

1. Introduction

- 1.1.1 This note has been prepared by Housing Finance Associates, using information supplied by council officers. It presents an updated set of 30 year baseline projections for the authority's HRA, incorporating revised budgets and assumptions. It also provides further information on potential actions available to the authority to help manage its position over the long term.
- 1.1.2 The projections summarise expenditure, investment, capital financing and borrowing in respect of council housing over a 30 year period, starting in 2023/24. The baseline position reflects the authority's best available data and assumptions and allows for inflationary pressures impact on budgets and programmes. It also assumes that rent policy on the part of the government will allow for rents to increase by CPI+1% in April 2024, which is consistent with its current stated position. The government plans to consult separately on rent increases from 2025/26 this Autumn. While we await this consultation the projections make the prudent assumption that rents will continue to rise by CPI from 2025/26.
- 1.1.3 Our projections confirm the deterioration in the authority's long-term position that we projected in January 2023. This is consistent with the pattern we are seeing at other local authorities and has been caused by a combination of:
- High levels of inflation. This has particularly impacted on building costs, which have risen by more than the high rates of general inflation
 - Inclusion in the projected capital programme of significant levels of additional investment in decarbonisation works. These add £113.000m (plus inflation) to the investment requirement over 30 years
 - The government imposed a 7% cap on rent increases for existing tenants in 2023/24, which was less than would have been permitted if it had continued with its previously stated policy (CPI +1%). This meant that rents increased by less than the authority's costs in 2023/24, placing additional pressure on HRA balances
 - Expectations for the interest rates chargeable on new borrowing have increased
- 1.1.4 We recommend that the authority reviews the risks facing its HRA regularly, with a view to identifying the effects of emerging situations at an early stage, testing its response and taking appropriate action to eliminate or mitigate the risk.

2. Baseline projections

2.1. Baseline assumptions

- 2.1.1 The baseline assumptions reflect the revised 2023/24 revenue forecast and medium-term projections for capital and revenue prepared by council officers. These update the approved budgets that were reported in the annual budget-setting report for 2023/24. Other information and assumptions we have used in preparing this baseline projection include:

- Budgets and the capital programme have been adjusted to allow for the following emerging cost pressures:
 - Decarbonisation expectations have been brought in line with emerging national expectations and allow for a net additional cost of £26,316 per dwelling by 2050
 - Revenue costs of £100,000 pa for responding to social housing regulatory requirements
 - Additional costs of £50,000 pa for key employees to gain social housing qualifications, plus associated implications for pay
 - Costs of £50k pa for 2024/25 and 2025/26 to help the authority to find solutions that relieve cost pressures on the HRA
 - A rolling programme of five year stock condition surveys, costing £40,000 pa
- Data from the 2022/23 right to buy pooling return that the authority submits to DLUHC
- We have assumed that the authority sells 20 homes a year under the right to buy
- The authority aims to maintain a minimum HRA balance of £0.500m
- Any sums generated by the HRA that are in excess of the minimum balance are made available to pay for the capital programme or to repay debt
- The rents paid by existing tenants increase at the maximum rate currently permitted by the rent standard. Under current stated government policy an increase of CPI +1% has been applied for 2024/25. Rents then rise by CPI from 2025/26.
- Formula rents are charged when a new dwelling is let or an existing property is re-let. We have assumed that formula rents increase at the same rate as the rents paid by existing tenants.
- In 2023/24 the authority re-lets 6.12% of its social rent stock (263 units in 2023/24) at formula rent, with future relets in the same proportion.
- Depreciation costs have been estimated in line with the authority's budget, uplifted for inflation at CPI.
- Inflation has been applied as follows:
 - Underlying CPI has been assumed at 6.7% for 2024/25 (based on actual CPI for September 2023) and 2.5% for 2025/26 (reflecting the expected rate in the final quarter of the previous year from projections prepared by the Bank of England and published in the August 2023 monetary policy report).
 - From 2026/27 onwards we have assumed CPI runs at the long-term government target of 2% pa.
 - RPI was 8.9% for 2024/25 (based on the September 2023 rate) and tracks at CPI +1% from 2025/26
 - Building costs increase by 1% more than RPI in 2024/25 and 2025/26, then continue to increase at RPI. This has been applied to costs for repairs and maintenance, major works, decarbonisation and the development of new units.
 - Other revenue and capital costs have been inflated by CPI.
- Repairs costs and elements of the major works and component replacement programme are treated as variable or semi-variable. These costs flex to reflect increases and reductions in the housing stock.
- The projections assume an interest rate of 4.9% is charged on new external loans in 2023/24, dropping to 4.3% from 2024/25 to 2026/27, then to 3.8% from 2027/28 onwards.

2.1.2 In preparing these projections we have assumed that the HRA would attempt to repay any additional external borrowing that it undertakes as quickly as possible. Our reason for

making this assumption is that it gives a clearer indication of how well the HRA can service and repay any borrowing that is required to deliver its long-term capital programme. Any actual borrowing undertaken by the authority would be subject to the prevailing market conditions and guidance received from the authority's treasury advisors.

2.2. Gaps in the data and potential risks

2.2.1 the authority's assessment of the decarbonisation works required to its existing stock continues to evolve. For this exercise we have used data supplied by officers, modified to reflect emerging intelligence from other authorities. This produces a net cost per unit of £26,316 and a programme that ends in 2049/50. We recommend that the authority continues to update its assumptions for decarbonisation works as its own stock-related data and specific investment requirement evolves.

2.2.2 Other key risks include:

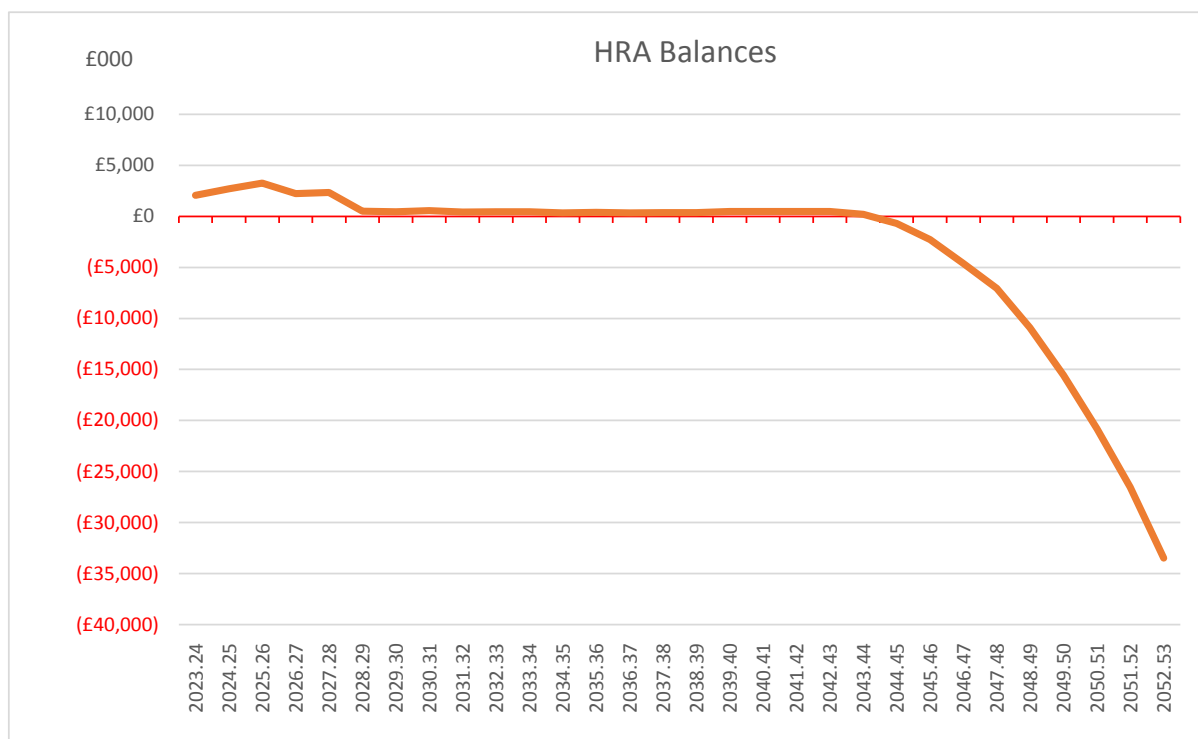
- fluctuations in the underlying rate of inflation, which can impact on both costs and income
- the potential for further constraint imposed on rent increases by government, or by the authority itself
- changes to underlying interest rates

2.2.3 We recommend that the authority continues to review the potential HRA impact of these risks regularly as part of its early warning system. This enables it to identify the effects of emerging situations at an early stage, test its response and take appropriate action to eliminate or mitigate the risk.

2.2.4 The effects of the baseline assumptions are shown in the following sections.

2.3. Baseline - revenue position

2.3.1 The chart below shows the authority's ability to maintain a minimum level of balances during the 30 year period covered by the baseline projection:

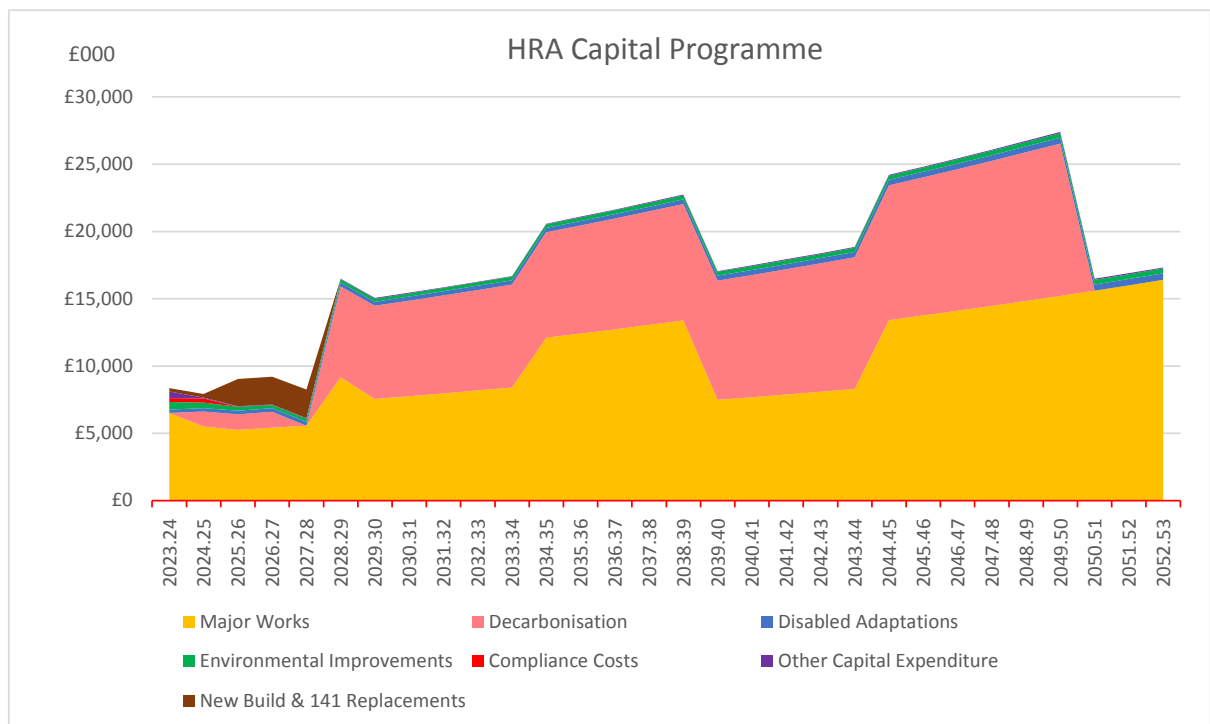


2.3.2 In this chart the orange line projects the cumulative HRA balance at the end of each year. Use of balances until 2027/28 reflects the authority's own medium-term budget. The HRA balance is then maintained at the minimum level, with any "spare" balances used to finance the capital programme or reduce debt.

2.3.3 The authority broadly maintains its minimum HRA balance until 2042/43. However, cost pressures throughout the period impacts on its ability to maintain the minimum balance in 2043/44, and from 2044/45 onwards the HRA falls into deficit. If left unaddressed, this would be a potentially unlawful situation.

2.4. Baseline -capital programme

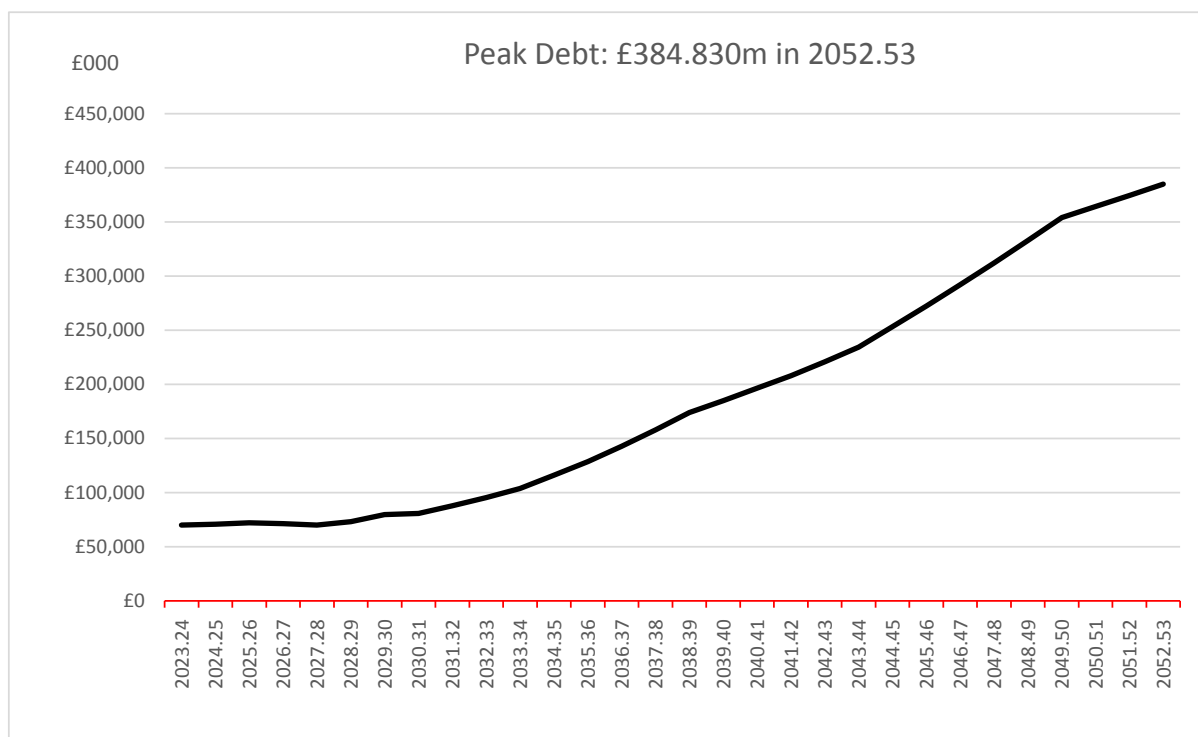
2.4.1 The next chart shows the scale and composition of the authority's projected capital programme:



- 2.4.2 This programme assumes the purchase or development of 39 new properties between 2023/24 and 2027/28 (brown area).
- 2.4.3 The Major Works (amber) area allows for investment required on stock condition. Fluctuations in major works spending represent programmed component replacement requirements, based on the authority's stock condition data and component lifecycles.
- 2.4.4 The Decarbonisation (pink) area allows for the delivery of the authority's existing plans for decarbonising and improving the energy efficiency of existing homes. This steps up to a more substantial programme from 2028/29 to 2049/50, providing an indication of the substantial cost of decarbonising the authority's stock over that period.
- 2.4.5 The average annual cost of major works at current prices, averages £1,280 per existing unit over 30 years (at current prices). This is in line with the "rule of thumb" range of between £1,200 and £1,300 per unit that some other authorities have used and indicates a reasonable level of investment for replacing existing key components over the long term. The average cost per unit of decarbonising the stock by 2049/50 comes to £26,316 at current prices. There is insufficient data available from the authority's stock to inform the decarbonisation projections fully, and so, this key assumption has been set to provide for a level of investment that is consistent with expectations at other local authorities.
- 2.4.6 We recommend that the authority continues to develop the data that underpins its stock investment requirements, to ensure that future projections reflect the best available information.

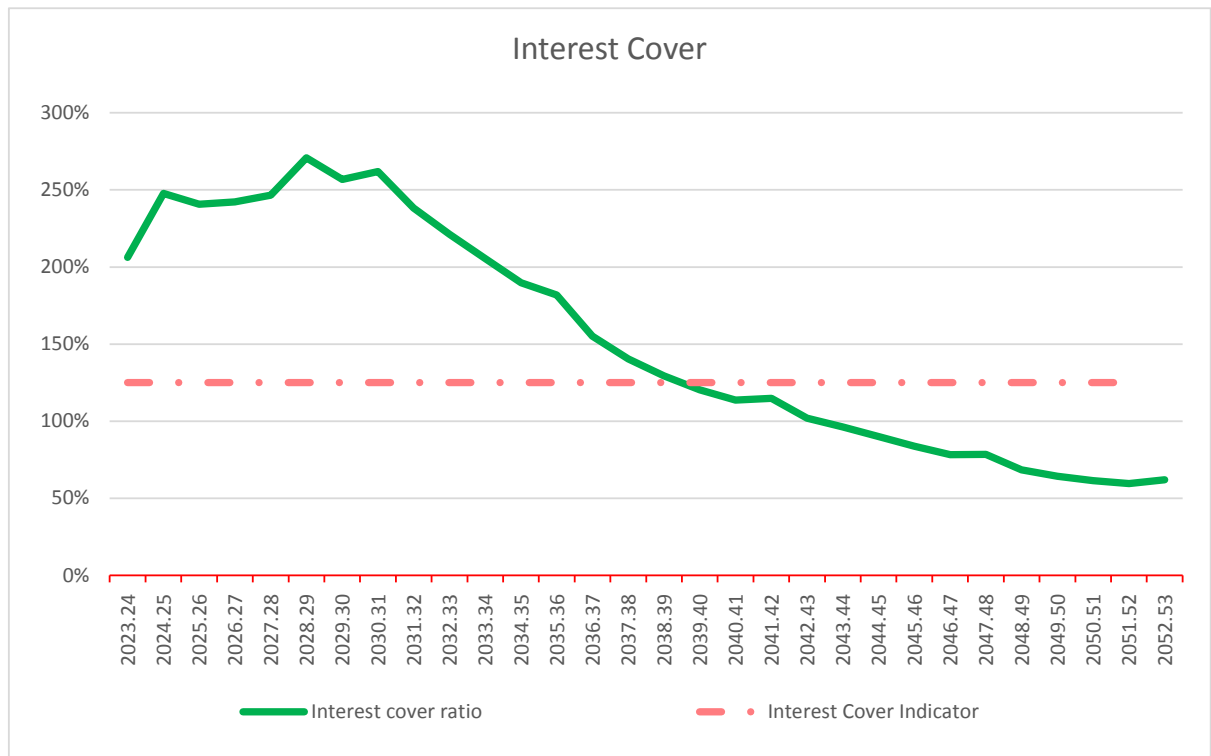
2.5. Baseline – debt

2.5.1 The next chart projects movements in the level of HRA-related debt during the planning period:

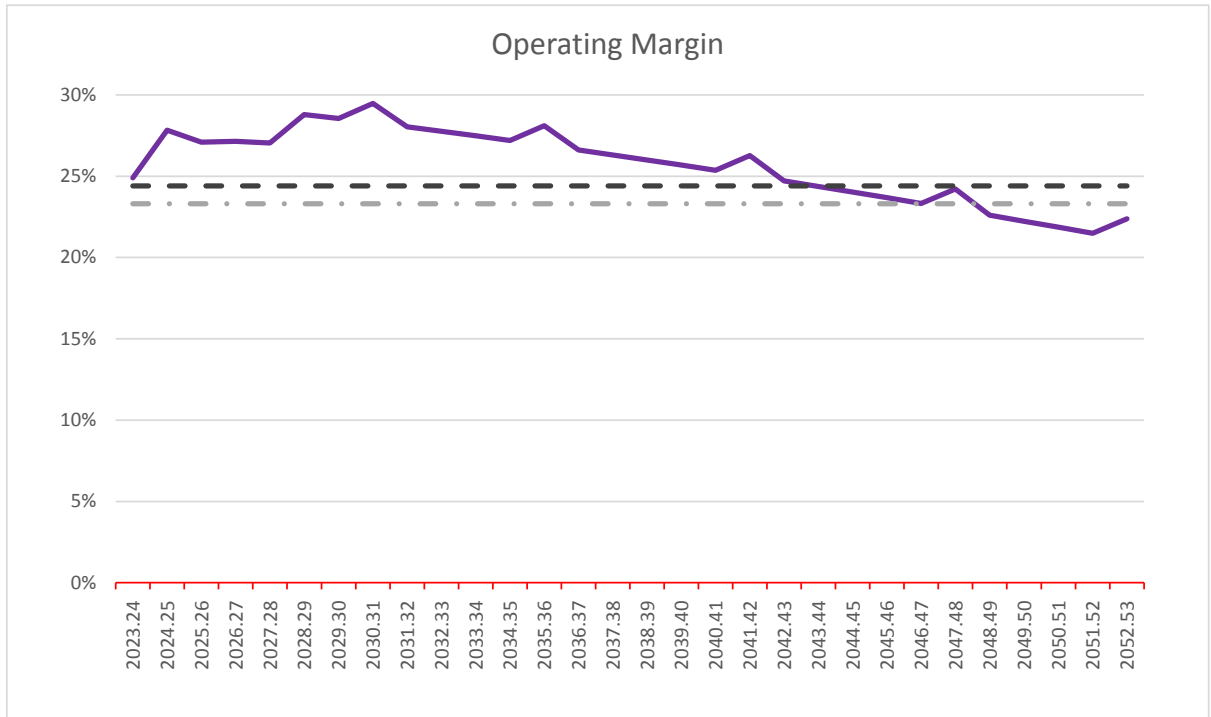


2.5.2 On these assumptions, the authority finances its capital programme from a combination of its major repairs reserve, revenue balance and capital receipts until 2028/29. From 2029/30 the HRA depends on borrowing to finance its capital programme. However, it needs to borrow more each year than it is able to repay from revenue. This causes HRA-related debt to rise continuously after the medium term to a peak of £384.830m in 2052/53. This rise in debt increases the capital financing charges the HRA must pay and is the key factor that causes the HRA to fall into deficit (as shown in the previous section).

2.5.3 The chart below further illustrates the affordability of these projected debt levels. It compares the authority's interest cover performance (covering the relationship between the HRA interest charge and operational surplus) with a standard indicator used by other landlords:



- 2.5.4 The green line in this chart shows the number of times the revenue HRA surplus is able to cover the assumed interest charges. When the green line goes down the authority is either making smaller surpluses or paying more in interest charges and the reverse is true when the green line goes up. The static dashed pink line sets an indicator level of 125%, below which the authority would be at risk of having insufficient capacity to respond to emerging pressures or being unable to cover its interest costs from its operating surplus.
- 2.5.5 This chart shows reasonable levels of interest cover over the medium term. Performance then starts to deteriorate, due to the additional interest charges incurred by a mounting debt and costs rising at a faster rate than rents. Mid-plan, interest cover drops below the minimum level and becomes unacceptable for the rest of the period. This coincides with the HRA falling into deficit, as shown in our earlier chart.
- 2.5.6 The chart below illustrates the level of operating surplus the authority is able to generate from its stock, on current assumptions:



- 2.5.7 In this chart the purple line represents the authority’s operating margin, which is the surplus generated after deducting the costs of managing and repairing the stock from the rent. The black dashed line shows the median performance by housing associations in the West Midlands in 2022, while the grey line shows the median performance for housing associations in England.
- 2.5.8 The operating margin chart shows the authority to be performing very well. This means that its net surplus is already higher than the median housing association performance for 2022. It is also higher than the performance of a typical local authority, which tends to be lower than the median for housing associations in England. This tells us that the authority’s net costs already compare well with other landlords and suggests there may be limited scope to address weaknesses in affordability simply by reducing revenue budgets.

2.6. Baseline – summary

- 2.6.1 The baseline assumptions produce a position that relies heavily on debt to deliver the projected long term capital programme. This results in a substantial rise in debt that starts towards the end of the medium term. The additional capital financing charges that result from this cause the HRA to go into deficit and interest cover performance to fall to unacceptable levels by the end of the projections.
- 2.6.2 This baseline represents an unsustainable long-term position for the HRA, indicating that the authority needs to take action over the medium term to resolve the situation.
- 2.6.3 The risks, which the authority needs to be able to manage include:
- Rising debt levels result in more expensive capital financing charges, which become unaffordable over the long term
 - Debt that does not peak over the medium term increases the authority's exposure to interest rate risks
 - Failure on the part of the Council to maximise rental income or continue to bear down on the costs that are charged to the HRA would also impact negatively on the financial health of the HRA
- 2.6.4 The projections suggest that the authority would retain insufficient “wriggle room” to respond to emerging risks and pressures after the medium term. It needs to take action to minimise its exposure to these risks. Where possible, funding should be maximised and spending pressures should be outweighed by increases in the income from rents and other charges.

3. Options available

3.1. Types of action available

3.1.1 The authority can take a range of actions to address the weak long-term affordability resulting from the current projections. These include:

- reduce operating costs
- increase income
- secure additional funding
- reschedule or scale back existing plans
- generate additional receipts from selling assets on the open market
- a combination of these measures

3.1.2 The following section presents a menu of scenarios we have modelled to illustrate the actions the authority could take.

3.2. Menu of options

3.2.1 Potential measures that the authority might consider when addressing the baseline situation include:

- Review the authority's housing processes to help minimise operating costs. This would need to be through a medium-term programme of reviews, ideally conducted in conjunction with the authority's corporate strategy for whole council sustainability.
- Introducing a sustainable rent flexibility charge for dwellings that are re-let after having benefited from decarbonisation works. This would increase income for those dwellings, in recognition of the lower energy and heating costs that would be paid by the tenant.
- Maximise the recovery of service costs from tenants who receive special services. Any under-recovery of service costs represents a hidden subsidy, which is paid by all tenants. Moving towards full recovery reduces that subsidy and generates income that can be used to meet emerging pressures.
- Ensuring that all schemes for the delivery of new homes are financially viable before approving them. This ensures that new developments pay back within a reasonable timescale (ideally, 30 years) and do not require long term subsidy from existing HRA tenants.
- Consider re-prioritising or rescheduling elements of the authority's capital programme.
- Make the case to government and others for additional funding to help pay for the cost of decarbonisation works.
- A combination of the above actions.

3.2.2 We have prepared the following set of scenarios, which illustrate the effects of some of these options along with other sensitivities, which we discuss below.

3.3. Scenarios and sensitivities considered

3.3.1 We have prepared ten illustrative scenarios. These include:

- A. Cancelling the provision of new units from 2024/25
- B. Applying 5% rent flexibility to a proportion of the authority's re-lets
- C. Implementing a 7% rent increase in April 2024, which is lower than the maximum rent increase of 7.7%
- D. Implementing a 5% rent increase in April 2024, which is lower than the maximum rent increase of 7.7%
- E. Implementing a rent freeze in April 2024
- F. Government policy reverts to CPI+1% rent increases for four years from April 2025
- G. Implementing a 2% pa efficiency programme for 5 years from 2025/26
- H. The authority is able to generate 20% funding for its decarbonisation programme
- I. Extend the decarbonisation programme to 2060
- J. Scenarios G, H & I combined

3.3.2 The following tables compare the effects of these scenarios.

3.4. Scenario results

Impact on HRA balances

3.4.1 The table below summarises the effects of each scenario on the health of the HRA Balance at 10 year intervals during the projections. These are shown alongside the results produced by the baseline position:

| Scenario/ Sensitivity | HRA Balance | | | |
|---|-----------------|-----------------|-----------------|-----------------|
| | 2023.24 £000 | 2032.33 £000 | 2042.43 £000 | 2052.53 £000 |
| Baseline | £2,062 | £451 | £479 | -£33,466 |
| A. No new homes from 2024/25 | £2,062 | £450 | £477 | -£35,927 |
| B. Apply rent flexibility from 2024/25 | £2,062 | £492 | £547 | -£4,926 |
| C. 7% rent increase in 2024/25 | £2,062 | £448 | £475 | -£34,990 |
| D. 5% rent increase in 2024/25 | £2,062 | £440 | £63 | -£39,587 |
| E. Rent freeze in 2024/25 | £2,062 | £420 | -£2,472 | -£51,935 |
| F. CPI +1% rent rises | £2,062 | £476 | £520 | -£13,938 |
| G. Five year efficiency prog from 2024/25 | £2,062 | £492 | £548 | -£4,715 |
| H. Decarbonisation funding at 20% | £2,062 | £485 | £539 | -£18,272 |
| I. Extend decarbonisation to 2060 | £2,062 | £503 | £572 | -£12,892 |
| J. Scenarios G, H & I Combined | £2,062 | £1,759 | £682 | £506 |

3.4.2 Of the scenarios that are wholly within the authority's control, only Scenarios B and G help the council to reduce its HRA deficit over the life of the projections. They do so because the additional rent or efficiency gains generated enable the authority to reduce HRA debt levels slightly throughout the period, thereby reducing the level of interest charges. Scenario A results in the loss of net rent from the dwellings that would otherwise be delivered and means the authority's interest charges are less affordable than under the Baseline.

3.4.3 Scenarios C, D and E all lead to the authority foregoing rent in 2024/25, which also suppresses the rents chargeable in subsequent years. Under Scenarios C and D the authority would increase rents by less than the maximum of 7.7% in April 2024. Scenario E shows the effects of implementing a rent freeze in 2024/25, which has a substantial detrimental impact

on future rental income and the ability of the authority to keep its HRA in balance. If the authority were to implement a rent freeze the HRA would fall into deficit four years earlier than under the Baseline, in 2040/41.

- 3.4.4 The remaining scenarios are all beneficial to the HRA. Scenario F permits the authority to increase its base levels of rental income by more than inflation over the medium term. Under Scenario G the authority's efficiency programme would reduce overall costs, allowing it to manage debt more easily. Scenario H introduces additional external funding, which helps reduce the authority's reliance on debt finance. By extending the decarbonisation programme by 10 years (Scenario I) the authority can spread its costs and associated borrowing over a longer period. By combining the effects of Scenarios G, H & I, Scenario I shows the potential effects of a co-ordinated strategic approach. Only Scenario I permits the authority to maintain its minimum HRA balance throughout the period, indicating that a substantial programme of mitigating actions is required.

Impact on HRA debt

- 3.4.5 The table below shows the impact of each Scenario on the level of HRA-related debt:

| Scenario/ Sensitivity | HRA CFR | | | |
|---|-----------------|-----------------|-----------------|-----------------|
| | 2023.24 £000 | 2032.33 £000 | 2042.43 £000 | 2052.53 £000 |
| Baseline | £69,981 | £95,492 | £220,902 | £384,830 |
| A. No new homes from 2024/25 | £69,981 | £92,234 | £218,310 | £381,753 |
| B. Apply rent flexibility from 2024/25 | £69,981 | £84,997 | £183,091 | £334,857 |
| C. 7% rent increase in 2024/25 | £69,981 | £96,648 | £223,543 | £387,470 |
| D. 5% rent increase in 2024/25 | £69,981 | £99,942 | £230,664 | £394,592 |
| E. Rent freeze in 2024/25 | £69,981 | £108,117 | £246,745 | £410,672 |
| F. CPI +1% rent rises | £69,981 | £88,437 | £196,988 | £356,829 |
| G. Five year efficiency prog from 2024/25 | £69,981 | £83,447 | £181,133 | £332,601 |
| H. Decarbonisation funding at 20% | £69,981 | £86,898 | £187,666 | £335,180 |
| I. Extend decarbonisation to 2060 | £69,981 | £83,340 | £170,837 | £332,106 |
| J. Scenarios G, H & I Combined | £69,981 | £68,479 | £110,719 | £212,869 |

- 3.4.6 Scenarios A, B and F to J all enable the authority to reduce HRA-related debt levels over 30 years. In the case of Scenario A, this is because the authority needs to borrow less to deliver new homes. Scenarios B and F generate additional income, enabling the HRA to repay more debt. Scenarios G to J all reduce costs or reliance on borrowing to finance the capital programme, which means the council can maintain lower debt levels.
- 3.4.7 Scenarios C to E all result in higher debt levels. This happens because the HRA generates less rent, so is less able to repay debt.

Impact on affordability

- 3.4.8 Our final table shows the impact of each scenario on the interest cover performance of the HRA:

| Scenario/ Sensitivity | Interest cover ratio | | | |
|---|----------------------|--------------|--------------|--------------|
| | 2023.24 % | 2032.33 % | 2042.43 % | 2052.53 % |
| Baseline | 206.20% | 221.14% | 101.94% | 62.07% |
| A. No new homes from 2024/25 | 206.20% | 223.41% | 100.32% | 60.64% |
| B. Apply rent flexibility from 2024/25 | 206.20% | 296.25% | 151.64% | 90.73% |
| C. 7% rent increase in 2024/25 | 206.20% | 216.06% | 99.99% | 61.35% |
| D. 5% rent increase in 2024/25 | 206.20% | 202.18% | 94.77% | 59.41% |
| E. Rent freeze in 2024/25 | 206.20% | 171.05% | 83.58% | 55.07% |
| F. CPI +1% rent rises | 206.20% | 267.22% | 130.14% | 77.43% |
| G. Five year efficiency prog from 2024/25 | 206.20% | 300.89% | 152.87% | 91.07% |
| H. Decarbonisation funding at 20% | 206.20% | 240.50% | 119.32% | 71.26% |
| I. Extend decarbonisation to 2060 | 206.20% | 249.23% | 130.55% | 72.83% |
| J. Scenarios G, H & I Combined | 206.20% | 352.76% | 244.57% | 144.15% |

- 3.4.9 Interest cover shows the ability of the HRA to afford the interest payments on the debt it needs to borrow. As a guide, interest cover of less than 125% would indicate a greater risk that surpluses would fall below those required to cover the cost of interest charges.
- 3.4.10 This table shows that interest cover would be stronger under Scenarios B, and F to J, each of which would see the council either receive higher levels of rental income or incur lower costs. The remaining illustrations (Scenarios A, C, D and E) all result in lost rent, which causes affordability levels to drop.
- 3.5. Further testing
- 3.5.1 The scenarios we have tested for the authority provide an indication on key risks, along with policy decisions that the authority may need to consider. However, it does not constitute a full stress test of the HRA.
- 3.5.2 We recommend that the authority continues to develop its approach to reviewing its HRA assumptions and testing the effects of different decisions, changes in economic circumstances and potential changes in government policy. In particular, it should regularly review its assumptions on inflation and interest rates, while updating expenditure assumptions to reflect its in-year monitoring of budgets and programmes.
- 3.5.3 Adopting a rigorous approach to stress testing the authority's HRA will help it to identify the effects of potential risks at an early stage, test its response and take appropriate action to eliminate or mitigate the risk.
- 3.6. Summary
- 3.6.1 The baseline shows the HRA to be financially sustainable and affordable over the medium term. However, underlying cost pressures and a reliance on borrowing to deliver the capital programme cause the HRA to become unaffordable over the long term. The authority needs to take corrective action over the medium term to correct this situation and secure an HRA that is able to manage and maintain the existing housing stock sustainably over the long term.
- 3.6.2 The scenarios presented further show that the financial health of the HRA changes considerably as a result of changes in the decisions made by the council and rent policy set by the government.

- 3.6.3 Reducing costs and increasing the income generated from rents and service charges would help the HRA to reduce its reliance on debt finance. However, the metrics suggest that the authority already has an efficient housing service, and so may have limited scope to reduce its HRA operating costs. The measures outlined for addressing the situation are not sufficient to return the long-term financial health of the HRA to optimal levels.
- 3.6.4 The authority should explore the options available for making cost savings for the HRA as part of its corporate programme for improving financial sustainability. It should also examine the options for generating additional income and funding to improve interest cover performance of the HRA over the long term. Such actions would enable it to counter potential risks associated with higher inflation, further regulatory requirements, increases in interest charges, commitments to spend more on providing additional or improved services, or further constraint on rent levels (whether imposed by government, or by a local decision to set rents at a lower level).
- 3.6.5 The authority's HRA operates as a long-term business and needs to be managed accordingly. It is important that the authority safeguards the financial sustainability capacity of its HRA before committing to additional commitments or schemes that impact negatively on affordability over the long term. It can do this by continuing to bear down on costs and maximising the income it generates from rents and service charges. Other actions it might take include generating additional capital receipts from a programme that disposes of appropriate assets on the open market.
- 3.6.6 It will also be important to ensure that any new schemes or initiatives produce a positive financial contribution to the HRA over the long term. The authority can promote this by ensuring that any new homes delivered are able to payback within a reasonable period (ideally, 30 years) and that initiatives for improving or updating services produce sufficient cost savings or additional income to pay for themselves over time.