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# Housing Revenue Account Business Plan & Capacity Review

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November 2021

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## 1. Introduction

### 1.1. Background

Charnwood Borough Council (CBC, the Council) have commissioned Savills to produce an updated HRA Business Plan and review of the Asset Management Strategy which were both last produced in 2014.

The report focuses on the production and outputs of the HRA business plan but does refer to the outcome of the separate review of the Asset Management Strategy. It takes a holistic view on the current HRA budget and compares current cost levels with benchmarks for similar sized local authorities.

In updating the HRA business plan we have also considered the impact in light of the abolition of the HRA debt cap, and the potential for the introduction of greater flexibilities around the reinvestment of Right to Buy receipts. Like many authorities, the Council has adopted a new approach to setting out the financial capacity and capability of the HRA to deliver on its objectives towards refurbishment, investment, regeneration and new supply. This 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 updated the 2014 HRA business plan, in conjunction with officers, offering our thoughts on the methodology, approach and assumptions, with a focus on setting a series of target prudential indicators / metrics which may then inform the basis of the long-term financial management and investment strategy delivered within the business plan.

### 1.2. Approach

In order to carry out this commission we were provided the following:

- A full breakdown of the 2021.22 HRA Budget
- The 30-year projections for investment in the stock
- The full rent schedule for existing properties
- Potential investment opportunities

We have also drawn on our extensive financial database to provide appropriate benchmarks for both a high-level and in-depth comparison.

To produce the HRA business plan we have used our latest platform to model the 30-year projections and to provide a view on both viability but also borrowing capacity to allow for future and additional investment.

## 2. HRA Budget Review

### 2.1. HRA Budget

The HRA business plan is launched from the latest approved budget which is detailed below:

Table 2.1: HRA Budget

	2021.22 Budget
<b>Income:</b>	
Dwelling Rents	£21,100,000
Non-Dwelling Rents	£355,000
Charges for Services & Facilities	£441,000
Warden Charges	£49,000
Central Heating	£67,000
Other Income	£95,000
Interest & Investment Income	£25,000
<b>Total Income</b>	<b>£22,132,000</b>
<b>Expenditure:</b>	
Repairs & Maintenance	£6,802,000
Supervision & Management	£5,666,000
Contribution to Bad Debt Provision	£383,000
Depreciation (transfer to MRR)	£3,409,000
Debt Management Costs	£10,000
Interest Payable	£2,709,000
<b>Total Expenditure</b>	<b>£18,979,000</b>
<b>Surplus</b>	<b>£3,153,000</b>
Contribution from Reserve	£365,000
Revenue Contribution to Capital	(£3,523,000)
<b>Net Surplus / (Deficit)</b>	<b>(£5,000)</b>

The HRA shows a forecast deficit of £5,000 which occurs after the revenue contribution to capital. CBC also holds an HRA Financing Reserve of £5.623million which is after the £0.365million contribution to the general HRA reserve. This is therefore in addition to the £0.602million forecast balances within the HRA general reserve.

The HRA business model has been balanced to the above budget in order to project future cashflow income and expenditure prior to the financing of capital expenditure.

*Table 2.2: HRA Capital Budget*

	2021.22 Budget
<b>Expenditure:</b>	
Investment in Stock	£6,331,500
Acquisitions	£1,050,000
<b>Total Income</b>	<b>£7,381,500</b>
<b>Financed By:</b>	
Major Repairs Reserve	£3,408,700
'1-4-1' Receipts	£450,000
Revenue Contributions	£3,522,800
<b>Total Expenditure</b>	<b>£7,381,500</b>

The Major Repairs Reserve, to which the depreciation charged to the HRA is credited, is forecast to hold balances of £3.111million in March 2012.

A small programme for 6 open market acquisitions is budgeted this year, which is part-subsided by the use of '1-4-1' retained right to buy receipts.

## 2.2. Benchmarking

In order to compare Charnwood's cost basis we have utilised our national database of the accounts for stock holding local authorities and identified a peer group of 15 local authorities with a range of 3,600 to 5,700 properties located in the Midlands and East of England. The results are shown on a per unit basis to allow for direct comparison.

The costs for financial year 2020.21 will be impacted due to the Coronavirus pandemic in that expenditure, particularly for repairs, would be lower than previous years, hence we have shown the values for 2019.20 as well.

For further comparison we have shown the per unit values for the 2021.22 budget as well.

Table 2.3: Benchmarking Analysis (per unit)

	2019.20 Actual		2020.21 Actual		2021.22
	Charnwood	Peer Group	Charnwood	Peer Group	Charnwood
All Management (per unit)	£1,056	£1,258	£1,100	£1,257	£1,027
Net Management (per unit)	£813	£889	£880	£896	£845
Repairs (per unit)	£1,086	£1,030	£1,003	£1,053	£1,234
Depreciation (per unit)	£586	£914	£625	£972	£618
Operating Surplus (per unit)	£1,056	£1,256	£1,054	£1,284	£1,057
Rents	£71.73	£81.70	£74.73	£83.14	£75.26

The all management costs incorporate the total running costs for the service exclusive of the provision for bad debts, depreciation and interest charges, whereas the net management cost offsets the income from non-dwelling rents, service charges and other income, excluding interest earned.

The analysis shows that both gross and net management costs are lower than the peer groups for the two years of accounts with 2021.22 likely to follow suit.

Repairs expenditure is relatively in-line with the peer group, although 2021.22 shows an increase in expenditure, to which we review further in the following section.

The depreciation charge is lower than the peer group by some margin. Whilst this is not material as surpluses generated by the HRA, which would be increased by a lower depreciation charge, are offset by higher revenue contributions to capital to fund the programme. It is however, a key component when considering borrowing capacity further in this report.

The operating surplus (prior to interest) remains relatively stable across all three years, but is lower than the peer group. A major factor in accounting for the difference is the level of rent charged, but also the lower depreciation charge.

In order to make further comparisons we have shown graphically the difference in the key HRA expenditure headings expressed as a percentage of the total income (which includes rents less voids, non-dwelling rents and charges, service charges and other forms of income).

Chart 2.4: 2019.20 Benchmarking Analysis (percentage expenditure)

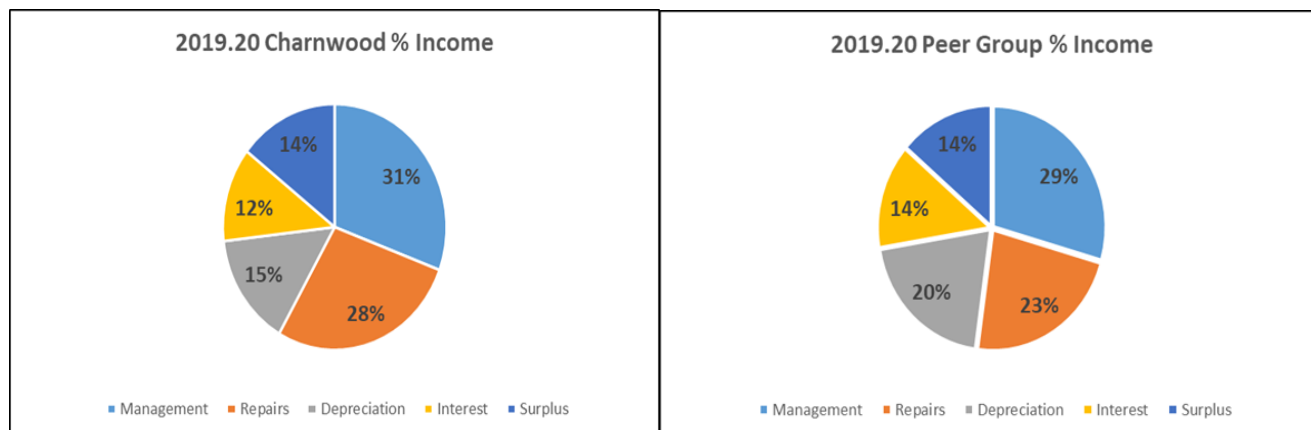


Chart 2.5: 2020.21 Benchmarking Analysis (percentage expenditure)

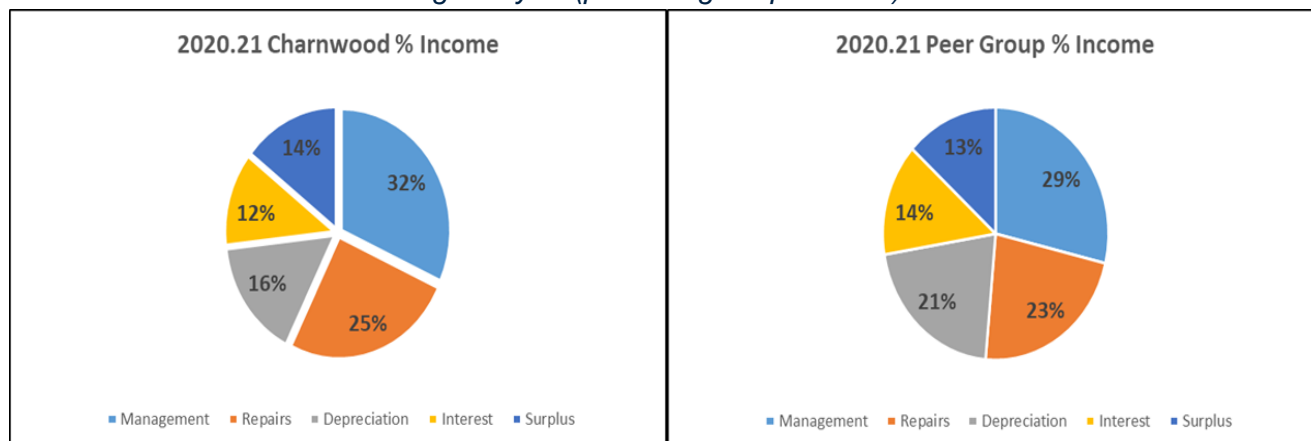
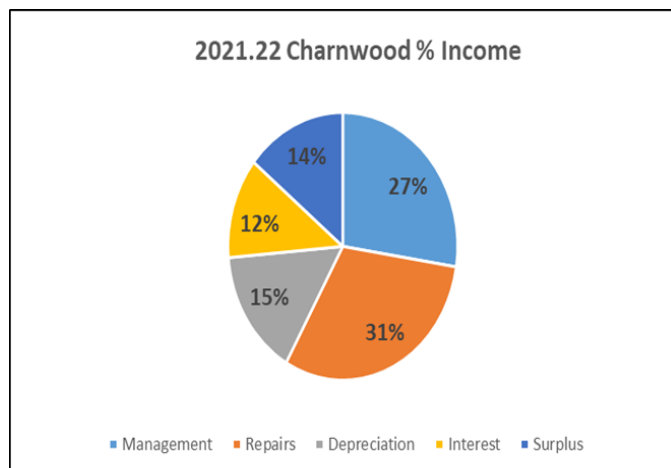


Chart 2.6: 2021.22 Benchmarking Analysis (percentage expenditure)



In terms of the two years direct comparison with the peer group and 2021.22 budget there are no significant outliers other than the following:

- Repairs expenditure for 2019.20 and 2021.22 demonstrates a higher level of expenditure, which is reflected in the above table.
- Depreciation also differs again due to the lower provision made by CBC
- Interest charges are lower on account of the smaller debt level in comparison to the peer group

Interestingly though, the resulting surpluses appear to be in line, which results in no draw upon reserves.

## 2.3. In-Depth Review

As per our commission we undertook a desktop holistic review of the key budgets within the HRA. In doing so we were provided with a comprehensive list of all of the HRA budgets by both cost centre but also account code. This allowed us to categorise expenditure in order to compare with our knowledge and database of other HRAs.

Our summary of the accounts is as follows:

### Non-Rental Income

The budgets primarily cover:

- Rent from Land
- Garage Rents (less 31% void allowance)
- Shop Rents (less 24% void allowance)
- Service Charges (less various levels of void allowance c34%)
- Council Tax Recharged
- Ground Maintenance Contributions

These are set locally and therefore cannot be benchmarked as they based on the profile of assets specific to CBC. The void rates, however, have a significant impact to the coverage of actual costs for services.

### Management

We have reviewed the detailed budgets that make up the £5.441million costs for management.

We have categorised the expenditure for the costs by reviewing the account codes for the following headings:

- Direct Salaries: £3,168,200
- Direct Costs: £1,681,200 (net of income)



- Overhead Costs: £1,651,400
- Recharges: (£1,023,500)

The proportion of salary costs is equivalent to 49% of expenditure, whilst net direct costs account for 26% leaving 25% for central overhead recharges.

The level of recharges appear to be at the higher end than other authorities to which we hold data as a percentage of overall management expenditure with ranges between 12% and 27%.

Another analysis is the split between core and non-core management activities. Our analysis shows that 19% of expenditure is deemed non-core, which is deemed supplementary to the specific landlord function. This compares to benchmarks of between 15% and 21% elsewhere.

### Repairs

As with management budgets we have reviewed the cost centre and accounts that are associated with the repairs service.

We have categorised the expenditure for the costs by reviewing the account codes for the following headings:

- Direct Salaries: £2,847,712
- Direct Costs: £3,264,729
  - Of which: £635,000 on subcontractors
- Overhead Costs: £689,859

The salaries proportion is 42% which is at the lower end of benchmarks with other local authorities that have a direct workforce rather than a repairs contractor.

Overheads from the General Fund charged to repairs account for 10% of the overall budget which again is line with benchmarks with local authorities with a typical range of 8% to 16%.

The direct costs are formed from a variety of expenditure including materials, sub-contractors, transport and internal operational related costs. The level of sub-contractor accounts for 9% which is very much at the lower-end of what we have seen with other Councils. This is a positive, given less reliance upon external services.

### Financing Costs

There will be a variety of reasons for the cost of borrowing charged to the HRA. This will be due to loans attributed to the HRA, when they were financed and duration. Currently, the average interest rate for CBC is 3.43%. This compares favourably with the national average rate of 4.01% whilst the peer group used for the benchmarks above is 3.06%.

Given the majority of borrowing would have been to finance the self-financing settlement the rates are within the expected range, given the duration of some of the loan facilities.

## Capital Fees

From the accounts analysis £299,700 is charged to capital expenditure for the management of the capital programme. Due to the fluctuation of capital expenditure the fees equate to between 4% and 7% which is well within the expected 8% benchmarks.

## 3. Capital Investment & Financing

### 3.1. 30-Year projections

The following table shows the latest projections for the stock investment required for the stock summarised in 5-year segments. Year 1 in the table represents financial year 2020.21, and as we have launched the model from 2021.22 and used the actual capital programme we have drawn from the figures commencing in year 3 with allowances for inflation. Therefore, we have had to assume an average level of expenditure for the plan in the final 2 years.

*Table 3.1: 30-Year Stock Investment Requirements*

Component	Yrs 1-5	Yrs 6-10	Yrs 11-15	Yrs 16-20	Yrs 21-25	Yrs 26-30	TOTAL
Bathrooms	5,369,532	2,159,425	3,682,901	2,143,959	6,744,495	4,479,596	<b>24,579,909</b>
Kitchens	2,354,912	3,692,371	8,393,990	6,654,473	2,683,123	2,916,973	<b>26,695,841</b>
Heating	2,354,681	6,921,857	1,650,028	2,609,547	11,211,874	2,540,702	<b>27,288,690</b>
Wiring	1,582,256	2,526,553	2,526,553	2,526,553	2,526,553	2,526,553	<b>14,215,022</b>
Windows	419,628	2,391,879	6,174,126	5,684,560	607,062	2,798	<b>15,280,053</b>
Doors	3,459,170	150,250	492,140	542,200	1,704,600	1,641,520	<b>7,989,880</b>
Roof/Insulation	2,105,600	1,222,800	16,000	1,750,300	2,240,000	2,181,600	<b>9,516,300</b>
Structural	1,250,000	1,250,000	1,250,000	1,250,000	1,250,000	1,250,000	<b>7,500,000</b>
Asbestos	530,000	200,000	200,000	200,000	200,000	200,000	<b>1,530,000</b>
Fire Safety	700,000	50,000	50,000	50,000	50,000	50,000	<b>950,000</b>
Smoke Detectors	449,325	0	0	449,325	0	0	<b>898,650</b>
Adaptations	2,800,000	2,800,000	2,800,000	2,800,000	2,800,000	2,800,000	<b>16,800,000</b>
Major Voids	1,340,000	1,250,000	1,250,000	1,250,000	1,250,000	1,250,000	<b>7,590,000</b>

Component	Yrs 1-5	Yrs 6-10	Yrs 11-15	Yrs 16-20	Yrs 21-25	Yrs 26-30	TOTAL
Communal Works	2,140,370	850,925	850,925	850,925	850,925	850,925	<b>6,394,995</b>
Estate Works	1,015,000	1,000,000	1,000,000	1,000,000	1,000,000	1,000,000	<b>6,015,000</b>
Other Sheltered	275,000	0	125,000	240,000	60,000	0	<b>700,000</b>
IT Replacement	0	300,000	0	300,000	0	300,000	<b>900,000</b>
Garages	470,000	0	0	0	0	0	<b>470,000</b>
<b>TOTAL</b>	<b>28,615,474</b>	<b>26,766,060</b>	<b>30,461,663</b>	<b>30,301,842</b>	<b>35,178,632</b>	<b>23,990,667</b>	<b>175,314,340</b>

This table demonstrates a total of £175,314,340 of capital investment for the HRA over the 30 year period. The above table excludes the provision for capitalised fees to manage the annual programme of £299,700, which has been included within the financial projections.

Within the model we have assumed that some components, for example kitchens and bathrooms, are considered variable and therefore adjusted within the projections for loss of stock through right to buy.

### 3.2. Review of the Asset Management Strategy Framework

Savills have been appointed, as part of our commission, to review the database used to arrive and the above costs and provide support for the preparation of the Asset Management Strategy Framework.

The key themes of the Asset Management Strategy Framework:

- **Stock Investment-** Investing to maintain the stock to a standard that meet customer and business need and regulatory requirements.
- **Active Asset Management-** Activities to improve the performance of assets that have a poor social, economic or environmental performance, because of low demand or high costs, and either improving them or replacing them with properties which are fit for purpose.
- **Supporting wider objectives** - Being clear where and how asset management is supporting wider objectives, such as building safety, energy efficiency and meeting housing need in line with our strategic aims.

Our observations of the current database are:

- Stock Condition data:
  - Based on 50% sample carried out 2012 which has not been regularly updated
  - Risk that condition and components reaching end of life cycle are not factored into the projections
  - The need for a sample survey to validate business plan/asset management strategy and decent homes compliance

- Other non-survey requirements:
  - Energy – RDSAP data held but appears old and not updated
  - Mechanical & Electrical – costs not up to date - specialist surveys may be required for complex equipment
  - Sheltered Housing Improvements – small provision made
  - Fire Safety – not large exposure but allowances made for additional works need reviewing – additional specialist surveys and additional FRAs
- Asset Performance Evaluation:
  - Currently the focus is on when rather than if to invest in the stock.
  - Understanding asset performance critical in future
- Investment Standards:
  - Charnwood Standard used as reference point
  - Beyond decent homes standard
  - Based on life-cycle rather than condition and need for replacement
  - Risks replacing items still in reasonable condition
  - Asset management strategy to be reviewed in context of wider investment priorities
- Business Planning:
  - Existing commitments covered but age and extent of existing data means manual adjustments required
  - Raw data shows backlog expenditure – risk of spend profile being incorrect
  - Risk of less effective investment programmes without link back to effective core data

In summary, the levels of expenditure are within expected benchmarks over the 30 years but risks some expenditure not being properly prioritised.

Therefore the Asset Management Strategy Framework has identified a series of tasks to tackle this through two phases.

More work and conversation however, is required for the move towards the stock becoming zero-carbon.

### **3.3. New Housing Supply**

At present the model includes for the acquisition of 6 properties in the form of ex-Council homes for 2021.22 only. The acquisitions utilise the 1-4-1 receipts that occur from right to buy receipts.

Whilst the regulations are changing for the use of right to buy receipts the impact of this has no bearing on CBC's HRA and would actually allow for a greater percentage of 1-4-1 receipts to be used.

We have modelled a scenario of the continuation of the continuation of the acquisition programme in section 6 on this review.

### 3.4. Sheltered Scheme Review

Currently CBC is witnessing high void levels within in sheltered stock due to some of the properties not being fit for purpose and therefore difficult to re-let. This impacts upon loss of rental income but also service costs that are unrecoverable.

Within the above table no investment, that is included within the base plan, has been provided for sheltered scheme remodelling.

We have therefore modelled a scenario where some of the existing schemes are remodelled and then the impact to the plan can be assessed.

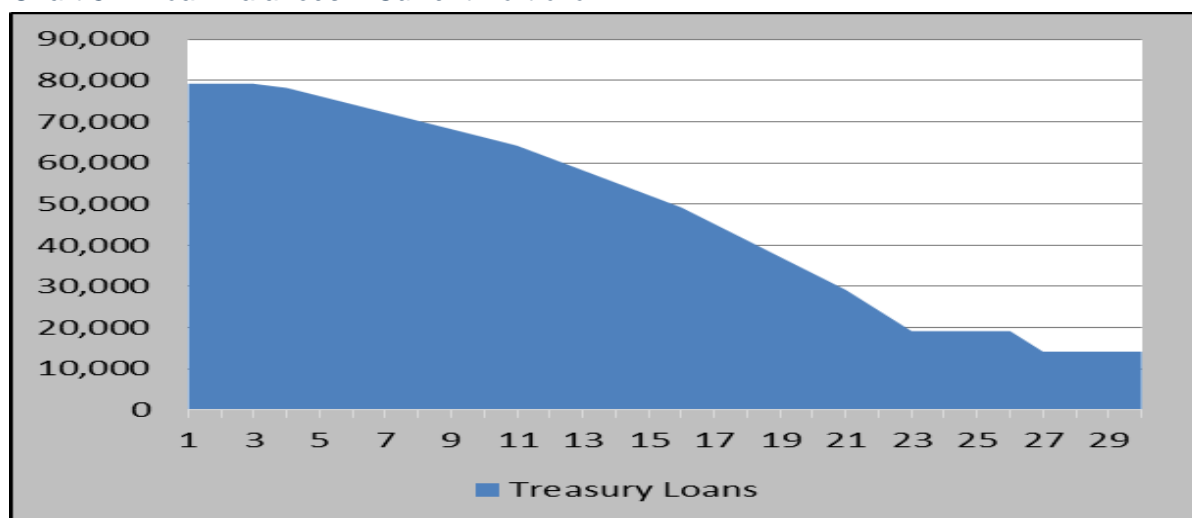
### 3.5. Current Financing of the HRA

The HRA level of debt is defined by its HRACFR (Capital Financing Requirement). It currently stands at £78,620,000 and is financed by:

- 24 Loans with various maturity dates totalling £79,190,000
- This results in 'over-financing' of £570,000 to which interest is received from the CBC General Fund

The loan portfolio and future balances from loan maturities is shown below:

Chart 3.1: Loan Balances – Current Portfolio



This demonstrates that the projected loan balances reduce to £14.190million over the 30 years. This excludes any refinancing of the loans or additional borrowing required.

The average interest charge for the current portfolio is 3.43%.

## 4. HRA Business Plan Projections

### 4.1. Future Assumptions

The model is launched from 2021.22 using the budgets as in table 2.1, the loans within chart 3.1 and the stock investment requirements in table 3.1.

In order to produce future cashflow projections for the HRA we have made the following assumptions:

1. Core Inflation running through the plan is set at 2% based on the Government's long-term CPI (consumer price index) target of 2%, with 2.5% applied for years 2 & 3.
2. Rents for 2022.23 will increase by 4.1% on the current levels of £75.28 and then for April 2023 and April 2024 by CPI plus 1% following the current social rent policy. Thereafter rents will increase by CPI only
3. Properties re-let to new tenants will be at formula rent which is £1.11 than the current level and a turnover rate of 2.5% is assumed on a reducing balance basis
4. Void rates rent lost are set at current reflecting the difficulties with letting some sheltered stock
5. Bad Debt Provision continues to be set at 1.77% of rental income
6. Right to Buys remain at 40 per year for the first 3 years and then reduce by 10% per year, at total of 476 properties representing 8.6% of the current stock
7. All service charges and other forms of income will increase by CPI only
8. All management related costs will increase by CPI only
9. Repair cost will increase by CPI only but adjusted by 20% (pro-rate) for stock loss
10. Capital Expenditure increases by CPI only with some components adjusted for stock loss, with an uplift of an additional 7% on the values in table 3.1 for application from 2022.23 onwards
11. Loans upon maturity will be repaid from HRA reserves or surpluses but where refinancing is required an interest rate of 3.5% is assumed for medium-term borrowing
12. The minimum balance for the HRA has been set at £0.55million and increases with inflation
13. We have assumed that the HRA Financing Reserve is utilised to finance the loan repayments over years 4 to 7 of the plan.

### 4.2. Financial Outputs

The charts below summarise the forecast:

- Revenue reserves forecast over 30 years
- Capital programme forecast over 30 years
- HRA Debt forecast over 30 years.

Chart 4.1 - Revenue Reserves forecast 2021-2051 Baseline Position

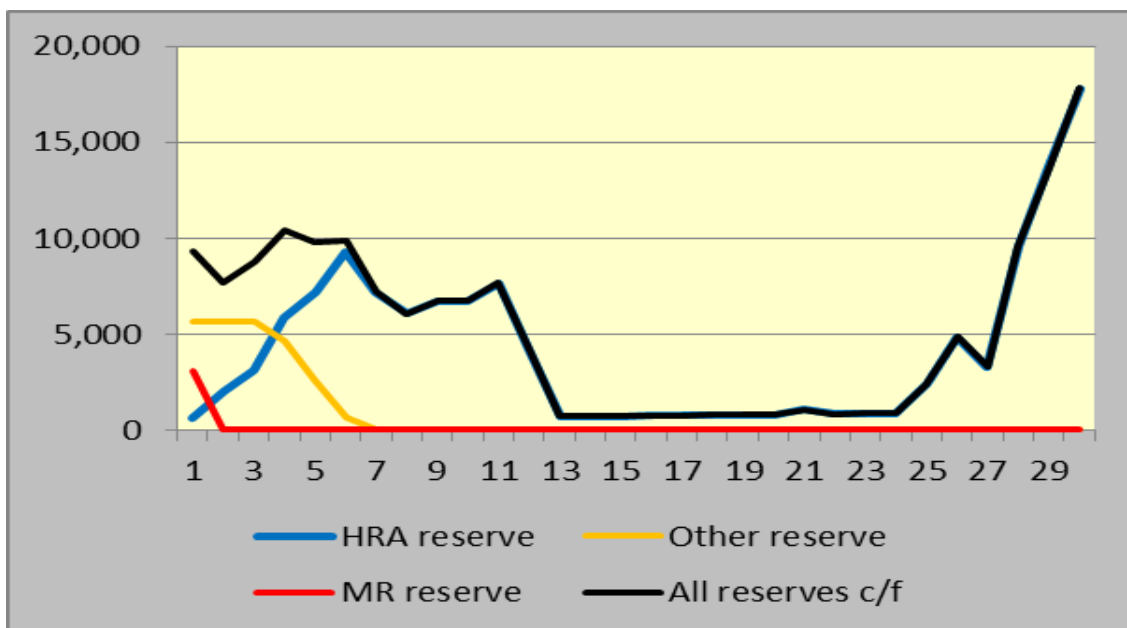


Chart 4.2 - Capital expenditure and financing forecast 2021-2051 Baseline Position

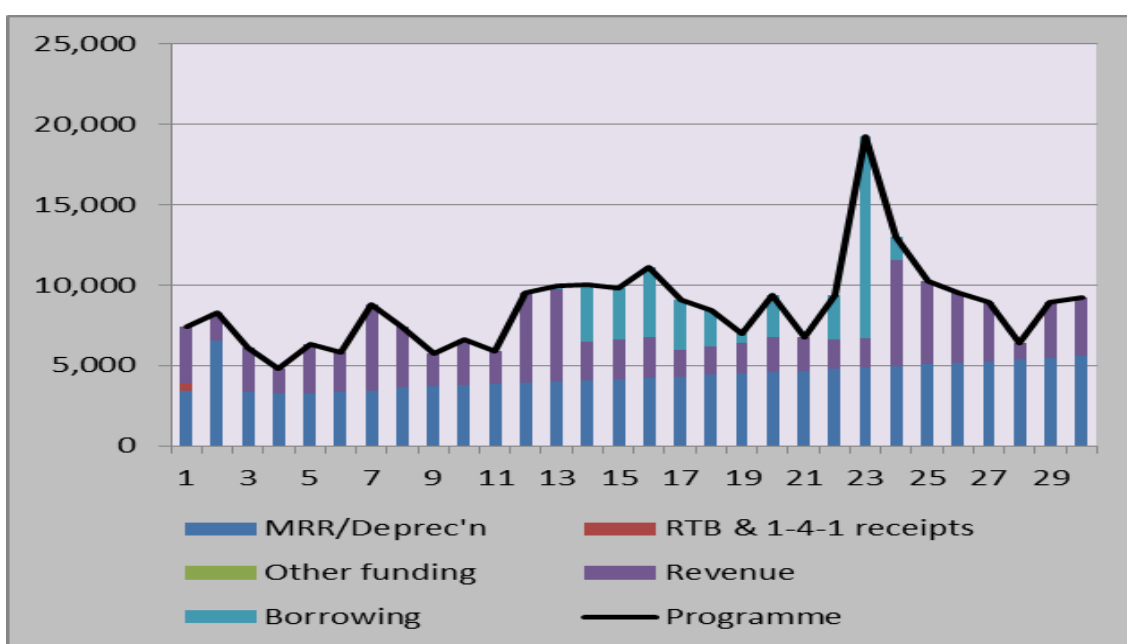
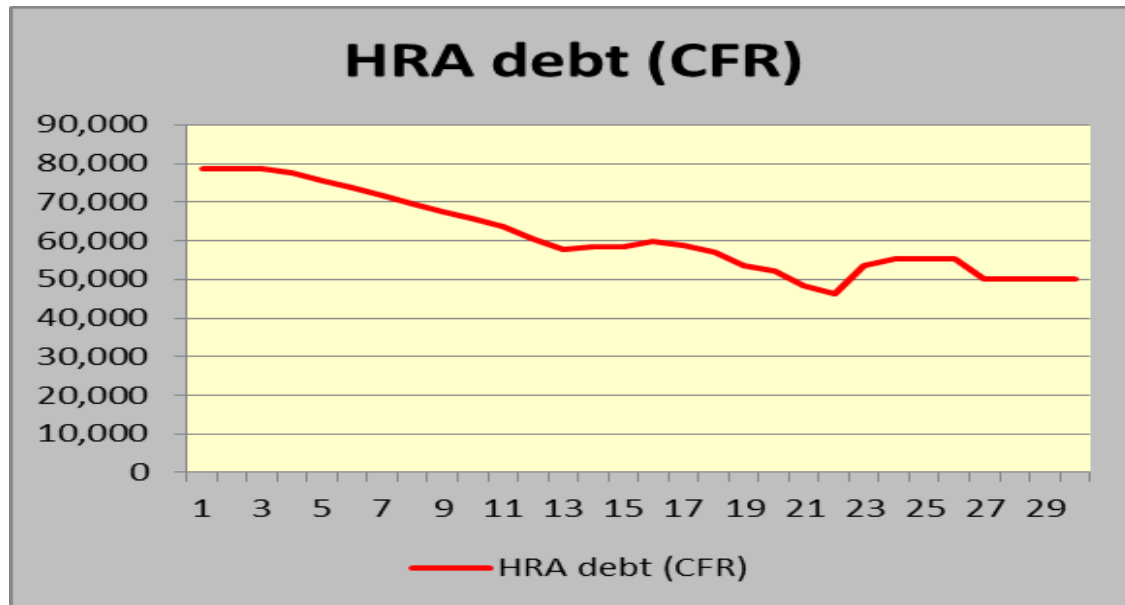


Chart 4.3 - HRA Debt forecast 2021-2051 Baseline Position



### 4.3. Summary

The revenue projections show that available reserves are utilised over the early stages of the plan to finance both capital expenditure and loan repayments. Due to capital expenditure increasing in year 12, in comparison to the previous years, the HRA balance falls to the pre-set minimum levels. This continues for a period of 12 years and then balances begin to accrue as capital expenditure begins to reduce compared to the mid-term levels of the plan.

The capital expenditure chart shows that the programme is fully funded in each of the years by a variety of resources, but substantially from the HRA itself but with the requirement for additional borrowing in the mid-term of the plan.

The debt levels of the HRA (HRACFR) initially reduce on account of the loans maturing during this period. However, in the mid-term of the plan whilst there are loans continually maturing there is a need to both refinance these loans but also additional borrowing required. The net effect of this is shown in chart 4.3 where in years 14 to 17 there is an overall growth in borrowing. Later into the plan, due to the high levels of forecast capital expenditure, further borrowing is required.

In overall terms the HRA revenue position remains balanced and is forecast to have reserves of c£17.8million in 30 years, whilst ensuring a fully financed capital programme. The levels of debt commence at £78.62million and are forecast to be c£50.2million in 30 years, of which £14.9million will be accounted for with existing loans.



There is no statutory requirement for the repayment of debt within the HRA. It is likely though that once a revisit of the stock investment requirements is undertaken that the profile of required borrowing may change.

## 5. Capacity analysis

### 5.1. Introduction and methodology

The HRA debt cap represented an artificial constraint on borrowing set outside the HRA and linked to future income and cost assumptions which were made in 2012. The housing and financial policy environment has moved on considerably since then, however the only change in the debt cap until 2018 that was implemented was for a small minority of authorities that opted to bid for an increase in 2014.15.

The proposition within this analysis is that, whilst there is theoretically now no limit to borrowing within the HRA, the existing asset and operating base generates a net income stream that does offer a logical limit on sustainable borrowing levels. In setting out its investment strategy, the Council therefore needs to consider how it will take decisions on whether to invest, how to fund, the extent of new borrowing, and determine a framework within which decisions will be taken for the business plan overall, within the MTFP and within successive budget rounds.

This report applies some metrics developed in the light of the experience of 40 years' of successful private finance of housing associations, during which associations have developed hundreds of thousands of new affordable homes, without a single association ever going into default with any of its lenders.

This is not the only approach that can be utilised, for example the Council will have an established approach to the setting of Prudential Indicators in the General Fund which it might wish to consider in the HRA context. However, as will be seen, looking at tried and tested principles from a privately financed sector in the HRA context provides a powerful and persuasive evidence base to provide for a significant increase in funding for new HRA developments.

### 5.2. Housing association metrics

Housing associations have traditionally been funded from long-term bank lending from the High Street banks and Building Societies. There is over £60billion of debt on HA balance sheets. Bank lending has been built on lending covenants which have become established in the marketplace and associated with the delivery of cheap debt. Whilst local authority borrowing is not directly secured on its asset base, the covenant approach provides a key insight into the viability and sustainability of borrowing as viewed by private lenders.

We have identified three covenants/ratios or metrics which we consider potentially relevant in the HRA context, set out below.

### *Interest Cover Ratio (ICR)*

This is the ratio of 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 2019.20 was around 1.65; typical lending covenants vary between 1.10 and 1.50 depending on the size and nature of the HA, with 1.25 being a typical "golden rule".

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, 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.

### *Loan to Value (LTV)*

This is an essential tool for private lenders where debt is secured against properties, hence theoretically against their value. The basis for valuation in HAs has been Existing Use Value (Social Housing) - EUV(SH) - for decades with many HAs and lenders now adopting Market Value Subject to Tenancy as a valuation method. Typical covenants prescribe 65-70% maximum LTV.

For the HRA, borrowing is not directly secured against the properties. In addition, the EUV(SH) calculation prescribed by government is not cashflow based, but is based on vacant possession values discounted by a regional factor periodically published by the government.

LTV is best defined in the HRA context as Outstanding Debt / Fixed Asset Value. Debt is defined as the HRACFR as this is the amount that must be financed with interest payments in the HRA. Asset values include all assets, dwellings and non-dwellings, as all assets are included in the generation of net income cashflows in the HRA.

Whilst the LTV definition works for the HRA to an extent, the absence of a clear relationship between net rental income and asset values means that the ratio tends to deliver a “low” result, compared to HAs.

### *Debt: Turnover ratio*

Another measure we have developed for this analysis is the ratio of Debt to Turnover. This measures the level of turnover in relation to debt, which differs slightly from the ratio used for assessing debtor balances against turnover. As a proxy we have suggested a ratio of 5:0, so that turnover can cover the level of debt outstanding by a factor of 5 times. This measures the capability for gross income to cover debt and is becoming an established and readily accessible measure for local authorities.

### *Others*

There are other covenants and ratios that are utilised in the HA context, including in particular Asset Cover (broadly, the inverse of LTV). Lenders and HAs are tending to move away from this towards gearing as a key measure.

Gearing is also another measure, which is effectively the LTV ratio but with the inclusion of reserves.

### **5.3. Using the metrics & benchmarking**

The application of each metric to the cashflows and balance sheet within the business plan will result in a deemed maximum *constraint* on borrowing.

In the HRA context, the projected constraint on borrowing will operate separately because of the lack of direct dependency between net income streams and asset values and the level of debt. We would expect to see quite different results from each, and the extent to which the measures vary will offer additional insight into the viability and sustainability of new investment within the business plan.

The maximum capacity will result from the lowest outcome from each of the three metrics and each will change over time. A forecast for all three illustrates potential capacity frameworks for OCC, however we have proposed that the key focus might be on the Interest Cover Ratio as this provides the most straightforwardly interpreted and practical measure.

Savills has undertaken an analysis of the national position based on the HRA accounts for 2020.21. In addition we have used the same peer group as used for the cost benchmarking. OCC's outputs are compared below.

Table 5.1: metrics comparison to peer group and national average

Description	CBC Projections 2021.22	CBC Actual 2020.21	Peer Group 2020.21	National Actual 2019.20
Operating margin	26%	26%	28%	22%
Interest Cover Ratio	2.16	2.16	1.92	1.67
Loan to Value	25%	25%	34%	27%
Debt: Turnover	3.6	3.6	4.7	3.3

It is possible to draw general conclusions that:

- Interest cover remains greater than the peer group and the national position for 2019.20, however as per the benchmarking analysis we have commented on the lower level of depreciation charge which will influence by the operating margin and interest cover ratio.

If we were to use the average depreciation value of the peer group the impact is shown below:

- Operating Margin: 18%
- Interest Cover Ratio: 1.46

- The loan to value is below both the peer group and the national average
- Debt to Turnover is also favourable in comparison to the peer group and national average
- In measures the performance between 2020.21 actuals and 2021.22 budgets remains static

#### 5.4. Metrics for CBC HRA BP model

We have taken the outputs from the HRA Business Plan model and analysed the three metrics from the key financials of the modelling.

The three graphs below illustrate the metrics described in section 5.2

We have set minimum metrics as follows:

- ICR @ minimum 1.25
- LTV @ maximum 50%
- Debt:Turnover @ maximum 5.0

These are not minimum/maximum constraints, rather guidelines based on benchmarks within the HA sector and with other HRAs..

The Council may wish to operate with leeway within each.

It is emphasised that these are guideline measures to assist the central finance function (s151 officer) to determine what are prudent borrowing limits. Ultimately, the s151 is accountable for any specific borrowing is undertaken according to the principles of prudence in the Prudential Code.

The modelling has been amended to reflect the impact of a higher depreciation charge, based on the average derived from the peer group.

Chart 5.1– Interest Cover Ratio Projections

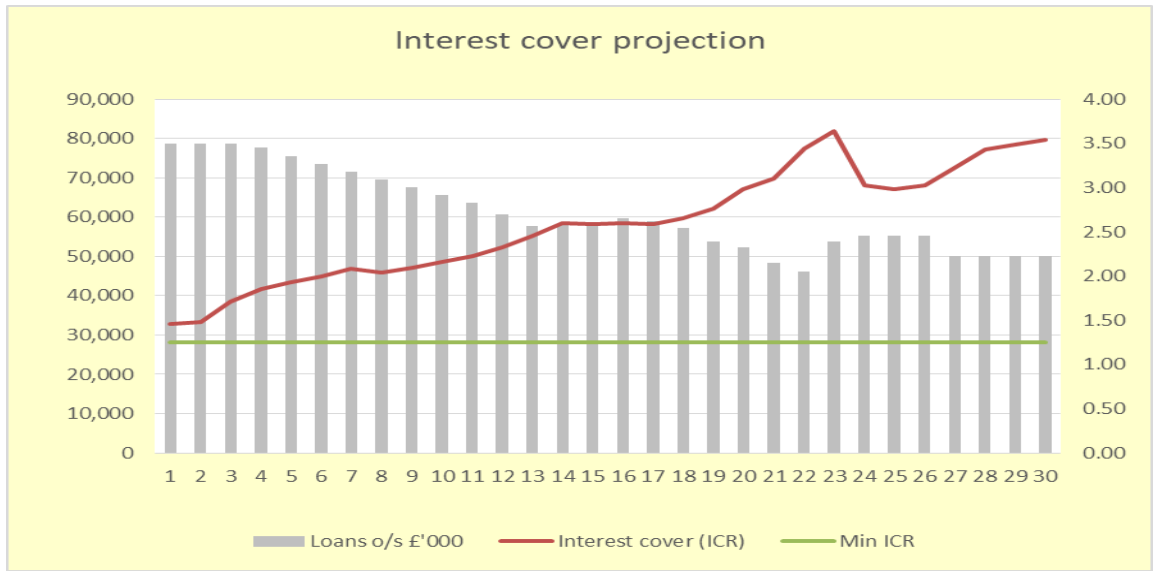


Chart 5.2 – Loan to Value Ratio Projections

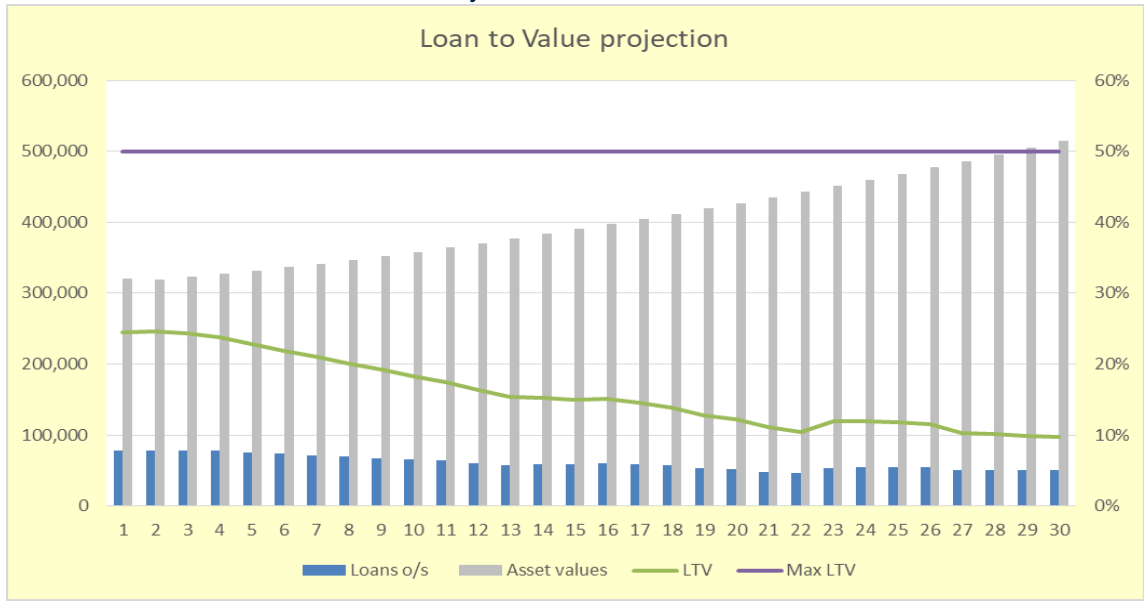
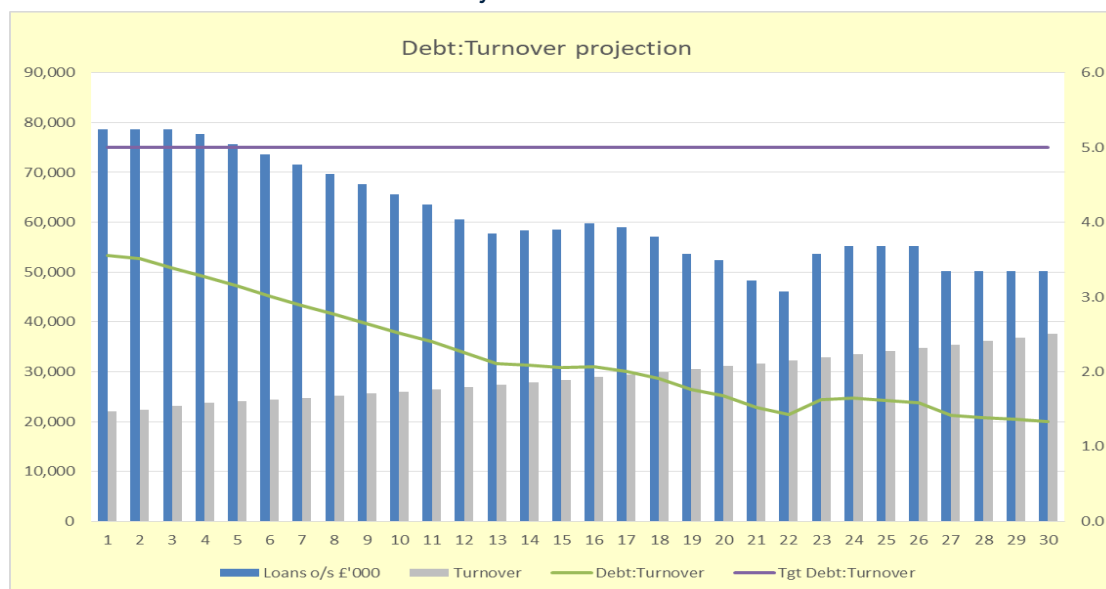


Chart 5.3 – Debt:Turnover Ratio Projections



The three graphs illustrate the following:

- The ICR shows that there is additional capacity available in all of the years and shows growth for the majority of these. Part of the reason will be the net repayment of loans, thus reducing the levels of interest paid
- That there is the same direction of travel in terms of LTV but growth is extended by the repayment of loan maturing offset by refinancing and additional borrowing
- The Debt:Turnover ratio shows a similar pattern to the ICR

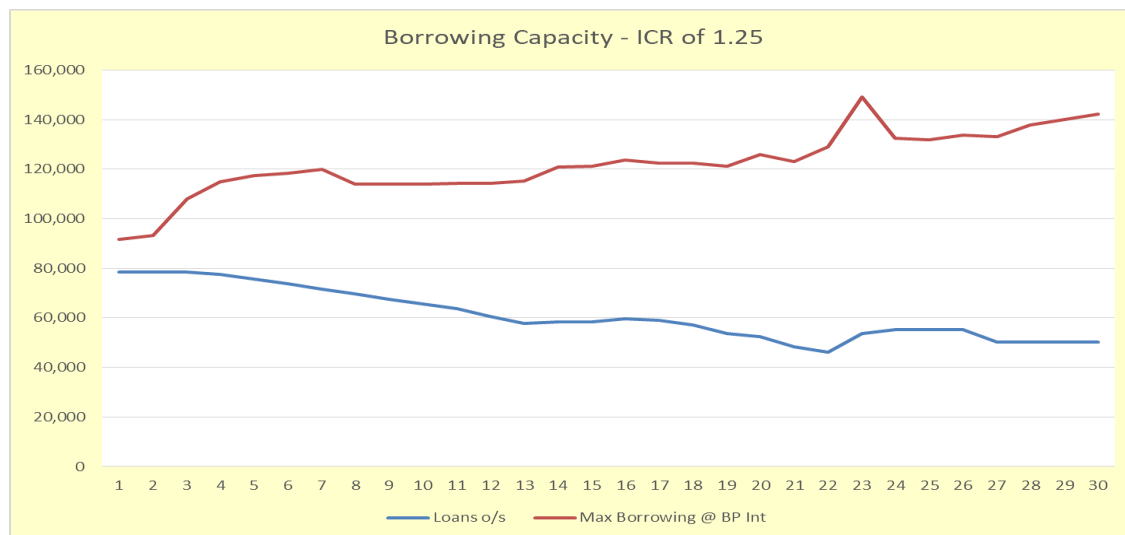
The interplay between these metrics illustrates the importance of adopting an overall approach to setting a framework, rather than relying on any specific measure or measures.

In particular, whilst interest cover remains broadly within expected limits in the early years and grows quickly for the remainder of the plan, highlighting the underlying strength of net cashflows in the current stock and due to net loan repayments.

## 5.5. Additional capacity over time

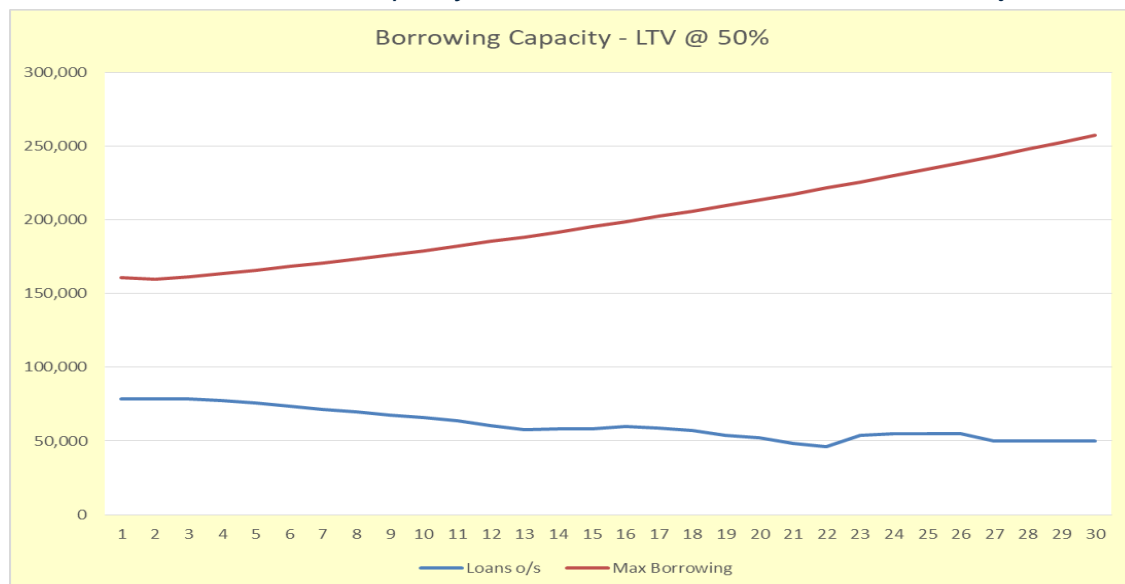
We have set out below our forecasts for how borrowing capacity changes during the term of the plan. These are based on the outputs from the charts 5.1 to 5.3 above.

Chart 5.4 – Forecast Debt Capacity based on a Minimum ICR of 1.25



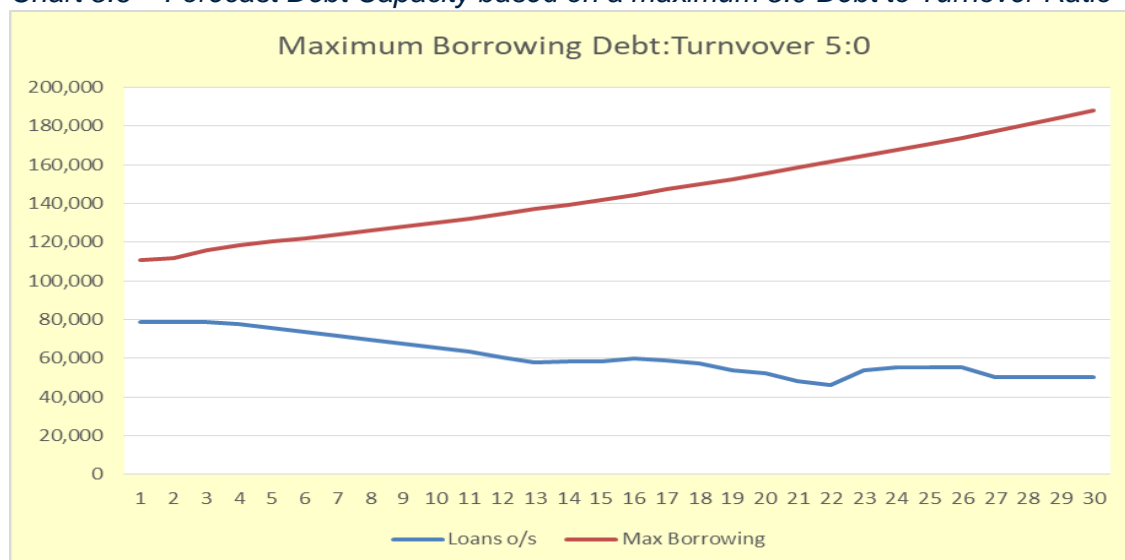
This chart demonstrates that capacity (the gap between the two lines) is available immediately of c£13.2million and steadily increasing.

Chart 5.5 – Forecast Debt Capacity based on a maximum Loan to Value Projection of 50%



The asset value is increasing over the years on account of the development programme, inflation but offset by right to buys. In all years there is borrowing capacity, which increases as net debt is repaid.

Chart 5.6 – Forecast Debt Capacity based on a maximum 5.0 Debt to Turnover Ratio



As set out above, this graph presents a similar position to the ICR metric demonstrating that capacity is increasing throughout the plan.

## 6. Sensitivity & Scenario Modelling

### 6.1. Sensitivity Testing

As part of the business planning process we have run a series of sensitivities to demonstrate the impact of changes to the assumptions used within the model and are shown in the table below:

Table 6.1: Sensitivity Test

Sensitivity £'m	HRA Bal Yr 10	HRA Debt Yr 10	ICR Yr 10	HRA Bal Yr 30	HRA Debt Yr 30	ICR Yr 30
<b>Base</b>	<b>6.718</b>	<b>65.620</b>	<b>2.16</b>	<b>17.805</b>	<b>50.157</b>	<b>3.55</b>
CPI -0.5%	6.051	65.620	2.04	13.177	53.509	2.85
CPI +0.5%	7.401	65.620	2.28	22.961	46.670	4.44
Int Rate +1%	6.718	65.620	2.16	15.023	52.085	2.82
Cap Exp +10%	0.760	65.620	2.16	9.975	78.757	2.26
Voids -1%	8.741	65.620	2.27	21.727	42.078	4.47
RTB Halved	10.655	65.620	2.49	31.471	29.893	7.72
Rents +1% all yrs	11.764	65.620	2.79	113.931	13.620	33.45
Rents CPI Only	1.442	65.620	1.92	10.267	73.508	2.12



The plan shows a resilience to changes but mostly impacts upon the resulting level of debt. Any changes to rent assumptions have the greatest impact.

## 6.2. Scenario Modelling (Sheltered Review)

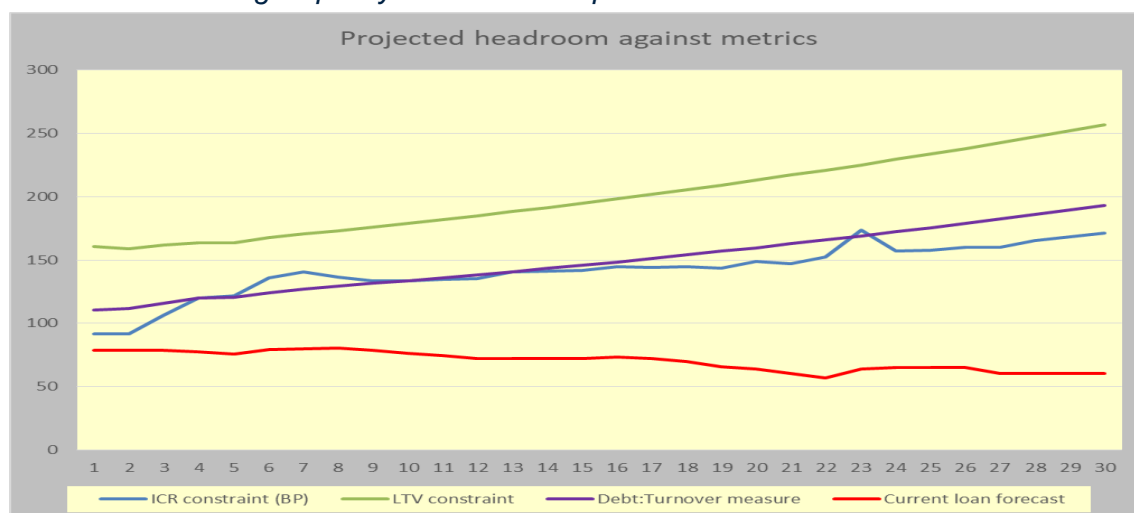
The result of the capacity analysis in section 5 has identified that the HRA has borrowing headroom if the metrics suggested are applied.

For example, if £17.5million was invested in the next five years in improving the sheltered accommodation over and above that allowed for within the existing levels provided for stock investment, the impact on the plan would be as follows.

Table 6.2: Impact of Sheltered Improvements Scenario

Scenario £'m	HRA Bal Yr 10	HRA Debt Yr 10	ICR Yr 10	HRA Bal Yr 30	HRA Debt Yr 30	ICR Yr 30
Base	6.718	65.620	2.16	17.805	50.157	3.55
Sheltered Improvements	2.018	76.481	2.17	21.414	60.091	2.56

Chart 6.1 Borrowing Capacity – Sheltered Improvements Scenario



With the projected level of borrowing required offset partially by the reduction in voids allowance for rents and service charges the result of the sheltered remodelling is not as significant as might have been expected. Whilst debt levels increase, there is a marginal increase to projected revenue balances.

In terms of borrowing capacity the ICR remains relatively static in the medium-term but as demonstrated in chart 6.1 there remains capacity with all metrics as presented.

## 6.3. Scenario Modelling (Continuation of Acquisitions)

Whilst CBC continues to sell properties through right to buys we have modelled the scenario of the continuation of open market acquisitions utilising the useable receipts to maximum effect.

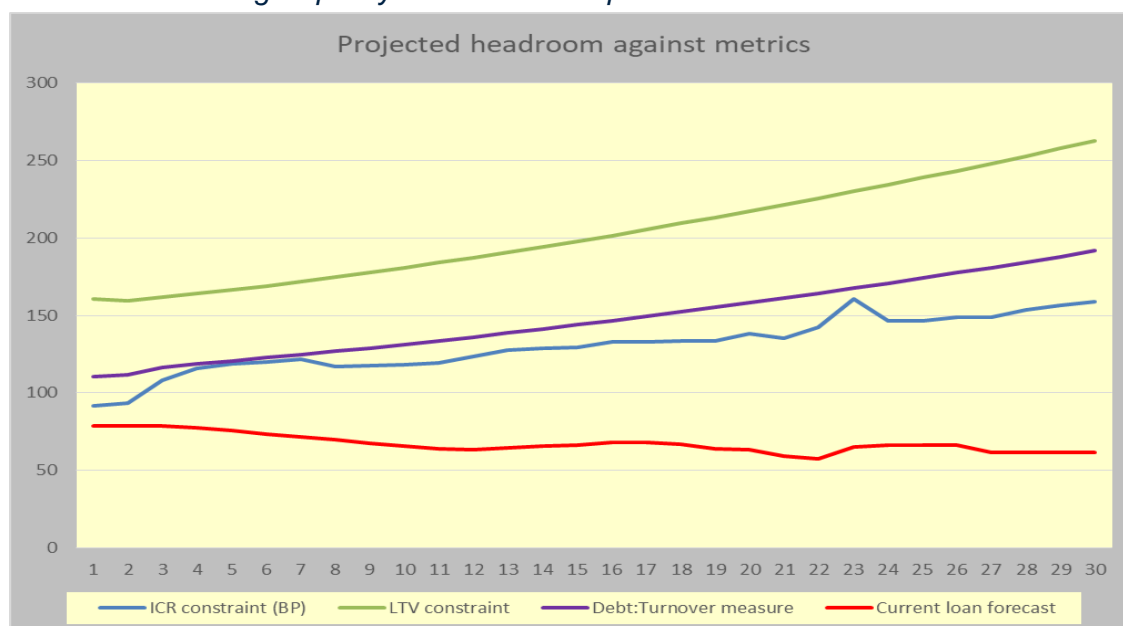
This scenario assumes that over the next 29 years an additional 108 properties will be acquired.

The results are as follows:

Table 6.3: Impact of Additional Acquisitions Scenario

Scenario £'m	HRA Bal Yr 10	HRA Debt Yr 10	ICR Yr 10	HRA Bal Yr 30	HRA Debt Yr 30	ICR Yr 30
Base	6.718	65.620	2.16	17.805	50.157	3.55
Additional Acquisitions	1.668	65.620	2.24	17.771	61.367	3.24

Chart 6.2 Borrowing Capacity – Additional Acquisitions Scenario



In order to facilitate the continuation of the acquisition programme additional borrowing is required in the longer-term and use of reserves in the shorter-term. Whilst the level of subsidy towards the acquisitions is modelled at 40% the levels of rent modelled demonstrate that the existing stock cashflows need to also provide a form of subsidy.

The result is additional debt to the plan with equivalent reserves projected.

In terms of borrowing capacity, as demonstrated in chart 6.2, there remains borrowing headroom throughout.

## 7. Summary

- 7.1 Our review has demonstrated that in overall terms CBC's operating and investment costs are within benchmarks for similar authorities HRAs.
- 7.2 This provides for an appropriate basis in which forecast the HRA business plan from.
- 7.3 The HRA business plan forecast as set out in our modelling for CBC has been refined to generate an analysis of future borrowing capacity.
- 7.4 We have defined three metrics or ratios to illustrate how a capacity framework might be developed to underpin future decision making in investment and borrowing strategies. Whilst based on the experiences of covenants in the housing association sector, these have been refined to reflect the particular accounting and funding issues applicable in the HRA.
- 7.5 Over the next few years the Council could borrow and use reserves in order to fund the required investment in the stock, supporting the Asset Management Strategy Framework, additional investment in its sheltered housing stock and fund further acquisitions.
- 7.6 The primary capacity constraint, therefore, within CBC's business plan is the Interest Cover Ratio, which measure the extent to which operating surpluses can cover debt interest payments and provide comfort against short-medium term reductions in income or increases in costs.
- 7.7 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
- 7.8 This review 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. This needs to be set against the backdrop of considering the repayment of debt as it falls, the potential to use reserves rather than borrow to deliver the initial development programme and use of reserves to fund future developments rather than borrow. However, this needs to be considered in the context of CBC's treasury management strategy.
- 7.9 The business plan will continue to evolve as the Asset Management Strategy developments as to when the costs of zero-carbon are established, funding mechanisms available and budgetary changes.



Steve Partridge & Simon Smith  
Savills  
November 2021