Social housing is under financial pressure

Is HRA reform a solution?

HRA reform
PwC

October 2011
HRA reform timeline

2009/2010
PwC engaged by CLG to develop debt re-allocation proposals

April - July 2010
Consultation on CLG prospectus and indicative debt allocations

October 2010
CSR confirms reform proposals with detailed debt allocations to be announced

2010/2011
Localism bill including announcement of debt allocation principles

February 2011
Publication of PwC debt allocation model including indicative debt allocations by authority

2011/12
Council strategic planning and preparation to operate HRA as a major housing business

1 April 2012
The national picture

1.8m Council houses – 175 Councils

£7bn annual rental income - £5bn costs

£21bn HRA debt

In the future Councils will retain surpluses and take on cost of debt servicing

£2bn surplus paid to Government through subsidy system

Debt servicing costs met by Government

HRA reform principles

- Annual subsidy system ending from 2012/13
- Councils to keep rents and be responsible for all housing costs
- Once and for all debt settlement – Councils responsible for long term business plan including debt servicing
- Debt allocations typically £10k - £30k per property, largely depending on local rent levels and regional costs
- Nationally some £28bn of debt likely to be allocated to Councils

October 2011
HRA reform changes at local level

HRA today

• ‘Looks after itself’ – cannot bankrupt the Council

• Annual subsidy determinations provide natural controls - prevent potentially reckless borrowing

• No need for active debt management strategy as Government covers debt costs

• Inflation and interest rate risks absorbed by Government

• Asset management strategy constrained by capital resources provided by central Government

• No real scope for strategic planning as reliant on annual Government subsidy

HRA in the future

• Significant potential borrowing capacity – but constraints

• No future Government funding of housing investment needs – long term asset management risk is the Council’s responsibility

• Council entirely responsible for debt management strategy including level, risks and costs

• Impact of general fund cost pressures on surplus HRA capacity

• Managing debt particularly in the early years

• Opportunity to develop a new strategic financial framework for the HRA

October 2011
**Self-financing debt allocations**

### HRA reform - debt allocation by region

<table>
<thead>
<tr>
<th>Region</th>
<th>Properties '000</th>
<th>Allocation £m</th>
<th>Per property £000</th>
</tr>
</thead>
<tbody>
<tr>
<td>London</td>
<td>422</td>
<td>7,227</td>
<td>17</td>
</tr>
<tr>
<td>South East</td>
<td>187</td>
<td>4,093</td>
<td>22</td>
</tr>
<tr>
<td>South West</td>
<td>102</td>
<td>1,461</td>
<td>14</td>
</tr>
<tr>
<td>East</td>
<td>157</td>
<td>3,577</td>
<td>23</td>
</tr>
<tr>
<td>West Midlands</td>
<td>210</td>
<td>3,514</td>
<td>17</td>
</tr>
<tr>
<td>East Midlands</td>
<td>185</td>
<td>2,672</td>
<td>14</td>
</tr>
<tr>
<td>North West</td>
<td>113</td>
<td>1,474</td>
<td>13</td>
</tr>
<tr>
<td>North East</td>
<td>117</td>
<td>1,476</td>
<td>13</td>
</tr>
<tr>
<td>Yorkshire &amp; Humber</td>
<td>238</td>
<td>2,924</td>
<td>12</td>
</tr>
<tr>
<td><strong>Total</strong></td>
<td><strong>1,730</strong></td>
<td><strong>28,418</strong></td>
<td><strong>16</strong></td>
</tr>
</tbody>
</table>

### Debt allocations

- Based on discounted cash flow of future net rental income
- Builds in allowances for management, maintenance and life cycle investment needs – higher than current subsidy rates
- Discount rate of 6.5% (real) to reflect risks taken on by councils
- Higher debt allocations in east and south east – reflection of relatively high rents and low costs
- Debt allocations represent the “debt capacity” of the housing
**HRA debt**

Initial debt allocations reflect the “debt capacity” of the housing – ie a level of debt that can be supported from the underlying cash flows

- Nationally this is £28bn an average of £16,000 per property
- Some authorities have a natural inclination to pay down debt – but with a sound asset management strategy, this is not necessary
- Based on underlying debt allocation assumptions, on average debt could be repaid by year 22
- Whilst housing may have a finite life, an effective asset management strategy (including selective renewal) should sustain its debt capacity at the current level
- If national housing debt capacity is sustained in real terms, by year 22 this would be some £48bn in money terms - £28,000 per property
At a national level, using surplus resources to pay down debt would lead to repayment by year 22.

But the housing would still have debt capacity:

- £28bn if initial capacity was preserved in money terms
- £48bn if capacity was preserved in real terms (ie inflated)

Source: DCLG/PwC debt model 1 February 2011
HRA self-financing – increasing surplus resources

Assumptions

- Rent converging to formula then increasing at 0.5% above inflation
- Revenue costs based on 2012.13 subsidy allowances increasing by inflation (2.5%)
- Interest at 5.5% (3% above inflation) on constant debt at starting level
- Capital needs in line with Government benchmarks
Potential new investment resources

### HRA reform - new investment resources

<table>
<thead>
<tr>
<th>Region</th>
<th>Rent £m</th>
<th>Surplus £m</th>
<th>Per property £000</th>
</tr>
</thead>
<tbody>
<tr>
<td>London</td>
<td>101,576</td>
<td>15,618</td>
<td>37</td>
</tr>
<tr>
<td>South East</td>
<td>39,038</td>
<td>7,191</td>
<td>39</td>
</tr>
<tr>
<td>South West</td>
<td>18,231</td>
<td>2,761</td>
<td>27</td>
</tr>
<tr>
<td>East</td>
<td>32,183</td>
<td>6,124</td>
<td>39</td>
</tr>
<tr>
<td>West Midlands</td>
<td>38,064</td>
<td>6,177</td>
<td>29</td>
</tr>
<tr>
<td>East Midlands</td>
<td>31,577</td>
<td>4,986</td>
<td>27</td>
</tr>
<tr>
<td>North West</td>
<td>19,209</td>
<td>2,949</td>
<td>26</td>
</tr>
<tr>
<td>North East</td>
<td>19,323</td>
<td>2,688</td>
<td>23</td>
</tr>
<tr>
<td>Yorkshire &amp; Humber</td>
<td>39,307</td>
<td>5,527</td>
<td>23</td>
</tr>
<tr>
<td><strong>Total</strong></td>
<td><strong>338,508</strong></td>
<td><strong>54,023</strong></td>
<td><strong>31</strong></td>
</tr>
</tbody>
</table>

Source: PwC self-financing model, DCLG 1 February 2011

### Assumptions

- Based on published PwC/DCLG model and assumptions
- Rent increases as government policy
- Council expenditure reflects uplifted allowances
- No repayment of debt – interest paid for full 30 years
- Excludes interest received on surplus balances
HRA reform opportunities

- Councils will have control over valuable assets, generating more than £300bn of rental income over the next 30 years
- Far greater freedom over asset and debt strategies for housing
- In the past, council housing options have focused on “dealing with a problem” – now it is a question of “making the most of the opportunity”
- Real choices for councils – ability to shape their housing “business” to deliver against local priorities for services and investment

In the past medium/long term strategic financial planning has been impossible – now it is not only possible but essential
HRA self-financing – the financial opportunity

Increasing surpluses in later years

Self-financing model shows debt repayment by year 19

But housing will still have debt capacity in the future

Opportunity to convert later years surpluses into early years investment

Creating new sources of income to increase surpluses

Need for housing capital investment £££m

- Planned works to existing housing
- Regeneration of existing housing estates
- New Council housing
- Green investment
- Supported housing

£xm
**Self-financing “borrowing cap”**

Latest DCLG publication – “Planning the transition” confirms the Government position and arrangements for controlling debt

- Recognition that self-financing gives councils control over a very large rental income stream – hence significant borrowing capacity

- Even though additional borrowing to fund investment may be affordable locally, it also needs to be “affordable within national fiscal policies”, i.e. fit with national borrowing limits.

From the local authority perspective:

- Whilst early years may be tight, a well run authority should see capacity increase over time as the benefit of future rent increases flows through

- Optimal asset management and business planning may lead to need for early capital investment

- Whilst there is some headroom – the borrowing cap is seen by some as an artificial barrier to efficient asset management and business operation
## Housing investment models

<table>
<thead>
<tr>
<th>Model</th>
<th>New build</th>
<th>Estate renewal</th>
<th>Access to HRA resources</th>
<th>Compatible with debt cap</th>
<th>Ballot need</th>
</tr>
</thead>
<tbody>
<tr>
<td>Traditional land disposal to RSL</td>
<td>Yes</td>
<td>No</td>
<td>No</td>
<td>n/a</td>
<td>No</td>
</tr>
<tr>
<td>RSL development agreement</td>
<td>Yes</td>
<td>Yes</td>
<td>No</td>
<td>n/a</td>
<td>No</td>
</tr>
<tr>
<td>New build leasing models</td>
<td>Yes</td>
<td>No</td>
<td>Yes</td>
<td>???</td>
<td>No</td>
</tr>
<tr>
<td>Community housing trust (estate transfer)</td>
<td>Yes</td>
<td>Yes</td>
<td>No</td>
<td>n/a</td>
<td>Yes</td>
</tr>
<tr>
<td>HRA PPP models</td>
<td>Yes</td>
<td>Yes</td>
<td>Yes</td>
<td>Yes</td>
<td>No</td>
</tr>
<tr>
<td>Alternative new build options</td>
<td>Yes</td>
<td>No</td>
<td>Yes</td>
<td>Yes</td>
<td>No</td>
</tr>
</tbody>
</table>
## Delivering investment through HRA reform

<table>
<thead>
<tr>
<th>Identify surplus HRA investment resources</th>
<th>Match surplus resources to investment priorities</th>
<th>Assess investment priorities</th>
</tr>
</thead>
<tbody>
<tr>
<td>Move from “traditional HRA business planning” to develop strategic assessment of investment resources likely to be generated over the medium to long term.</td>
<td>Look at full range of delivery and funding models to match resources with needs – including relative merits of delivery outside or within the HRA.</td>
<td>Identify strategic housing investment priorities and delivery options.</td>
</tr>
<tr>
<td>Model funding of asset investment needs and implications for debt management strategies under alternative scenarios.</td>
<td>Develop a number of demonstrator projects for priority investment priorities.</td>
<td>Work up a number of priority investment projects in outline to assess the likely scale and timing of investment needs.</td>
</tr>
<tr>
<td>Quantify impact on resources of alternative rent and service policy options.</td>
<td>Impact of investment and funding options on risk profile, balance sheet and borrowing limit.</td>
<td>Compare investment needs to available funding sources to identify investment gap.</td>
</tr>
<tr>
<td>Analyse and quantify business risks to be supported by the HRA, model sensitivities and assess potential financial impact.</td>
<td>Informed options appraisal and decision making based on range of strategic financial options</td>
<td>Model potential impact on existing housing asset base and future HRA resources of delivering the projects through different models.</td>
</tr>
</tbody>
</table>