Appendix A4
Housing Revenue Account
Business Plan Model Commentary

FINAL

January 2022

Contents

1. Introduction **1**

1.1. Background ... 1

1.2. Approach ... 1

2. Business plan model **2**

2.1. Introduction ... 2

2.2. Overview of methodology and assumptions ... 2

2.3. HRA Business Plans Projections ... 5

2.4. HRA Borrowing & Capacity ... 7

3. Sensitivity & Scenario Modelling **11**

3.1. Sensitivity Modelling ... 11

3.2. Scenario Modelling ... 11

4. Summary **13**

1. Introduction

1.1. Background

Bristol City Council (BCC, the Council) have appointed Savills to support officers in the production of the HRA Business Plan and associated presentations.

This builds upon the past changes such as the abolition of the HRA debt cap, and the introduction of greater flexibilities around the reinvestment of Right to Buy receipts. BCC, like many authorities, has adopted a new approach to setting out the financial capacity and capability of the HRA to deliver on its objectives towards refurbishment, investment, and new supply. Consideration of a new approach is also consistent with the requirement for the publication of Prudential Indicators specific to the HRA following their reintroduction alongside the abolition of the debt cap.

Savills have therefore worked with officers to produce the HRA business plan, that projects the cashflows over the next 31 years, forecasting of reserve balances and refinancing of loans originally taken out in March 2012 to fund the self-financing settlement, prior borrowing and new borrowing required.

It is based on the latest 2021.22 forecasts and anticipated budget for 2022.23 for both capital and revenue.

1.2. Approach

This report sets out our findings as follows:

1. The results of the latest HRA business plan model in the light of market conditions, policy initiatives and other factors.

2. Outputs from financial modelling and sensitivity testing (where appropriate) to establish alternative delivery scenarios for the business plan.

3. The impact to the metrics and indicators which can form the basis of future management and planning for the HRA.

2. Business plan model

2.1. Introduction

The latest version of our HRA Business Plan model has been provided and populated with officers in order to progress the 2022.23 budget process and forms the basis of this report, alongside the projected outturns for 2021.22, which is demonstrated as year 0.

The model has been presented via a workshop with officers from the finance and management team and elected members to agree the methodology and assumptions.

It will continue to have revisits in respect of the new development schemes as details become more apparent and investment strategy for the existing stock.

2.2. Overview of methodology and assumptions

Overall

The plan is based on the following overarching principles:

- 31 year projections from 2021.22 based on most recent forecasts, including those for 2022.23
- Core inflation projected at 3.4% for April 2023, 2.2% for April 2024 and then 2.0% thereafter with exemptions as detailed below;
- Rents increasing at CPI+1% per annum up to and including April 2024 in-line with the current social policy and then CPI thereafter. The forecasts include a provision for re-lets at formula rent levels based a reducing balance of 3% per year.
- Depreciation provision increasing at CPI throughout and adjusted based on stock numbers
- Maintenance of the existing tenanted stock (subject to Right to Buy sales and inflation) is modelled at a total of £1,250million over the 30 years using the latest HIP figures equating to c£46,750 per unit
- In addition to these provisions have been made from 2022.23 for:
    - £80million of investment in energy efficiency over 9 years to bring properties up to EPC rating C
    - £8.7million of investment over 5 years for improvements to communal blocks and estates
    - £12.5million over 5 years of bathroom improvements
- Inclusion of a range of new development schemes totalling £424.3million from 2021.22 over 8 years covering a wide range of sites and acquisitions which will deliver a total of 2,069 of affordable properties. An extension of the development and acquisition programme has been modelled as a scenario further on in this commentary.
- £1.8 billion invested into deliver new council homes over lifetime of the plan.
- The inclusion of 47 loans directly attributable to the HRA totalling £244.6million.
- Opening reserve balances totalling £109.7million as of April 2021, which include a provision of £1million towards a hardship fund to be utilised over 3 years.

The overall methodology within the plan is also founded on the following key approaches:

- The model seeks to fund the capital expenditure by utilising all available receipts as the first call, then balances available within the Major Repairs Reserve (whilst observing a minimum balance of £10million from 2022.23), then available resources from the HRA itself (whilst maintain a minimum balance of £20million) and finally the residual funding required is via borrowing through increasing the HRA CFR
- Newly arising borrowing for both new developments and acquisitions and investment in existing properties is set to repay via a charge to the HRA on the following basis:
    - Development & Acquisition borrowing: 50-year repayment on an equal basis commencing from the year of borrowing
    - Investment in Existing Stock borrowing: 30-year repayment on an equal basis commencing from the year of borrowing
- The existing 47 loans totalling £244.6million are refinanced upon maturity

We have set out below some more details in respect of some of the key inputs and assumptions.

Rents

For both social and affordable rented properties, the rents contained within the modelling are consistent with the latest social rent policy where a CPI plus 1% have been applied and will be until April 2024. With September's CPI standing at 3.1% a 4.1% rent increase has been modelled for April 2022. This continues with 1% above CPI increases for the next two years. Beyond April 2024 we have modelled rents to increase by CPI only. Void rates of 1.06% and Bad Debt provision of 1.5% have been modelled throughout the plan, based on current performance.

Shared Ownership rents will increase on the same basis, but without the provision for void loss.

Right to Buy sales volumes

The level of sales is initially modelled at 140 per annum and then reduce gradually to 50 per year over the next 31 years which accounts for a stock loss of 7.5% over the plan period, before the addition of new properties. It might be expected that BCC will see further reductions in sale volumes but the approach taken is prudent. We have made adjustments to both rents, repairs and future investment expenditure to reflect these stock losses.

Capital Works to Existing Properties

We have used the capital programme for 2021.22 and the 30-year HIP expenditure as identified within Appendix A2 which totals £1,250million. As identified, the plan will increase the expenditure derived from the HIP to allow for inflation. However, a reduction is also factored in for stock losses, hence the forecast figures within the plan total £1,738million over the 30 years (post 2021.22) when compared to the original £1,250million.

An additional annual provision is made for HRA infrastructure costs of £0.5million (inflated) and disposal costs of £0.050million (inflated).

Finally, future investment costs from the newly delivered rented properties are factored into the capital expenditure forecasts, accounting for £46million, allowing for inflation.

New Development Assumptions

The plan has a significant amount of expenditure built into it in respect of various sites within the City.

Appropriate rent levels have been assumed for the mixed tenures of both social rented and shared ownership properties and operating costs including management, repairs and identified above future investment costs.

The majority of subsidy towards financing the new developments are from 1-4-1 receipts, with the balance from Homes England Grant. This may well change if right to buy sales levels result in less receipts being available and therefore the subsidy being replaced with Homes England Grant. The recent change in legislation around 1-4-1 receipts gives BCC more flexibility and certainty as to how receipt can be used and by when.

Sales receipts from shared ownership properties also form part of the subsidy towards the costs of development.

Interest Rates

The model incorporates a treasury function that models both the interest and repayment schedules for the 47 loans that were undertaken to finance both previous borrowing and that for the self-financing settlement. All of the loan facilities are at a fixed rate, thus providing certainty in respect of the interest charges for these loans until they mature.

The model also accounts separately for new borrowing from these 47 loans on a 'revolver' style basis given the debt repayment schedules modelled.

Upon maturity the 47 loans will be refinanced and new 'revolver' facilities modelled at the following levels:

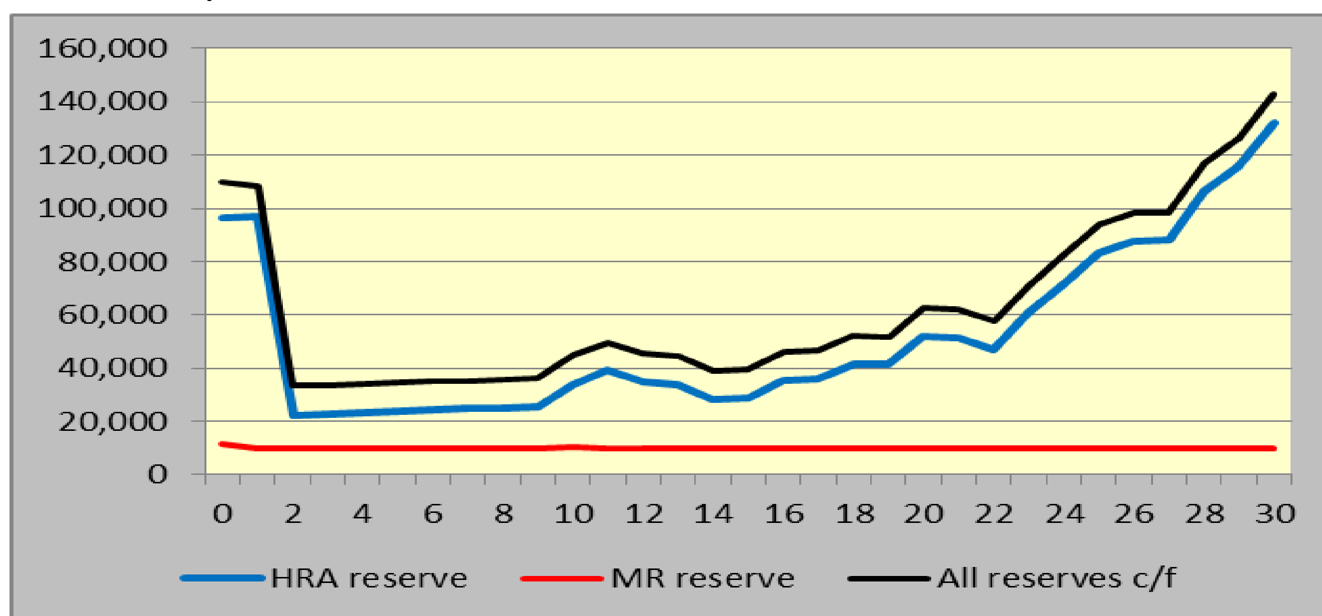
- Year 1: 2.5%
- Years 2-3: 2.75%
- Year 4: 3.00%
- Year 5: 3.25%
- Year 6 onwards: 3.5%

These interest rates have been provided by the Council's treasury advisors.

2.3. HRA Business Plans Projections

As detailed above we have modelled the business plan to retain the HRA reserves balance at £20million (plus inflation) and Major Repairs Reserve at £10million.

Chart 2.1 – Projected HRA reserve balances £'000

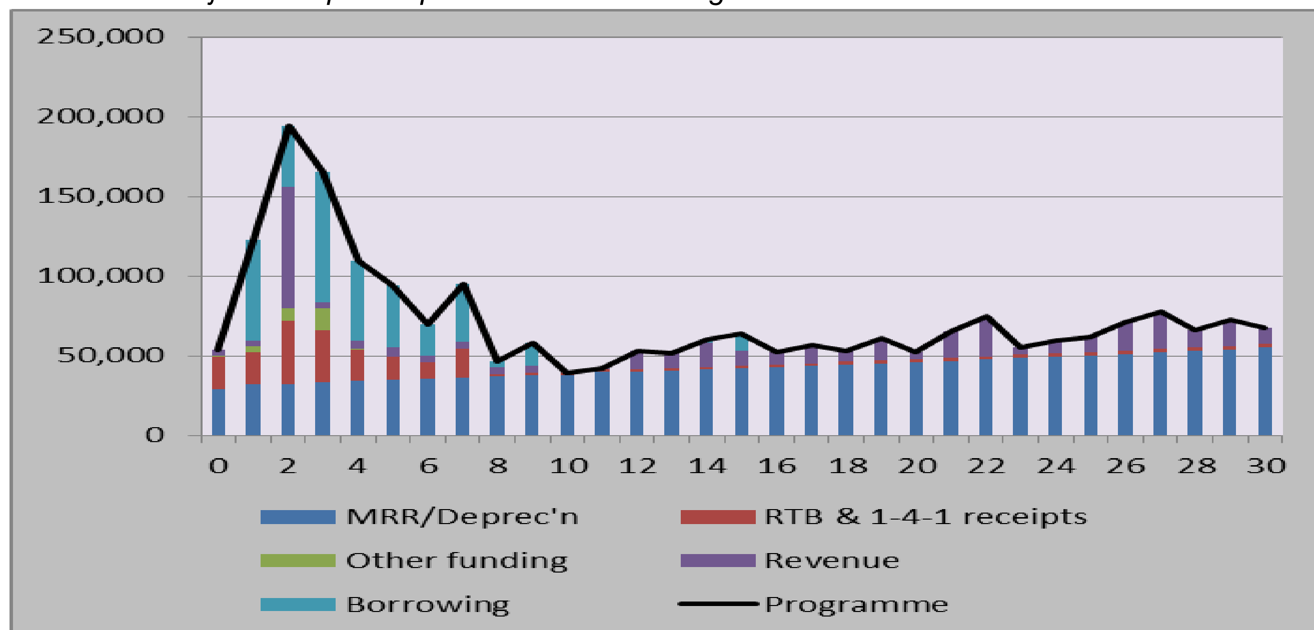


This demonstrates the accumulation of all the reserves that make up the black line for projected balances. The core HRA reserve balance is maintained at the minimum balance of £20million (plus inflation) but increases to a projected balance of c£132million in 30 years, whilst the Major Repairs Reserve remains at £10million.

The graph represents a positive position in that debt repayment levels are achieved whilst keeping minimum balances and that reserves being to accrue above the minimum level from year 10 of the plan and are then utilised a few years later and begin to increase once more.

This demonstrates that there is capacity within the plan in order to borrow or reconsider options in respect of debt repayment.

Chart 2.2 – Projected capital expenditure and financing £'000

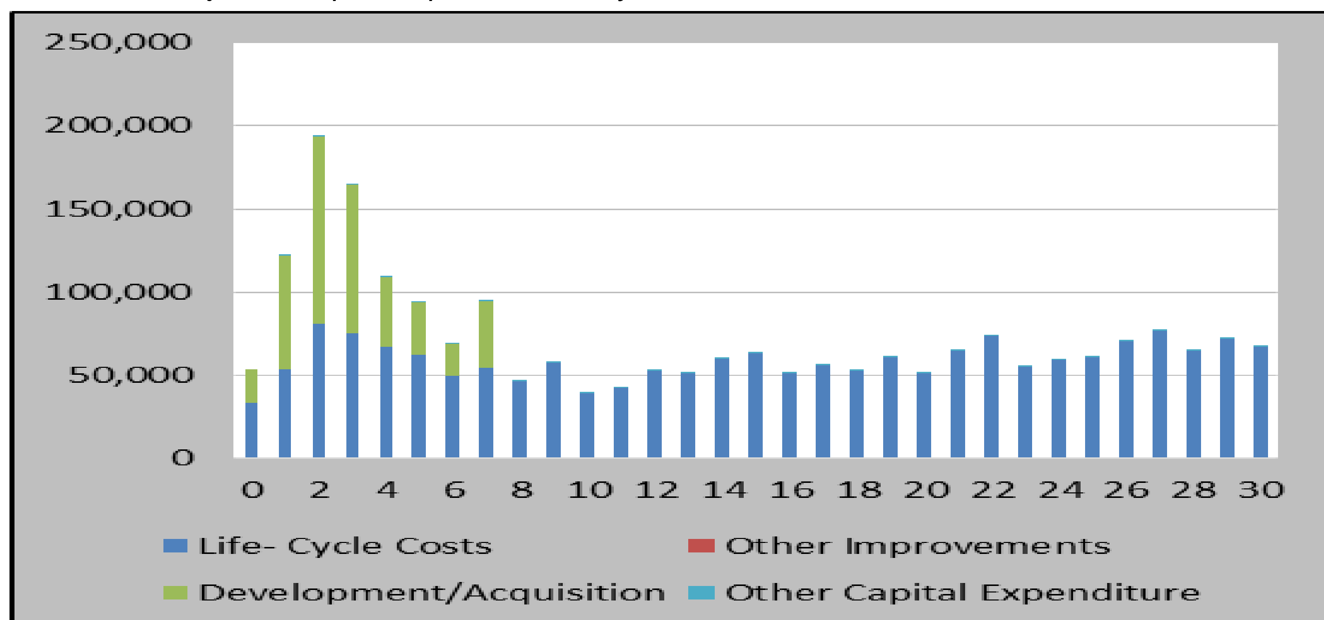


Capital expenditure remains fully funded throughout the 31 years, demonstrated by the horizontal black line matching the financing available presented by the vertical lines. The composition of the capital expenditure is demonstrated in the chart below.

Financing is primarily via the Major Repairs Reserve, revenue contributions and right to buy receipts. In the early years this is supplemented by 1-4-1 receipts, grants and shared ownership sales receipts towards the new developments and acquisitions. Borrowing is required up to and including year 9 to deliver the new developments and investment in the stock in respect of energy efficiency and other improvements.

In years 14 and 15 borrowing is required to finance the HIP expenditure in that year to the level of £12.7million. As the plan will be reviewed on an annual basis and the evolvement of the HIP expenditure it will be necessary to recast some of the expenditure within these years to prevent the £12.7million additional borrowing or refinancing.

Chart 2.3 – Projected Capital Expenditure Analysis £'000



This graphs explains the reasons for the high levels of capital expenditure in the early years, on account of the development and acquisition of new homes.

2.4. HRA Borrowing & Capacity

The HRA will require projected borrowing totalling £346.6million over years 1 to 9 of the plan to deliver the new developments and additional investment in the existing stock.

This obviously is significantly higher than the existing debt and certainly the debt cap that was in place up until October 2018.

BCC have decided upon provisional prudential borrowing limits based on a maximum Interest Cover Ratio of 1.25, whilst ensuring that minimum balances are held within both the HRA, Major Repairs Reserve and that newly arising debt has a provision modelled to repay over a timeframe and that this new borrowing is not refinanced.

The Interest Cover Ratio (ICR) is operating surplus divided by interest costs, and represents the cover that the HRA has against its interest cost liabilities in any year; the ICR is set to a minimum which provides comfort that if there were a sudden drop in income or increase in operating costs, there would be sufficient headroom to continue to cover debt interest. For housing associations, the usual definition of operating surplus is EBITDA-MRI (Earnings before Interest, Tax, Depreciation and Appropriations – Major Repairs Included). The average ICR for the HA sector in 2018.19 was around 1.8; typical lending covenants vary between 1.0 and 1.30 depending on the size and nature of the HA, with 1.25 being a typical expectation.

For the HRA, operating surplus is best defined as:

- Turnover (dwelling rents, other rents, service charges, contributions)

Less

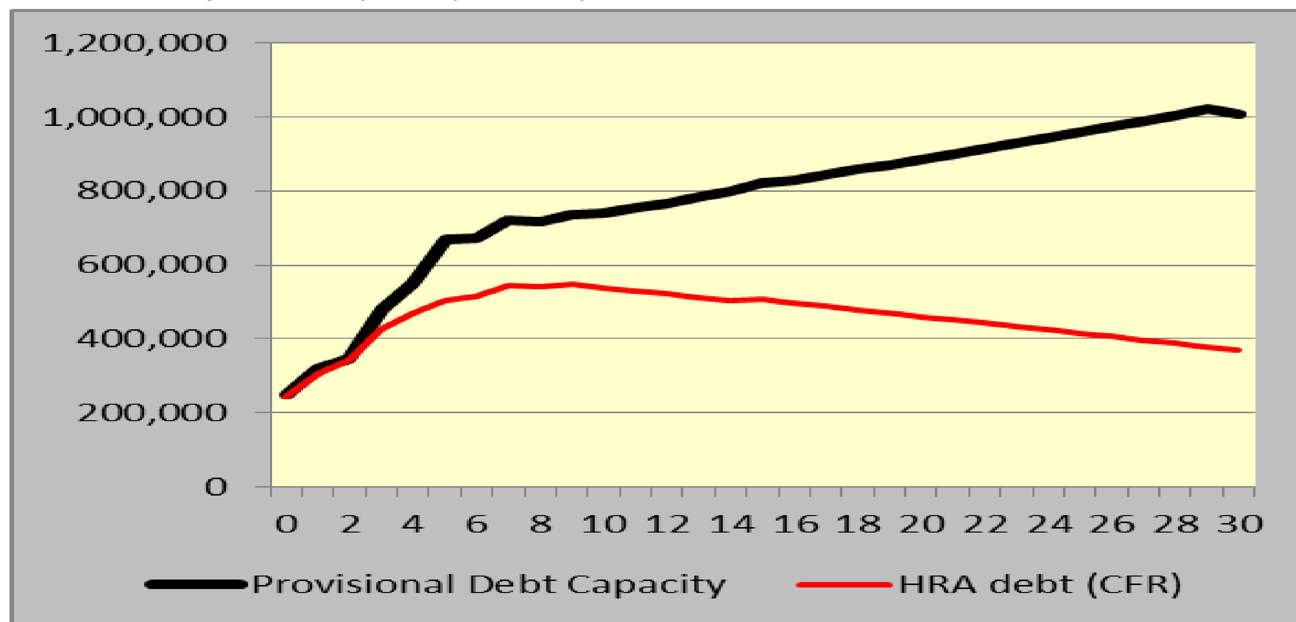
- Operating Costs (general management, special management, other management, repairs & maintenance, major repairs)

For housing associations, depreciation is not a cash transaction. In the HRA, because of the treatment of depreciation as a cash transfer to the Major Repairs Reserve (MRR) plus an adjustment to reflect actual transfers to MRR, it is essential to include the net amount transferred to MRR in the calculation. This represents the revenue expenditure on major repairs made legitimately as part of operating costs. Notwithstanding that these are subsequently treated as part of the capital programme, they are funded from revenue and properly an operating cost. Whilst transfers to the MRR may not be spent in-year, our experience is that the majority of balances carried in the MRR tend to be from expenditure slippage.

The above definition of ICR works in the HRA context as it determines the revenue surplus before interest, appropriations, debt repayment and other “below the line” adjustments, and already takes into account a significant element of costs relating to major repairs before comparing to debt interest capability.

The level of debt compared to provisional prudential limits ensuring that the ICR does not fall below 1.25 is shown in the graph below.

Chart 2.4 – Projected debt profile (HRACFR) £'000



This chart reflects the current loan portfolio and the additional borrowing with subsequent repayments.

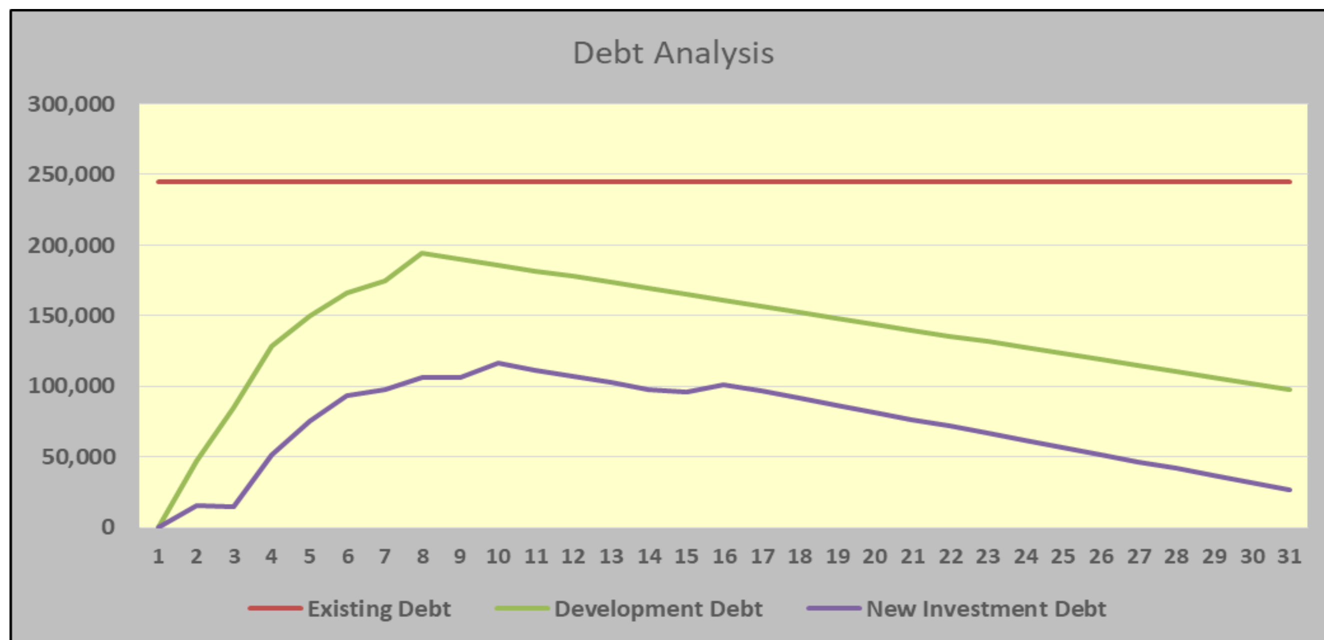
The gap between the red line (current debt) and the black line (provisional borrowing limits) is effectively the borrowing headroom available.

In all years the provisional borrowing limit is not exceeded, with the minimum headroom being £0.6million in year 2. There after borrowing capacity increases, largely on account of the above CPI rent increases in years 2 and 3 but also the newly arising net rents from new properties.

The graph below separates the HRA CFR (total debt) into the three categories:

- Existing debt of £244.6million through existing loans and refinanced
- New borrowing for development and acquisition, which is repaid over a 50-year period
- New borrowing for existing stock investment, which is repaid over a 30-year period

Chart 2.5 – Projected debt profile by financing type £'000



This graph shows that all new borrowing is being reduced year on year post the initial drawdown period. The exception being years 14 and 15 for new investment in existing stock debt where some refinancing is required, totalling £12.7million, which will be readdressed in the next iteration of the plan.

It is primarily for this reason that additional investment in the existing stock is limited unless additional resources become available over and above those assumed within the plan through future rent increases above inflation, if Government policy allows, or additional subsidy through new build. The latter point is considered in the scenario selection below.

3. Sensitivity & Scenario Modelling

3.1. Sensitivity Modelling

We have modelled a range of scenarios that demonstrate the impact to the plan as per the table below.

Scenario £'m	HRA Balances Yr 30	Peak Debt (Year)	Debt Yr 30	Re-financing Required
BASE	**142.8**	**546.9 (9)**	**369.4**	**12.7**
Inflation +0.5% pa	205.6	546.6 (9)	365.6	5.1
Inflation -0.5% pa	87.8	547.2 (9)	376.3	24.6
Interest +0.25% pa	124.0	551.6 (9)	373.7	19.4
Rents CPI +1% all years	910.3	532.4 (7)	355.3	0
Rent Freeze (Yrs 4-5)	49.6	570.1 (9)	517.2	216.9
Capital Expenditure +10%	49.6	603.0 (15)	533.6	229.4
Capital Expenditure Inf +1% 5 Years	68.4	565.6 (9)	404.8	66.3
Repairs Expenditure Infl +1% 5 Years	80.9	559.5 (9)	394.7	51.7
Right to Buys (NIL Yr 6+)	146.8	553.6 (9)	374.5	19.9
Voids +0.5% Bad Debts +1%	85.6	562.3 (9)	393.4	47.6

The plan shows a varied impact to both positive and negative sensitivities. Areas of concern would be more around the residual debt that the HRA has at year 30, and low HRA balances, although there is no statutory requirement for repayment.

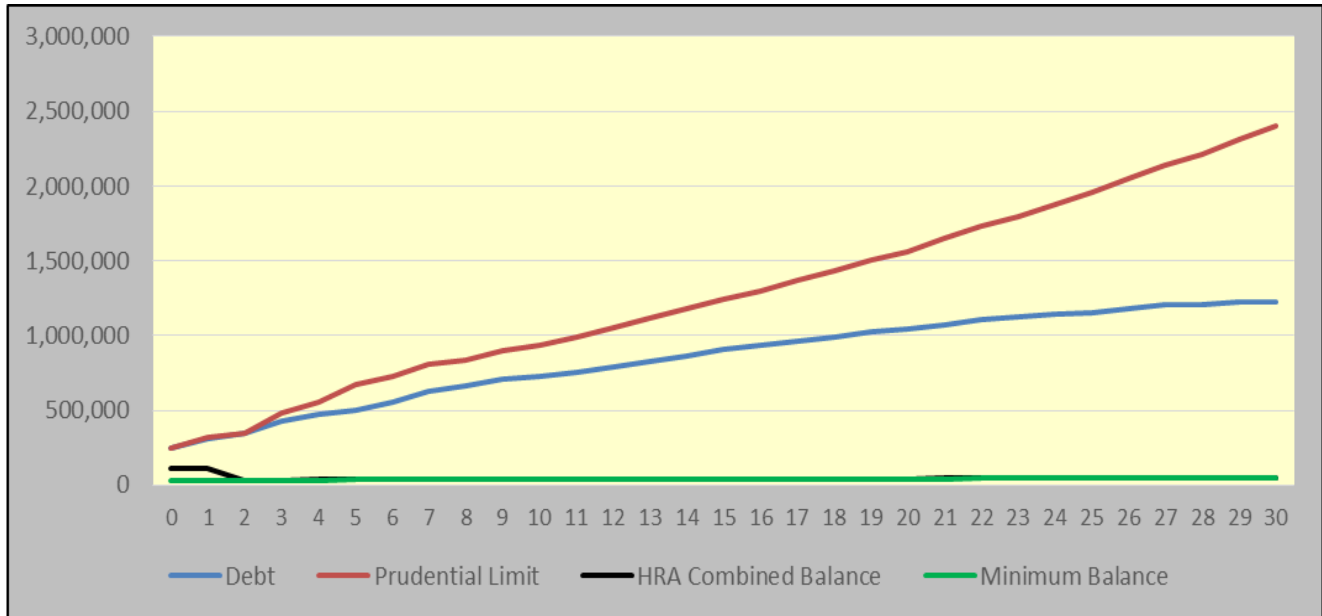
3.2. Scenario Modelling

The sensitivity table above demonstrates the impact to the plan for areas that will be primarily outside of the control of BCC.

This section models the impact of increasing the supply of homes as we have already commented on the inability of being able to make additional investment in existing homes in the short to medium term in order to avoid refinancing of this defined debt.

We have modelled the continuation of the acquisition programme post year 6, with the acquisition of 300 units per annum at a cost of £200,000 with subsidy via either 1-4-1 receipts or Homes England Grant of 40%. Rents will be at social rent levels with no shared ownership.

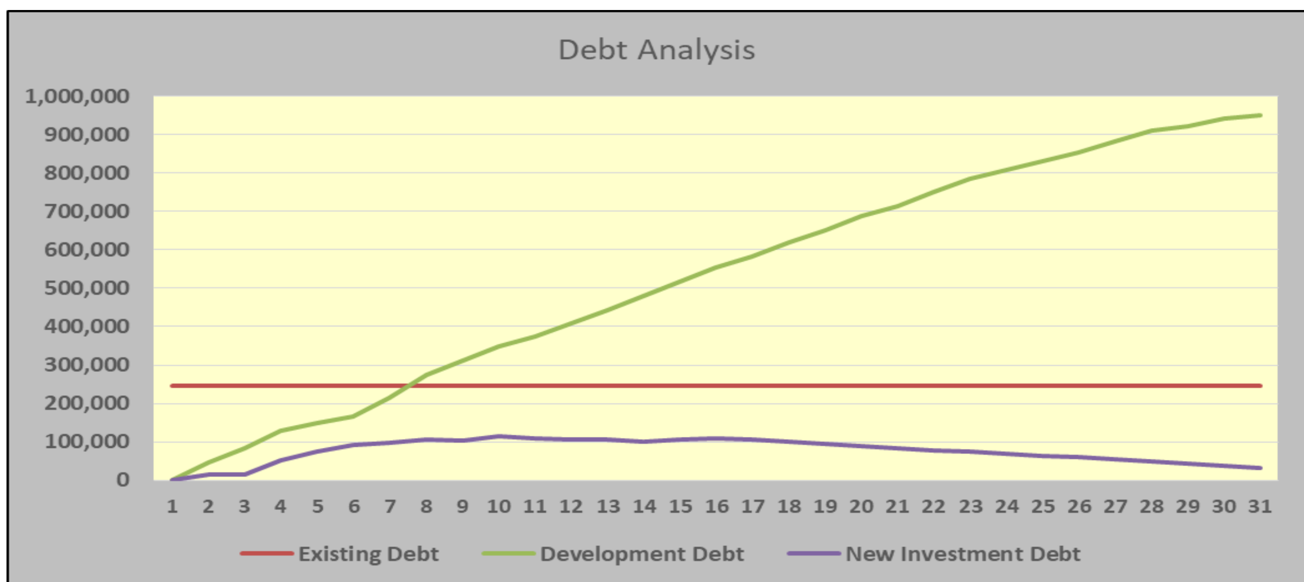
Chart 3.1 – Combined Outputs of Scenario of addition 300 units per year (from year 6)



This shows debt increasing over the 30-years from the baseline position of the HRA due to the ongoing programme of acquisition.

The debt level remains within provisional prudential limits, whilst the HRA and Major Reserve Balances remain at their minimum levels.

Chart 3.2 – Debt Projections of Scenario of addition 300 units per year (from year 6)



This graph shows that the debt in respect of new investment in existing stock does not have a reducing profile.

As a result the refinancing increases to £25.6million and is spread over a greater number of years. So, in effect, the application of the additional acquisitions has a negative impact in terms of the existing stock in respect of the level of investment that could be made. In order to avoid this a number of areas of the assumptions could be reviewed in terms of the acquisition price, the level of subsidy or the charging above social rent levels.

The 300 units per year scenario demonstrates the impact to the plan and the need to further progress appraisals in terms of viability.

4. Summary

1. The HRA business plan forecast as set out in our modelling for Bristol City Council shows future potential borrowing capacity.

2. The plan provides a robust base upon which to analyse future debt capacity levels.

3. The Council is able to increase borrowing immediately based on existing capacity within the business plan if using the ICR metric based on a minimum of 1.25.

4. Using the ICR metric, the Council could sustainably increase borrowing but is limited in respect of investment in existing stock on account of the avoidance of refinancing the associated debt.

5. This result is based on no underlying change to the operating cost base and no changes to the capital programme for the stock. The longer term capacity growth is significant and grows steadily over time.

6. The Council can affect future operating surpluses through effective cost management and this would increase borrowing capacity. Similarly, increases in inflation and in particular in rent inflation would add significantly to future capacity to enable investment in the existing stock.

7. This report should provide a sound basis for the Council to inform its future approach to establishing a decision making framework for its HRA investment and development strategies, and also inform the work to be undertaken to adopt Prudential Indicators for the HRA.

Steve Partridge & Simon Smith
Savills
January 2022