ROTHERHAM BOROUGH COUNCIL – REPORT TO THE AUDIT COMMITTEE

1.	**Meeting:**	**Audit Committee**
2.	**Date:**	**21 November 2012**
3.	**Title:**	**Risk Management and Mitigation in the Housing Revenue Account 30 Year Business Plan**
4.	**Directorate:**	**Neighbourhoods and Adult Services**

5.0 Summary

The implementation of Housing Revenue Account (HRA) Self-Financing, from April 2012, presents the Authority with significant investment opportunities.

However, this initiative also transfers all risks from the DCLG to the Council in respect of Council houses. Changes in inflation, local rent policy, interest rates and investment and debt management decisions, will impact on the financial viability of the Business Plan. Robust, proactive management of all aspects of the Plan will be essential throughout the 30 year period. This report demonstrates how the risks identified within the Business Planning process are being managed and mitigated.

6.0 Recommendations

It is recommended that Members note the steps taken to manage and mitigate risk.

7.0 Proposals and Details

7.1 Background

The concept of the HRA 30 year Business Plan which was introduced within the Housing Revenue Account – Self Financing Regulations on the 1st April 2012.

In summary, under this arrangement, Councils were allocated a proportion of the national housing debt, and in return allowed to collect and retain all housing income. All risk was transferred to authorities, who have to utilise the income to manage debt, repair and maintain stock and estate infrastructure, and provide housing management services to ensure a sustainable business going forward.

The main drivers supporting the implementation of the Self Financing Initiative were to:

- Give local authorities the resources, incentives and flexibility they need to manage their own stock for the long term.

- Give tenants greater transparency and accountability as to how rent collected is spent on the services provided.

It is clear that the Self-Financing Initiative would:

- Require long term planning and asset management.

- Give greater flexibility to councils to make the best use of stock, and make decisions linked to local conditions and local needs.

In order to demonstrate the financial viability of this initiative, a 30 year Business Plan was drawn up to determine indicative income and expenditure for the short, medium and long term.

This report identifies the key risks which need managing in the 30 year Business Plan and outlines to members the actions which are being taken to mitigate these risks.

7.2 The HRA 30 Year Business Plan

The 30 year Business Plan has been developed by the Director of Housing and Neighbourhoods in conjunction with Financial Services.

The base data included in the model (that has been extrapolated over the 30 Year Plan) is based upon the following:-

- The current costs of delivering housing services as per the 2012/13 revenue budget.

- Current treasury management assumptions and forecasts associated with servicing the existing debt.

- The 30 year capital investment requirements of the existing stock as identified from the APEX stock condition survey.

- The Authority will work towards rent convergence by 2016/17.

Based upon a range of key assumptions which are detailed within paragraph 7.3, the base case 30 year Business Plan, as at October 2012, shows that the HRA has total surplus resources of £628m over the 30 year period, illustrating the long-term benefits of the Self-Financing Initiative.

The utilisation of these resources is critical to meet both local and national policies and to the delivery of first class housing services. Major investment decisions will be made based upon the forecasted resources available with the Plan. It is therefore imperative that the key assumptions made to formulate the Plan are based upon sound knowledge, and are robustly challenged, monitored and updated on an ongoing basis.

7.3 Key Assumptions

In order to model the base data, various key assumptions have been made which are critical to the financial viability of the Plan.

Appendix A of the report details the prevailing rates and assumptions which have been applied to the current Plan, and are summarised below together with the associated risk and mitigation.

- General Inflation. (Retail Price Index – RPI). The 2013/14 RPI assumption is 3.2% and is applied to revenue spend and capital investment, and is also taken into consideration within the rent setting process. Treasury forecasts are applied across subsequent years of the Plan, as shown at Appendix A.

  Risk: An increase of 1% in the inflation rate assumption would increase the surplus resources available at year 30 by £169m. This is because the rent increase assumption tracks RPI inflation, and annual income exceeds expenditure in the Plan. Conversely, a reduction of 1% in the inflation rate assumption would reduce surplus resources by £146m.

  Mitigation: Budgets are set utilising the most up-to-date information available through Treasury forecasts. Future inflation forecasts are then tracked through the financial year. The model also allows differential inflation rates to be applied, for example to capital or salary costs.

- Interest Rates – Rates applied in 2012/13 are 4.71% rising to 5% up to 2016/17 and 6% thereafter and are applied to the HRA outstanding debt of £304m.

  Risk: An increase of 0.5% in the interest rate assumption would reduce the surplus resources available at year 30 by £46m.

  Mitigation: Prudent assumptions have been made on borrowing and investment rates based upon current market conditions and Treasury forecasts. Loans will be refinanced when market conditions allow.

  In addition, historic high interest rate loans within the current debt portfolio when they expire and are repaid, will lead to a reduction in debt charges within the Business Plan, which will increase the resources available and/or generate borrowing headroom for future investment.

- Rent Convergence. The Business Plan assumption is that the Authority will work towards rent convergence in 2015/16 in line with Government expectations (with actual convergence being achieved in 2016/17) with future rent increases assumed at 0.5% above RPI. This is the key assumption to the viability or otherwise of the Business Plan.

  Risk: An assumption of rent increases of 0.5% below RPI following convergence, reduces the surplus resources available at year 30 by £411m to £217m. This would have a major impact on the Council's plan for future housing investment.

  A failure to achieve convergence by the required date could lead to repercussions from central government.

  Mitigation: Both the national and local context is set out within the Annual Rent Setting Report presented to Cabinet. The HRA Business Plan is updated to reflect the yearly rent increase following approval.

- Capital Investment Requirements. The Business Plan assumption for the 30 year investment requirements on current stock, to maintain them in line with the Decent Homes Standard, is informed from the APEX stock condition survey.

  Risk: Any inaccurate, incomplete, duplicate or missing property or survey data, will have an impact on the viability of the Business Plan.

  Mitigation: An extensive data cleanse and detailed survey exercise is currently ongoing to ensure that the investment requirements are up to date and the cost information incorporated into the Asset Management strategy is robust. The Business Plan can then be effectively managed to ensure that future investment needs can be addressed, with the certainty that the existing stock is being adequately maintained.

7.4 National Issues

In addition to the specific risks identified within paragraph 7.3 above, there are also several major policy issues which may have a bearing on the Business Plan.

- Right to Buy (RTB) receipts - The discount rate cap on RTBs has recently increased to £75,000 up to a maximum of 60% for houses and 70% for flats, of the property's value. It is anticipated that, as a result, there will be an increase in the number of Council properties lost through the RTB process. This will lead to a reduction in rental income within the Business Plan.

  Risk: An increase of 100 RTBs per year will result in a reduction in surplus resources at year 30 of the Business Plan of £171m.

  Mitigation: This initiative went live from April 2012, and bearing in mind that most RTBs take an average of 6 months to complete, it has been difficult to predict the take up rate. Therefore a prudent assumption of 100 RTBs per year for 5 years has been modelled into the Business Plan, reducing to 23 a year thereafter, in line with previous sales.

  Work is still ongoing to assess the likely impact of this initiative; a more accurate forecast of sales should be possible by Christmas, when actual completions can be measured.

- Welfare Reform - It is anticipated that the introduction of Welfare Reform from November 2013 and the Housing Benefit Reform from April 2013 will have a bearing upon the HRA Business Plan, as around 14,300 tenants will move from Housing Benefit onto direct payments, increasing the total rents to be collected by in the region of £50m.

  Risk: The move towards direct payment, and the removal or capping of other payments through Welfare Reform will, most likely, lead to an increase in housing debt as tenants are unable to pay the full rent due.

  Mitigation: Work is currently ongoing to assess the likely impact on rent collection and the likely increase in bad debts under Welfare Reform. In acknowledgement of the likely impact, the HRA provision for debts has been increased by £100k (0.9%) which is the equivalent to an increase in arrears of £1m.

Neighbourhoods and Adult Services is a member of the Corporate Working Group reviewing the Authority-wide impact of Welfare Reform, which is considering various initiatives to limit the impact upon both customers and the Council.

7.5 Monitoring and Modelling

Key assumptions are embedded into the Business Plan on an annual basis with intrinsic links to the budget setting process.

In addition, the Plan is reviewed on a quarterly basis in line with the quarterly budget monitoring framework to Cabinet Member for both revenue and capital.

All new initiatives within the Directorate are considered in the light of any financial impact on the Business Plan; this includes a current exercise to consider the provision of new homes through resources generated within the Business Plan.

A new Business Plan model has recently been purchased which provides greater flexibility for modelling different scenarios.

7.6 Supporting Strategies

A long term Asset Management Strategy is currently being developed to provide a detailed programme of planned additional investment works which will dovetail with future repairs and maintenance needs.

The Council's Treasury Management Strategy provides a framework for managing the debt and investments over the term of the Business Plan.

8.0 Finance

Covered in Part 7 above.

9.0 Risks and Uncertainties

Covered in Part 7 above

10.0 Policy and Performance Agenda Implications

The Self-Financing Initiative supports the effective use of Council assets and managing them to best effect. It contributes to the sustainable neighbourhoods agenda by addressing future investment needs and will help deliver a better quality of affordable housing in the community. This links to the key corporate strategic themes of:-

- Rotherham Proud
- Rotherham Safe
- Rotherham Active
- Fairness
- Sustainable Development

These key themes are reflected within the Individual Wellbeing and Healthy Communities outcome framework, as follows:

- Improved Quality of Life – by creating opportunities for an improved quality of life (Objective 6).
- Economic Wellbeing – providing affordable, high quality housing to meet identified needs and create sustainable neighbourhoods.
- Safe – by creating neighbourhoods that are clean, green, good quality homes.

The initiative links to the key investment theme in our Local Investment Plan.

- Climate Change – introducing a range of measures to address issues such as fuel poverty, reduce household energy consumption and minimise environmental impact.

These key investment themes align with the Council's corporate priorities of:-

- Making sure that no community is left behind.
- Helping to create safe and healthy communities.
- Ensuring care and protection are available for those people who need it most.
- Providing quality education, ensuring people have the opportunity to improve their skills, learn and get a job.
- Improving the environment.

11.0 Background Papers and Consultation

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Appendix A

HRA Self-Financing Business Plan Model Key Assumptions

Key Input	Assumption Used	Data Source	Outputs	Comments
Inflation				
General RPI	2013/14 – 3.2% 2014/15 – 2.6% 2015/16 – 2.9% 2016/17 – 3.3% 2017 on – 2.5%	Treasury Forecasts – February 2012	Capital / Revenue – Expenditure Items	Differential RPI increases can be applied to individual items.
Rent Calculations / Stock / Receipts				
Rent RPI / Formula Rent Increases	RPI + 0.5%	Current Formula Rent Increases	Rental Income	Key factor in determining surplus available for investment.
Stock	April 12 – 20,861		Rental Income Capital / Revenue – Expenditure Items	Model adjusts for new build / disposal assumptions
Voids / Bad Debts	Voids – 2% Bad Debts – 2012/13 - 0.86% 2013/14 on - 0.95%	Voids – DCLG model assumption. Bad Debts– Current RMBC provision	Rental Income	
Right to Buy Receipts	No receipts assumed.			Assumed 100 RTBs – 2012 – 17 23 RTB 2017 onwards
Working Balances / Debt Allocation / Subsidy CFR				
HRA Opening Balance	£8,327,386			As at 1st April 2012
Minimum HRA Balance	£3,500,000 Indexed			
MRR Opening Balance	£2,656,470			As at 1st April 2012 Used to Fund Capital Spend
Debt Cap	£336.623m	DCLG		
Current HRA Debt	£303.959m			As at 1st April 2012

Key Input	Assumption Used	Data Source	Outputs	Comments
Revenue Costs				
Annual Depreciation Charge	£18,815,210 – Indexed	PwC (DCLG) Assumption	Charge to HRA – MRR Capital Funding	2012/13 – Based on PwC (DCLG) model
Revenue Repairs Spend	£17,438,433 – 2012/13	2012/13 Budget	HRA Revenue Expenditure	
General Management Charges	£19,365,334 Indexed	2012/13 Budget	HRA Revenue Expenditure	
Capital Costs				
Capital Repairs on existing stock	2012/13 - £20.95m 2013/14 - £27.05m 2014/15 - £25.90m 2015/16 - £25.86m 2016/17 - £26.21m (unindexed values)	2012/13 Capital Budget. 30 Year Capital Investment Profile	Capital Expenditure	Information based on 30 year investment profile, including back-log repairs. Lifecycles based on decent homes standard. Spend smoothed out.
Interest Rates				
CRI	2012/13 - 4.71% 2013 – 2017 – 5% 2017 onwards – 6%	Derek Gaffney – Chief Accountant	HRA Revenue Expenditure	