on the business plan. The total rent income within the business plan may vary from the 2020/21 HRA budget because the business plan will be based on more up-to-date stock figures when compared to the budget-setting. Future increases are at CPI +1% for first 5 years, then CPI only thereafter.

12. In February 2019 the MHCLG issued guidance to the Regulator of Social Housing (RSH) to consult on the Rent Standard. This is primarily the mechanism by which LAs are compelled to increase/decrease their rents (in this case CPI+1% from 2020/21 for 5 years). Therefore, in line with the standard, the business plan includes rent increases at CPI+1% for 5 years from 2020/21. Thereafter the base business plan increases rents by CPI only.

13. The Rent Standard also excluded certain accommodation from its requirements, including properties rented out for intermediate rent to key workers, permissible from April 2020. This is a potential opportunity for the council to allocate some of the new build tenancies to key workers at intermediate rent levels. This flexibility would generate additional income to cross-subsidise the new build programme and also provide affordable housing to key workers.

14. Voids & Bad Debts. Voids cost is the loss of rental income from empty properties. There will be different rates for different types of property, such as general needs (1.8%) and temporary accommodation (8.7%). Bad debts are included within the business plan at 10% in 2020/21 due to the impact of Covid-19 and have necessitated careful monitoring of the financial position.

15. Other Income. Other income includes tenant service charges (£15m), leaseholder recharges (£11m), garage rents (£6m), commercial rents (£8m), and leaseholder service charges (£20m).

16. Right-to-Buy (RTB). The RTB scheme was amended in 2012 to increase the maximum discount to £75,000. This was further amended in 2013 by increasing the maximum discount to £100,000 for London boroughs and also reducing the qualifying period for RTB from five to three years. The changes resulted in a spike in RTB sales; in 2012/13 there were 94 sales compared with 24 in 2011/12. Sales peaked at 304 in 2014/15 but have since declined (there were 79 sales in 2018/19). This decline is probably due to three main factors

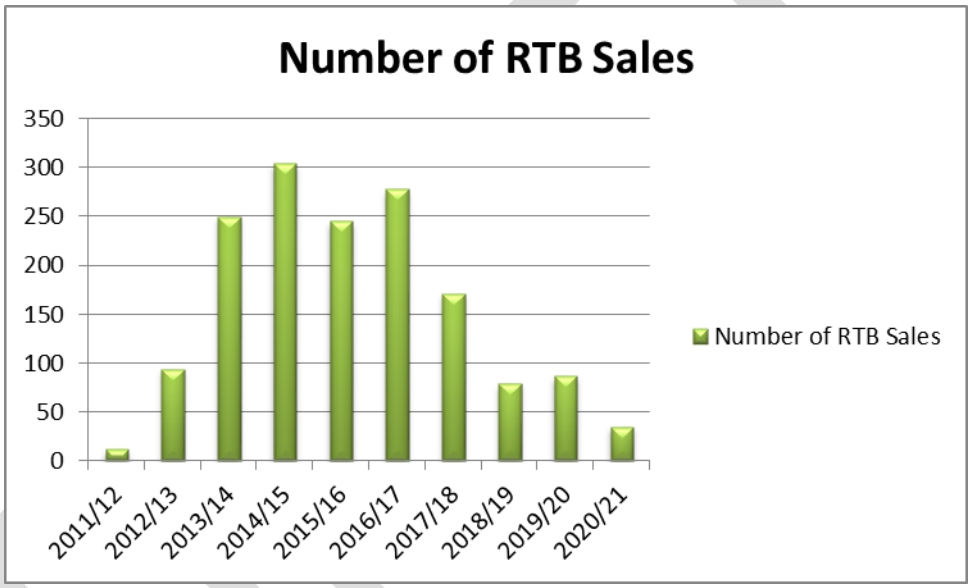
    - Most of the tenants who want to buy their property will probably have already exercised that option
    - High valuations are outstripping the increase in discounts making

RTB less affordable for many

- More stringent checks on fraudulent activity during the application process

17. There have been 1,500 RTB sales from 2012 to date. This equates to a significant loss of rental income to the HRA. The sales have generated capital receipts to fund new build development but restrictions in their use hinders flexibility e.g. 1-4-1 RTB receipts cannot be used in combination with GLA grant to fund a new unit.

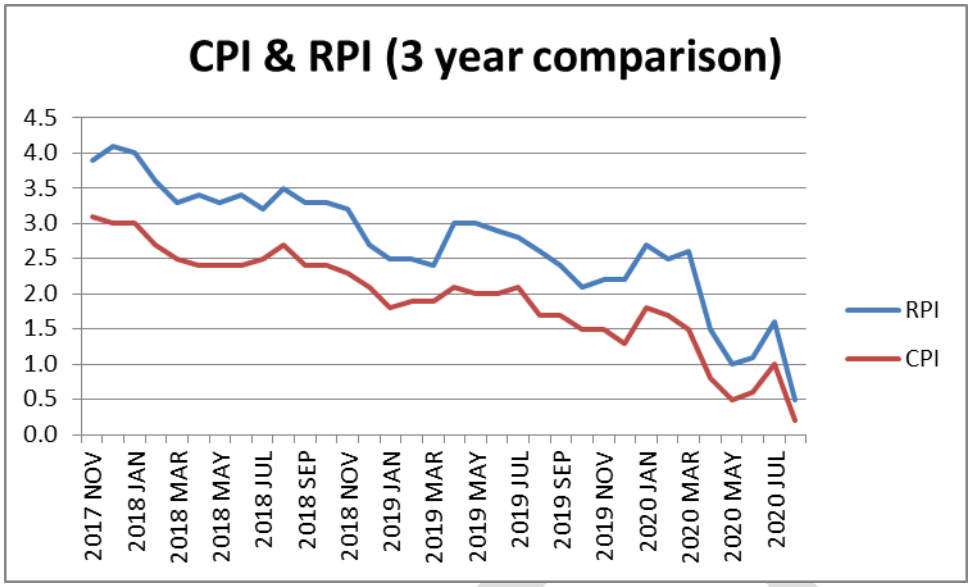
18. The profile of RTB sales since 2011 is shown in the table below and highlights the big jump in sales after the increase in the maximum discount in 2012:



19. Within the business plan it is assumed that RTB sales will be 40 in 2020/21 and will total 60 thereafter.

20. Inflation. The two rates of inflation contained within the business plan are Consumer Price Index (CPI) and the Retail Price Index (RPI). CPI is included as the rate by which future rents are set and the RPI is the rate by which other income and expenditure is projected forward within the business plan.

21. The recent inflation rates for both indices are shown in the graph below:



22. The revised assumption is that CPI is adjusted to 1.5% in 2021/22, and 2% in 2022/23 and thereafter. Differential with RPI is now 0.5% based on latest figures.

23. Management Costs. Management and service costs are set within the business plan at the budgeted amount as included within the HRA (for 2020/21 it is £89.3m). There are savings of 10% assumed in 2021/22.

24. Depreciation. Depreciation was introduced into the HRA accounts in 2012 with the implementation of self-financing. Depreciation is the decline in the value of an asset over time due to wear and tear. The charge reflects componentisation deterioration in both the housing stock and other housing assets. It is a charge to the revenue account but there is also a corresponding credit to the Major Repairs Reserve to fund capital spend on the existing stock. Depreciation within the business plan matches the HRA budget and is approximately £50m.

25. Treasury Management. As at 31st March 2020 the HRA had £393m of external loans ranging in interest rates from 1.18% to a high of 9%.

26. All the loans within the HRA are funded from the Public Works Loan Board (PWLB) as rates have been traditionally low. However, in a letter sent on 9th October, HM Treasury told local authorities that it had raised the margin above the price of government borrowing for the PWLB by 100bps for all new loans, setting it at 180bps over gilts, with immediate effect. For 50 year fixed maturity loans this increased the rate from 1.81% on the 8th October to 2.82% on the following day. However, this increase has now been reversed for new build borrowing and is incorporated within the business plan projections.

27. The PWLB interest rate used for new borrowing within the business plan is 2.1% (current PWLB actual rate is 2.54% before the 1% social housing new build discount is applied)

28. Minimum HRA Working Balance. To be prudent the HRA must maintain a minimum level of working balances. The 2020/21 HRA budget report states that balances as at 31st March 2020 stood at £23m although approximately three-quarters are earmarked for specific purposes. The business plan assumes that the minimum level of balances included is £15m.

Delivery of New Homes

29. LB Southwark's mission is to "provide a fairer future for all by creating 11,000 new high quality council homes and provide affordable housing that addresses the deficit in truly affordable housing being delivered in the private sector". The aim is to create 2,500 new council homes by 2022 and build 11,000 new council homes by 2043.

30. The council is not able to deliver this scale of new homes by itself but instead will coordinate a growing range of delivery mechanisms and partners to achieve its ambitious build programme. These may include; the council direct delivery on estates or other council owned land or assembling land through purchasing for the delivery of new homes. The council will also create strategic partnerships to enable the delivery of new homes as well as employing a range of agreements and ventures to enable delivery through the private, public and third party community organisations.

31. Delivery of the new build programme and the funding required for the 11,000 new build properties by 2043 can be modelled through the 30 year Housing Revenue Account (HRA) business plan.

32. To achieve delivery there are three distinct tranches which have been modelled within the plan:
    - Tranche 1 - model 5,000 units through direct delivery (estimated capacity) which is assumed achievable with available land
    - Tranche 2 - model acquisition of land (considers acquiring land either from the general fund or the private sector to build on)
    - Tranche 3 - model purchase & acquisition (considers acquiring additional units)

33. The above tranches are for illustrative effect only. In reality, the delivery of the new build programme will be dynamic and ever-changing to reflect the key delivery influences at that time. However, the above profile does allow the plan to gauge the relative affordability of both the new build programme and the required spend on the current stock.

Carbon Neutrality

34. In April 2019 the council reinforced its commitment to combatting carbon emissions and rising global temperatures, by joining the international Climate Change Campaign and declaring a Climate Change Emergency. The council has been working to reduce its emissions for some time, cutting them by 37 per cent since 2010. Moving forward, it will join forces with all

key stakeholders within the borough, to try to achieve carbon neutrality by 2030.

Asset Management – Existing Stock

35. Southwark's housing stock includes some poorly designed and built housing that is expensive to repair and costly to maintain. Challenges linked to the decision-making process regarding estate regeneration versus estate refurbishment have to be considered alongside the ramifications for the council arising from the Grenfell Tower tragedy. There is also a need to respond to the climate emergency and the council carbon reduction commitments, both of which have emerged as key drivers for change since the original 2016 Asset Management Strategy.

36. Previous HRA business plans have assumed a budget of £70m towards maintaining the housing stock. This is based on the total funding of Revenue Contribution to Capital Outlay (RCCO) and the amount of depreciation charged to the revenue account. The Asset Management team estimate that this budgetary provision has to increase to £110m per annum until 2025/26 to deliver its full QHIP commitment. This increased provision is included within the base business plan projections.

Heat Networks Strategy

37. In 2019, cabinet approved the development of a comprehensive District Heating Strategy, which highlighted the strategic direction the council wanted to take to heat its homes. Heat provided is to be reliable, affordable and sustainable, including through renewable and low carbon heating systems and the probable expansion of the SELCHP network.

38. The new strategy will require major investment and the council will have to look outside of its normal investment and operating structures. Due to the cost unknowns at this stage no costs or funding relating to the heating strategy are included within the base plan (illustrative costs will be included within a sensitivity test).

Fire Safety

39. The Grenfell fire disaster has had a major impact on the council in terms of workload and potential cost implications.

40. The Grenfell Tower fire occurred on 14 June at the 24-storey Grenfell Tower block of social housing flats in RB Kensington and Chelsea. Since which, the safety of all flat blocks, and especially those held for social housing, are being re-evaluated and checked. LB Southwark owns 174 flat blocks of 7 floors or over and all have being reassessed for safety by the council's fire safety team. There are 322 blocks at 6+ storeys. The new Building Safety Bill that is working its way through parliament classes buildings of high risk. The council has 369 that will potentially be in scope.

41. Additionally, the blocks at Ledbury were deemed an immediate fire risk until remedial work was actioned and this has necessitated a 24 hour staff presence with a significant revenue cost.

42. After the Lakanal fire, the council began an ongoing programme to ensure all its properties received a regular full fire risk assessment, beginning with those deemed to be high risk. Since 2009 the council has spent £62 million on its fire risk assessment programme and associated fire safety works for all its council housing in the borough.

43. The council undertook a further fundamental review of our approach to fire safety following the Grenfell fire, strengthening polices and procedures, making all of our fire risk assessments publicly available and investing further in fire safety work.

44. There are a number of recommendations which arose out of phase 1 of the Grenfell Inquiry which the council already have in place, including improved signage in high rise buildings.

45. There are also recommendations that if implemented will require considerable investment from the council. For example, rolling out premises information boxes to the whole stock. Another recommendation is that "checks at not less than three-monthly intervals to ensure that all fire doors are fitted with effective self-closing devices in working order". Southwark has more than 100,000 fire doors in the blocks, which would mean inspecting more than 33,000 doors per month requiring considerable staff investment.

46. As there is no certainty on what the requirements will be for the council arising from the Inquiry recommendations no costs have been included within the base business plan (indicative costs will be included in a sensitivity to the base plan).

Capital Resources

47. Key capital resources for funding the overall capital programme is described below:

48. Borrowing. In recent years borrowing has been the resource that is used by the council only when no other capital funding is available. The debt cap was abolished in October 2018 and the responsibility and risk for additional borrowing is now with the local authority. Current HRA debt held is £462m

49. Borrowing needs to be shown to be affordable in the medium to longer-term, and the business plan can inform these investment decisions. If an artificial debt cap of £1.5bn is agreed, then the impact on interest costs is shown in the table below:

Year	Debt (£m)	Capital Charges (£m)	Capital Charges/ Net Rental Income (%)
2020/21	462	25	12.5%
2021/22	564	27	12.3%
2022/23	788	33	14.6%
2023/24	1,155	38	16.2%
2024/25	1,361	41	16.3%
2025/26	1,500	42	16.5%

50. RTB Receipts. Sales are included at 40 for 2020/21 and 60 going forward. Sales will be carefully monitored and Covid-19 and the economic outlook may reduce the available resources from RTB in the future.

51. Grant. GLA grant is only included where it has been confirmed as allocated. Obviously, any future grant not yet determined or allocated would improve the financial outlook for the council.

52. S106 Resources. These are included at £10m per annum but it is uncertain at what level these resources will be achieved going forward.

53. RCCO. RCCO is included at levels which are affordable within the revenue account.

Government Policy

54. The implementation of self-financing to the HRA in April 2012 was intended to give more autonomy to landlord local authorities to let them retain the rental income so that strategic decisions could be made with regard to local circumstances and needs.

55. However, there were a number of changes implemented by government subsequent to self financing that have impacted on the council's business plan. For example, the self financing settlement was predicated on a 2016/17 convergence date. In May 2014 the government issued the publication "Guidance on Rents for Social Housing" which stated that from 2015/16 social housing rents were to increase by CPI+1% rather than increasing as per the rent restructuring guidance. This significantly reduced projected income for the majority of authorities where convergence had not been reached including Southwark.

56. The Welfare Reform & Work Act 2016 required social housing landlords to reduce rents by 1% a year for four years from April 2016. This policy equates to a loss in rental income to the HRA when compared with the previous rental assumption of CPI+1% of £820m over the thirty years of the HRA business plan.

57. There has been a significant loss of rental income since April 2012 arising from the change in RTB policy and the increased discounts for tenants. There have been 1,499 RTB sales in the borough from 2012/13 to 2019/20

since the revised RTB apportionment rules were introduced.

58. However, recent changes in approach have indicated that government policy has taken a more favourable approach to social housing:

- Pay to stay and the higher voids levy were abandoned as policy
- Social housing rents were allowed to increase by CPI+1% for at least 5 years
- The borrowing debt cap for local authorities was abolished on 29th October 2018
- GLA grant of £100k per unit for London Affordable Rent properties

Business Plan Projections

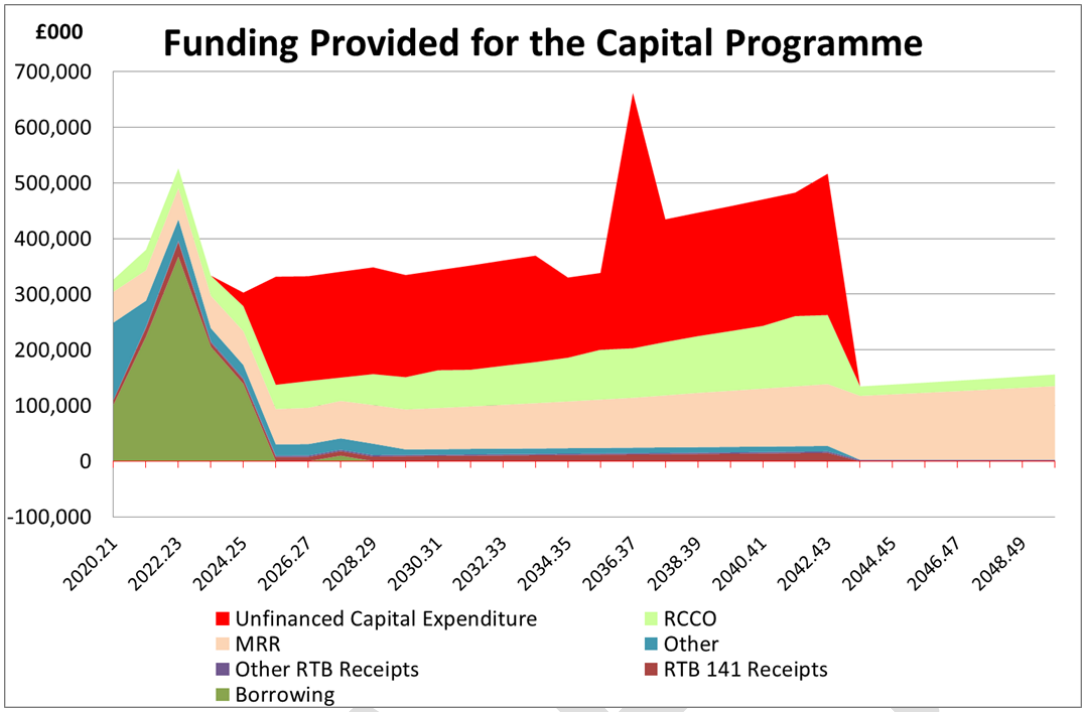
59. The business plan projects that with a £1.5bn debt cap the proposed current capital programme is affordable until 2024/25 and can fund approximately 3,000 new build properties (does not include those already delivered)

60. If the debt cap were increased to £1.8bn then the programme would be affordable until 2025/26 and would deliver an additional 600 properties (revenue interest charges would peak at £45m in this scenario)

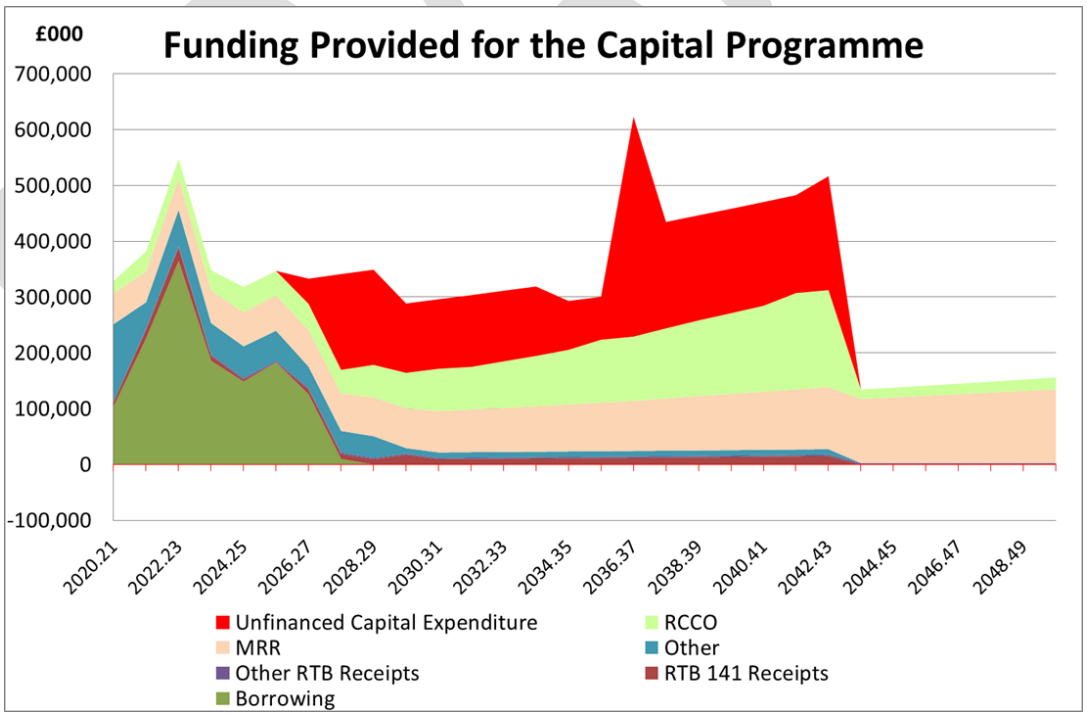
61. The council commitment to start on site or deliver 2,500 new build properties is financially viable

62. The borrowing levels to fund the HRA capital programme need to be determined with reference to the business plan but also the council's own prudential borrowing indicators (e.g. debt as a % of rental income)

63. The graph below indicates the funding required to meet the new build and overall capital requirements but the red block shows the as yet unfunded element of the capital programme:



64. The financial position could be improved if there was additional grant, the council cross-subsidised through private sales, and increased the imposed debt cap to £1.8bn as illustrated in the graph below:



65. The impact that Covid-19 has had on society has been devastating, and the financial implications are part of that overall impact The business plan has to monitor and reflect the financial impact of this virus and this includes:

- Rent arrears and bad debts, reduced income
- Inflation – what if CPI stays low and therefore rental income is reduced, yet other costs increase, such as build cost inflation

- Management arrangements – the virus has changed the way that Resident Services deliver the service; going forward there may be an increased emphasis on those residents deemed vulnerable
- General economic situation – impact on tenants, local businesses etc. Local and macro-economic uncertainty going forward

66. The business plan can be continually reviewed as new information becomes available to provide robust projections for future strategic decisions