www.pwc.com

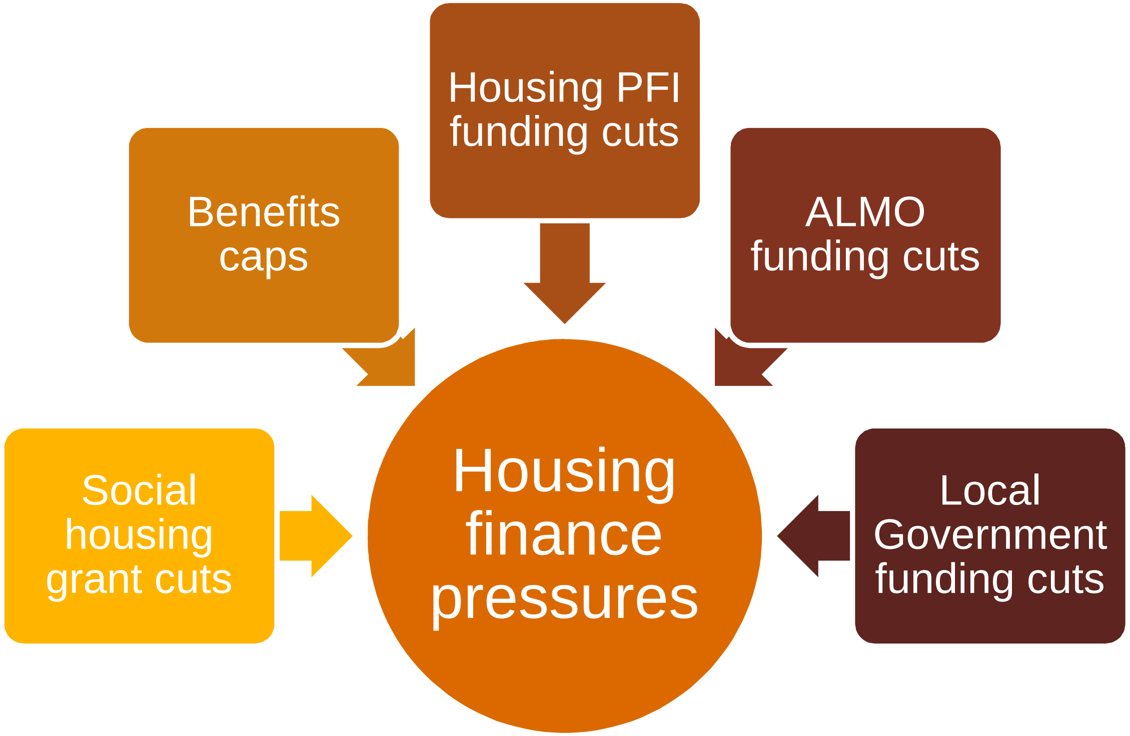
HRA Reform

Highbury Group

17 October 2011

pwc

Social housing is under financial pressure



Is HRA reform a solution?

HRA reform time line

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

Apr- Jul 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

Feb 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

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

Significant shift in responsibility and resources to local authorities

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

Self-financing debt allocations

HRA reform - debt allocation by region			
Region	**Properties '000**	**Allocation £m**	**Per property £000**
London	422	7,227	17
South East	187	4,093	22
South West	102	1,461	14
East	157	3,577	23
West Midlands	210	3,514	17
East Midlands	185	2,672	14
North West	113	1,474	13
North East	117	1,476	13
Yorkshire & Humber	238	2,924	12
Total	**1,730**	**28,418**	**16**

Debt allocations

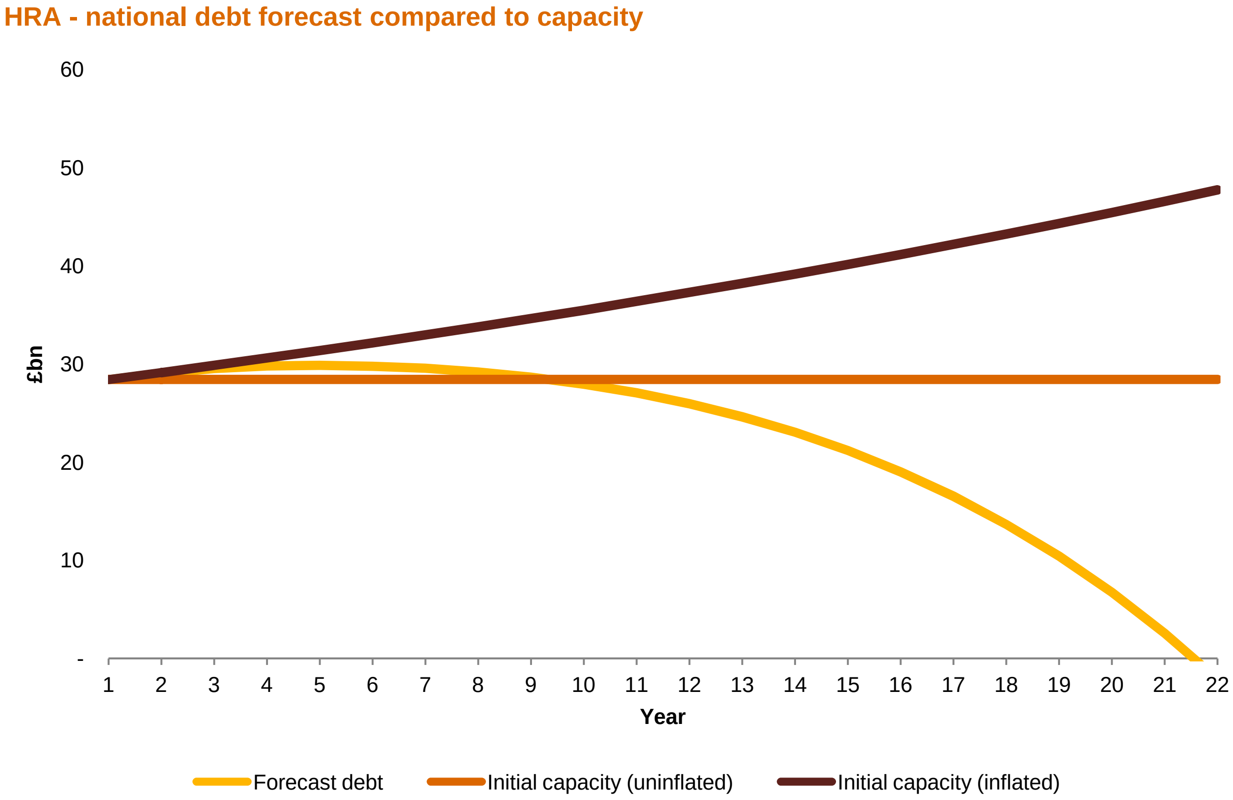
- Based on discounted cash flow of future net rental income
- Builds in allowances for management, maintenance and life cycle investment needs – higher than current subsidy rates
- Discount rate of 6.5% (real) to reflect risks taken on by councils
- Higher debt allocations in east and south east – reflection 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

HRA self-financing – debt capacity



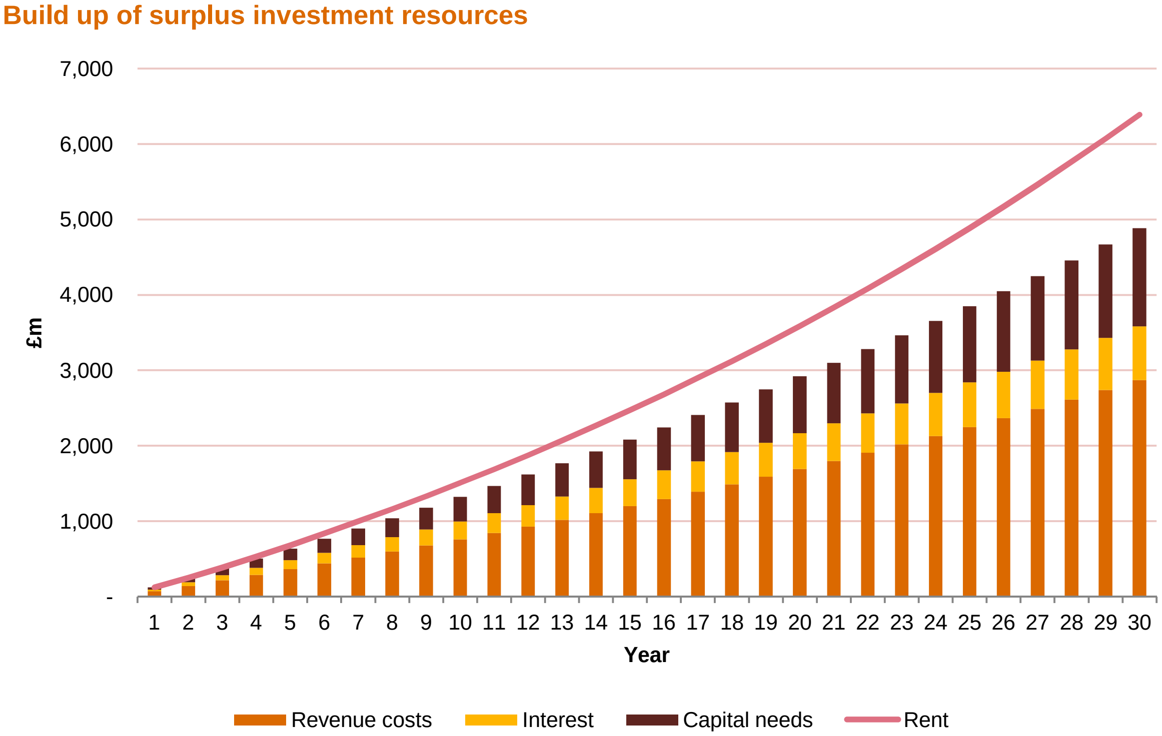
At a national level, using surplus resources to pay down debt would lead to repayment by year 22.

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



	Total £m	Per unit £000
Rent	6,389	267
Revenue costs	-2,871	-120
Interest	-712	-30
Capital needs	-1,300	-54
Surpluses	**1,506**	**63**

Increasing surplus resources build up over time

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

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

Assumptions

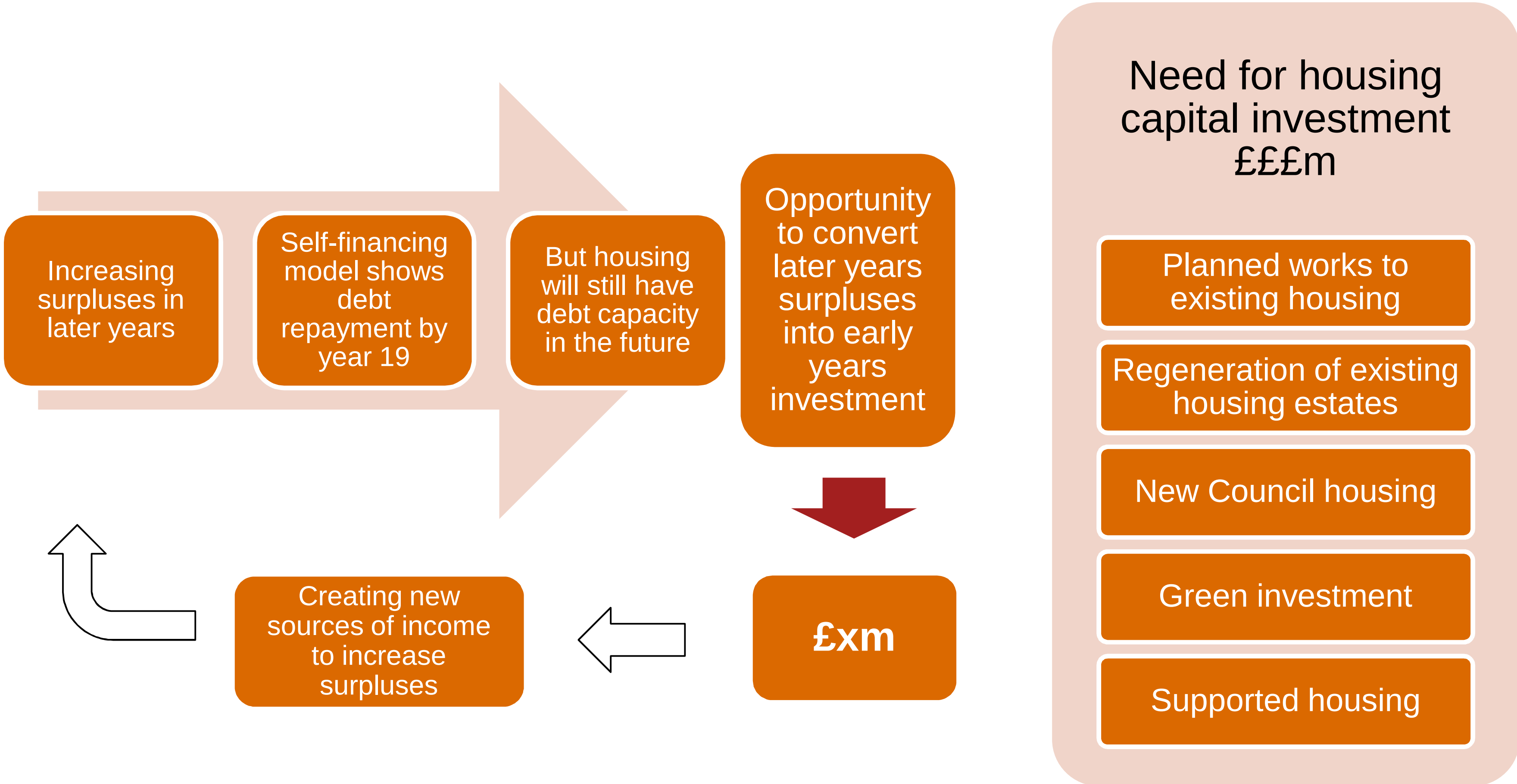
- Based on published PwC/DCLG model and assumptions
- Rent increases as government policy
- Council expenditure reflects uplifted allowances
- No repayment of debt – interest paid for full 30 years
- Excludes interest received on surplus balances

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



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 headroon – the borrowing cap is seen by some as an artificial barrier to efficient asset management and business operation

Housing investment models

	New build	Estate renewal	Access to HRA resources	Compatible with debt cap	Ballot need
Traditional land disposal to RSL	Yes	No	No	n/a	No
RSL development agreement	Yes	Yes	No	n/a	No
New build leasing models	Yes	No	Yes	???	No
Community housing trust (estate transfer)	Yes	Yes	No	n/a	Yes
HRA PPP models	Yes	Yes	Yes	Yes	No
Alternative new build options	Yes	No	Yes	Yes	No

Delivering investment through HRA reform

Identify surplus HRA investment resources

Move from "traditional HRA business planning" to develop strategic assessment of investment resources likely to be generated over the medium to long term.

Model funding of asset investment needs and implications for debt management strategies under alternative scenarios.

Quantify impact on resources of alternative rent and service policy options.

Analyse and quantify business risks to be supported by the HRA, model sensitivities and assess potential financial impact.

Match surplus resources to investment priorities

Look at full range of delivery and funding models to match resources with needs – including relative merits of delivery outside or within the HRA.

Develop a number of demonstrator projects for priority investment priorities.

Impact of investment and funding options on risk profile, balance sheet and borrowing limit .

Informed options appraisal and decision making based on range of strategic financial options

Assess investment priorities

Identify strategic housing investment priorities and delivery options.

Work up a number of priority investment projects in outline to assess the likely scale and timing of investment needs.

Compare investment needs to available funding sources to identify investment gap.

Model potential impact on existing housing asset base and future HRA resources of delivering the projects through different models.

Procurement and delivery

Joe Reeves
joseph.reeves@uk.pwc.com
07753 928269

Simon Martin
simon.j.martin@uk.pwc.com
07771 570841