HRA Self Financing
A revised debt settlement?

Highbury Group

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1

HRA self-financing debt settlement: background and basis

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Background

- Until 2012, Housing Revenue Account finance tightly controlled within the (then) **HRA Subsidy System**
- Subsidy system "**shadow**" HRA based on formulae for rents and costs – this **could be in "deficit"** (receive subsidy) **or "surplus"** (pay net rent into the system)
- Many authorities previously in "negative subsidy" had **transferred their stock** to housing associations
- In the run up to 2012, **entire subsidy system moved into surplus** – the "tenant tax"
- Extensive review process began in 2009
- Self-financing settlement a means to place HRA funding on a sustainable local footing
    - **Preventing annual swings** in subsidy levels
    - **Level of debt that could be sustained** by authorities over the long term
    - Avoid future stock transfers
- Settlement provided for an increase in allowances in the calculation when compared to the final year of the subsidy system
    - Cheap PWLB debt rates for new debt
- Hence **almost all authorities entered the system "better off"**

Key principles

- Fundamental principle: based on **"maintenance" of the Decent Homes Standard** (DHS)
- Starting point therefore was that the **DHS had already been achieved** - authorities with later round ALMOs received additional funding to achieve the target beyond 2012 settlement date
- **No provision for stock improvements or new build**
- Capability to use rental surpluses towards different programmes
- Key initial principle was the **implementation of a debt cap** – to prevent surpluses being used to borrow "too much"
- Further principle recognised that if public policy changed significantly affecting the application of the key assumptions, there was scope to reopen the settlement (built into the legislation)

Key components

- Assumption of **Right to Buy sales** – linked to 2009-2012 levels - historically low
- Guideline rents **converge to formulae**/target rent by 2016 – rents **increased by 0.5% pa over RPI**
- **Management and maintenance allowances increased** 5%, Major Repairs Allowance by 28% - no fundamental redistribution of allowances between authorities; settlement calculation recognised Disabled Facilities Grants for the first time
- Other **technical elements** were provided for, including any outstanding debt premiums, adjustments for PFI credits, and a small element for debt management
- Discount factor used to convert future net surpluses into a 2012-debt amount was 6.50%

2

2

Debt settlement: what has changed since?

- The bedrock of self-financing was that authorities were able to retain rents locally and spend them accordingly to local priorities
- Over time, cash surpluses would arise and there might be genuine choices in how business plans were managed
- There was a degree of resilience built into the system to cope with fluctuations in economic and interest conditions, and minor refinements to social housing policy
- However, in practice, the 2012-2024 period has included some major changes in six key areas, summarised as follows

NO. OF PROPERTIES

- Reinvigorated Right to Buy, there are many fewer properties in 2024 than envisaged
- Assumed 1,604k for 2023 is now 1,564k
- Authorities in theory been compensated for higher RTB sales through offsetting an element of debt from 141 RTB receipts – in practice massively constrained on reinvestment and has ultimately not allowed authorities to cover the stock loss impact
- Put simply… there are **fewer properties to sustain debt financing**

RENT POLICY AND RENT CONVERGENCE

- Rent policy has not moved at RPI+0.5%
- Increases were changed to a CPI basis for 2015.16 (for simplicity, CPI+1% considered equivalent of RPI+0.5%)
- **Minus 1% in cash terms, from 2016-2020**, real reduction over that period of 10.3% compared to CPI and therefore 14.3% compared to CPI+1%
- **CPI minus 3.1% for 2023.24** (7% cap)

STANDARDS (1)

- Major stock improvements are now required via regulators – these were not provided for in the settlement
- Fire and **Building Safety**
- **Energy Efficiency** (EPC C by 2030)
- **Awaab's Law** - damp and mould related
- Beginning preparations for **Net Zero Carbon**
- There has been some capital grant available – but nowhere near sufficient to cover the additional costs

STANDARDS (2)

- Prospective upgrade to the Decent Homes Standard
- Proposed revisions to the standard suggested likely to have **additional cost implications** arising from removing flexibility on component failures
- One off costs of increased supply chain pressures

ECONOMIC CONDITIONS SINCE 2020

- Unprecedented drive to higher cost inflation when compared to the core level of CPI over the period of the pandemic and since
- Whilst the settlement could reasonably have been expected to provide resilience to cyclical fluctuations in prices… strong sense in the sector that **prices have risen both significantly and irrevocably**

ADDITIONAL REGULATORY PRESSURES

- Two main drivers for increased costs…
- Competence and Conduct Standard as a driver for increases in costs
- Compliance against the Regulator of Social Housing's **enhanced consumer standards** – applies equally to repairs and management expenditure

3

A possible settlement revision?

There are two possible approaches to reopening the settlement and revising debt levels for local authorities

1 - Revise the original settlement and arrive at a debt addition/reduction to apply to each authority (as if it were still 2012)

- Retrospectively apply the changes to conditions and assumptions to the original settlement from 2012 to 2024
- Make assumptions about increased future costs through to 2042

2 - Undertake a completely new settlement

- Roll forward the settlement calculation to 2024.25 (or other short-term future date)
- Set out a set of assumptions to run from 2024 to 2054

Appropriate approach to revise the original settlement as this most closely represents the methodology adopted, and would allow a debt adjustment against that settlement

Revision calculation straightforwardly applied for rents, property numbers and inflation.

For higher standards, this could be financed via subsidy or grant – or captured within a settlement revision; this would be subject to a data analysis exercise (perhaps similar to the one undertaken by the BRE for 2012)

Estimate is an approach undertaken at a national level intended to stimulate debate: provides "order of impact"

NO. OF PROPERTIES

These can be applied to reduce the debt amount on a pro-rata basis

Using LADR and MHCLG data on social housing property numbers

RENT POLICY AND RENT CONVERGENCE

Changes to rent policy are known and applied, initially referenced to RPI and since 2016 to CPI

A general adjustment for moving the settlement from RPI to CPI when RPI is greater than CPI by 0.5%

STANDARDS (1)

An assumption of additional costs that have NOT been funded by capital grants

Starting point for modelling at £5,000 p/u 2020-2030

This would likely apply quite variably over different authorities

STANDARDS (2)

An assumption of what a revised Decent Homes Standard might mean – applied at a starting point of 10% introduced from 2024

Additional supply chain pressures of 5% applying 2025+

ECONOMIC CONDITIONS SINCE 2020

Recognising pressures on capital and revenue repairs

Cumulative impact of inflation captured in a single uplift to a revised capital expenditure profile – BCIS>CPI since 2020 starting point = 10% (actually 10.4%)

REGULATORY PRESSURES

Application of 5% uplift to both management (competency) and repairs (compliance)

4

HRA self-financing debt settlement: possible revision – step 1

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Step One: amend original settlement for changes in numbers of authorities

- The 2012 settlement included 171 authorities in total, two of which were included at zero
- There were four authorities that either had, or subsequently, transferred
  - Durham, Gloucester, Rochdale, South Lakeland
- Local Government Reorganisation has led to a further reduction in authority numbers by a net five
  - BCP (Bournemouth, Poole)
  - North Yorkshire (Harrogate, Richmondshire, Selby)
  - North Northants (Kettering, Corby)
  - Somerset (Sedgemoor, Somerset West and Taunton – itself formerly Taunton Deane)
- Two authorities are PFI-only authorities
  - Oldham and Salford – the latter included former Salix Homes subsequently stock transferred
- For reference, three authorities have either changed name or joined other LSVT authorities in Local Government Reorganisation

Step One: outcome

The resulting number of authorities at 31/3/2024 is 161 of which…

2 are PFI (Oldham, Salford)

1 is retained at zero debt (Isles of Scilly)

The original settlement

£29.188 billion

The original settlement recast for authorities at 31/3/2024

£28.685 billion

This is a reduction of **£0.503 billion** and represents the revised "starting point" for refreshing the settlement for the five changes

5

5

HRA self-financing debt settlement: possible revision – step 2

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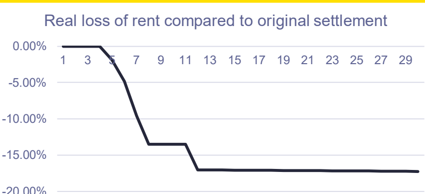
Step Two: amend original settlement for changes in rent policy 2012-2024

- Original settlement provided for real increases in rents at RPI+0.5% pa and convergence to target rents by 2016
- Convergence was "abandoned" from 2016 as a result of the 2015 post-general election budget
  - Case for incorporating an element of unachieved convergence is felt to be weakened by the fact that authorities had not converged effectively by then
  - However, the £2 weekly increase constraint may have prevented many from achieving full convergence by 2016 in any case – difficult to ascertain at this distance
- Rent increases were amended to be based at CPI from 2015 – initially at CPI+1%
  - Reasonable for this to be seen to be the equivalent of RPI+0.5%
- Rent increases were further amended as follows
  - Rent cut 2016-2020 minus 1% cash (14.3% below CPI+1% over those years)
  - Rent cap of 7% (CPI minus 3.1%) for 2023.24
- Chart shows the cumulative real loss in rent income across the settlement period from 2012-2042 (no changes to 2016 then cumulative changes thereafter)
- No adjustment for policy beyond 2024 though this is recognised as critical factor – sector as a whole pushing for CPI+1% over a long period (e.g. for 10 years)



Step Two: outcome

The original settlement recast for revised authorities

£28.685 billion

Reduction in rents as a result of real changes in allowed increases from 2016-2024

£18.501 billion

A reduction in the settlement of

£10.184 billion

Note… CPI only beyond 2025 would reduce the settlement by a further £1.06 billion

6

6

HRA self-financing debt settlement: possible revision – step 3

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Step Three: amend original settlement for changes in standards

- Original settlement covered life cycle elemental replacements assuming that the Decent Homes Standard had already been achieved
- Allowances in the settlement identified revised allowance totals based on property numbers and archetypes information collected for the final year of the subsidy system (2011.12)
- Allowance uplifted by 28% and included disabled facilities grants - national average allowance was £1,208 pupa – the equivalent of c £36k per unit over a 30-year planning period
- Since then, additional requirements to improve stock:
  - Energy efficiency and EPC C
  - Fire and Building Safety
  - Decent Homes Standard revision (yet to be published)
- Work undertaken by Savills in relation to these amounts suggests a national average unit total of c£5,000 applied between 2020-2030
  - Detailed work would be required to determine the impact locally
- Broad estimate of the cost of updated Decent Homes Standard would be an additional 10%
- Note that in all private finance deals - a “change in law” provision applies

Step Three: outcome

The original settlement recast for revised authorities

£28.685 billion

Application of higher standards relating to energy efficiency, fire and building safety and decent homes standard revision (prospective)

£24.150 billion

A reduction in the settlement of

£4.535 billion

The application of debt reduction nationally of 16% would widely vary between authorities given the number and proportion of high buildings held

7

7

HRA self-financing debt settlement: possible revision – step 4

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Step four: amend original settlement for excess inflation from 2020-2024

- The original settlement provided for increases in management, maintenance and major repairs effectively at RPI – no real increases beyond RPI
- Necessarily some resilience built into the settlement to cope with regular inflationary fluctuations
  - included a low settlement interest rate
- Now: challenges in supply chains, shocks to the world economy, effects of the pandemic and general inflationary pressures, inflation on capital repairs has been extensive, much higher than headline levels of CPI and according to local authority feedback, continues to remain above CPI
- Increases have been at a level that are unlikely to be reflected in sub-CPI increases through the next cycle – in other words, **costs have risen quickly and risen for good**
- Reflect a one-off increase in capital repairs inflation for the period from 2020-2024 as future inflation in this area is unlikely to ever be below headline CPI
  - BCIS medium range forecast is for CPI+0.5% - the differential between BCIS for repairs and CPI over this period was 10.4%
  - One off application of 5% increase to capital costs from supply chain pressures

Step Four: outcome

The original settlement recast for revised authorities

£28.685 billion

Application of excess and sustained inflation given pressure within supply chains from 2024/25 onwards

£27.130 billion

A reduction in the settlement of

£1.555 billion

This reduction in debt would likely apply differentially for those with higher capital repairs costs due to the nature of stock (high rise, flats etc)

8

8

HRA self-financing debt settlement: possible revision – step 5

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Step five: amend original settlement for higher regulatory burdens and pressures from 2023.24

- Social Housing (Regulation) Act in 2023 enhanced regulatory regime
- Better Social Housing Review provides for the professionalisation of management within the sector, now captured within the Competence and Conduct Standard
- Local authorities are incurring additional costs that were not envisaged within the original debt settlement
- In order to model the potential impact of these additional pressures: add 5% to management and maintenance
- 5% increase to management costs (additional professionalisation costs, additional officers to deliver effective additional governance and accountability)
- 5% increase to revenue repairs costs reflecting the potential for Awaab's Law cost pressures

Step Four: outcome

The original settlement recast for revised authorities

£28.685 billion

Application of additional costs for regulatory pressures in management and revenue repairs

£27.753 billion

A reduction in the settlement of

£0.932 billion

This reduction in debt would likely apply broadly uniformly across the HRA sector

9

9

HRA self-financing debt settlement: possible revision – step 6

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Step six: amend original settlement for higher property loss between 2012 and 2024

- Original settlement provided for reductions in property numbers cumulatively as a result of the right to buy
- Property numbers in the settlement relating to 2023.24 were 1.604m
- Actual property numbers are now 1.564m – a reduction of 40,000 or 2.56% more than provided for in the settlement
- Property numbers now are lower but still have to sustain the same level of debt as provided for in 2012 (with higher property numbers applying in that calculation)
- Might be argued that authorities have been able to reflect a debt reduction in excess property sales as a result of the 141 RTB agreements BUT
- In practice these receipts have not been applied to reduce debt, rather to assist in providing funding for new build (especially given the constraints on the 141 RTB reinvestment policy over many years)

Step Six: outcome

The movement in properties from 2012 to 2024 would provide for a further reduction against the original or revised settlement of 2.12%

If this was applied to the original settlement, this would be £607 million

Appropriate to apply steps one – five first, and then apply the stock reduction

10

10

HRA self-financing debt settlement: possible revision summary

Original settlement	**29,188**		*Notes*
Revision for authority numbers	-503		
Recast original settlement	**28,685**		*All figures in £million*
Revision to rent policy	-10,184	36%	*Property number revision applied after applying steps one-five*
Revision for standards	-4,535	16%	
Revision for capital repairs inflation	-1,555	5%	
Revision for regulatory pressures	-0.932	3%	*The %age reductions should be seen as a guide at the national level; the impact at the LA level would be around such an average*
Revision for property numbers	-228	1%	
Speculative consolidated revised settlement	**11,251**		

- Revisiting the 2012 debt settlement for the factors identified and average impacts modelled implies a reduction in debt of c61% overall
  - **Debt write down of £17.434 billion**
- Essential to acknowledge that these are a series of “average assumptions” applied to open the debate
  - Across a range of standards, inflationary and policy changes – these would not be the correct numbers if the exercise was undertaken bottom up, especially for building safety
  - **Rents policy and property number changes** - however – can be **straightforwardly applied** as they impact all authorities similarly
- There are other routes to invest in the system: grant funding, future rent policy, wider reform of the HRA offer – all of these might be seen alongside a revision to the debt settlement as components of a **Sustainable Financial Framework** for the HRA going forward

11