



Report of The Director of Corporate Services and the Director of Neighbourhoods and Housing

Executive Board

Date: 9 February 2007

Subject: Housing Revenue Account Budget 2007/2008

Electoral Wards Affected:

All

Specific Implications For:

Ethnic minorities

Women

Disabled people

Eligible for Call In

Not Eligible for Call In
(Details contained in the report)

EXECUTIVE SUMMARY

- 1.0 This report summarises the HRA budget and ALMO management fee distribution for 2007/08. Overall ALMO management fees have risen by an average of 4.5% on a comparable property basis.
- 2.0 Changes to housing subsidy property allowances has seen a loss of subsidy of £3.2 m.
- 3.0 The Department of Communities and Local Government (DCLG) has introduced a cap on average rent rises of 5% for the second year running. It is proposed that rents in Leeds rise on average by 5% for 2007/08.
- 4.0 There have been no changes in methodology of allocating management fees via the formulaic approach agreed in previous years. The fees have been updated to reflect the new ALMO arrangements.
- 5.0 The budget assumes no call on reserves.

1.0 Purpose Of This Report

1.1. This report sets out:-

- the Latest Estimate for 2006/07 and the Original Estimate for 2007/08 and comments on the major issues which have influenced the Budget.
- the proposals for rents to rise in 2007/08.
- the principles for allocating budgets to the ALMOs, via their Management Fees.

2.0 Background Information

2.1 The 2007/08 Original Estimate has been prepared at outturn prices which means that allowances for inflation have been included in the budget submission.

2.2 This report includes the ongoing financial arrangements in respect of the Arms Length Management Organisations (“ALMO’s”) which took responsibility for managing the Council’s stock of housing from February 2003. Following an ALMO review, including a city wide ballot of tenants, the management function will be delivered by three new ALMOs from 1st April 2007.

2.3 In accordance with the Council’s Policy and Budget Framework, decisions as to the Council’s budget and Housing Rent increases are reserved to Council. As such the purpose of this report is to propose a budget to Council, and thus the decisions recommended by this report are not eligible for call in.

3.0 Main Issues

3.1 Appendix 1 shows the projected Housing Revenue Account Summary for the 2006/07 Original Estimate, Latest Estimate 2006/07 and the 2007/08 Original Estimate.

Variation Original Estimate 2006/07 to Latest Estimate 2006/07

3.2.1 The original estimate 2006/07 budgeted for no net call on reserves. The latest estimate shows a contribution to general reserves of £801k.

3.2.2 The original budget assumed that general HRA reserves would be £2.97m at 1st April 2006, although the outturn position was actually £3.41m.

3.2.3 The main reasons for the variation in 2006/07 are:

- a) ALMO performance incentives – an additional £0.6m has been passed to the ALMOs.
- b) SCA allowances – an additional £1.5m is receivable following agreement of increased capital funding for decency from the DCLG. This is passed on in full to the ALMOs.

- c) Housing Subsidy trigger – as a result of not hitting the subsidy trigger, the negative subsidy payment (excluding MRA, capital and ALMO allowances) is projected to increase from £55.3m to £57.6m, a cost of £2.3m. More details on this are given at section 5.4.
- d) Additional MRA of £1.369m also results from failing to meet the subsidy trigger meaning a net loss of resources to Leeds of £0.9m.
- e) Additionally, final details of the compensation for restricting rent rises to 5% in 2006/07 have only recently been issued by DCLG. This has resulted in an additional £700k income.
- f) Property numbers – Property numbers are higher than originally projected due to lower RTB sales and demolitions. As a result, additional rental income of £1.1m is currently projected.
- g) Disrepair - The number of claims for disrepair has been steadily falling throughout the year with the average number of cases per month now around 9. Accordingly it has been possible to further reduce the provision required to meet these claims by £190k.
- h) Underpinning works – additional costs of £400k have been identified in relation to commitments in properties previously sold under Right to Buy legislation.
- i) Seacroft Lighting - An opportunity to claim compensation for the diminution in value of HRA properties next to the Seacroft lighting scheme has been identified and this claim is being pursued with the Highways Agency during the year with expected additional income of £105k being generated. This is a one off transaction and thus can not be repeated in subsequent years.

3.3 Swarcliffe PFI

- 3.3.1 There is also a contribution to the Swarcliffe PFI sinking fund of £800k in 2007/08. The contract for Swarcliffe PFI commenced on 1 April 2005.
- 3.3.2 This reflects the net surplus made in year being the excess of income, including government grant and the unitary charge. This is as a result of the way in which the Government allocates grant support for PFI which results in surpluses in the early years of such schemes.
- 3.3.3 The reserve is to be retained to fund deficits in future years.

3.4 Variation Original Estimate 2006/07 to Original Estimate 2007/08

- 3.4.1 The budget for 2007/08 has been constructed based on the achievement of working balances of £3.5m at 31 March 2008, which represents around 2.5% of the non-ALMO costs including negative subsidy. This is considered to be an acceptable minimum level of balances following the transfer of services and responsibilities to the ALMOs. The transfer of services also includes an element of transfer of risk and the ALMOs are able to retain their own working balances.
- 3.4.2 The reasons for the change are:

- a) The negative subsidy the Council is required to pay back to the Government has increased significantly following the housing subsidy settlement. The Council revenue contribution per property in negative subsidy has increased from £966 (net of Rental Constraint Allowance) per property to £1,008 which is a £3.2m increase. Additionally falling interest rates and reduced premiums and discounts have generated a cost of £2.2m, although this is offset by reductions in actual capital charges.
- b) There has been an increased management fee to ALMOs of £3.2m on a like for like basis (i.e. after taking account of costs disaggregated during the year) and further provision made for ALMO Performance Incentives of £1.05m.
- c) During the year, DCLG finalised the SCA allowances payable through the Housing Subsidy grant to the ALMOs. The original allowance of £21.086m has been increased to £22.58m and passed on in full to the ALMOs.
- d) A pay award of 2.5% has been provided which together with other inflationary increases means additional costs of £0.34m.
- e) Increases in net rentals & service charges are expected to generate an additional £5.4m, details of which are given below in section 4; it is anticipated that new Heat Lease schemes will increase service charges by a further £1.2m, although this will be offset by the costs of servicing the prudential borrowing necessary to fund these new schemes.
- f) The number of claims for disrepair has been steadily falling throughout the year with the average number of cases per month now around 9. Accordingly it has been possible to further reduce the provision required to meet these claims by £250k.
- g) Improved collection of current and historical debt has allowed a reduction of £275k in the cost of bad debts;
- h) The budget in 06/07 included approximately £500k in early retirement costs which are no longer required;
- i) Costs relating to support & other services within the HRA have been reviewed to ensure their continued appropriateness and costs have been identified which are more appropriately accounted for within the General Fund in accordance with CIPFA accounting requirements in 2007/2008. These have been partly offset by a review of a number of corporate charges. The net effect is a cost of £600k.
- j) Additional costs in PFI Procurement for Little London and Beeston Hill & Holbeck will be incurred in 2007/08 with a net cost to the HRA of £1.03m.
- k) There is a transfer to the PFI reserve for Swarcliffe of £0.8m (£2.1m 2006/07 LE) which reflects the net surplus made in the year. Additional contract payments of £1.4m are due in 2007/08 compared to 2006/07.
- l) Savings in the cost of debt has allowed reductions in interest costs of £2.2m, although this is partially offset by reductions in Housing Subsidy.
- m) Support costs (including applicable corporate recharges) have been reviewed with a number of opportunities identified which can generate savings of £42k, although

these will be subject to future staffing restructures and the ALMO review. Savings of £115k in Strategic Landlord costs have also been targeted .

4.0 Rentals

4.1 The level of Council House rents are controlled through the application of the Government's Rent Restructuring programme.

4.2 The Government's Rent Restructuring Policy is based upon the following principles:

- social rent should remain affordable and well below those in the private sector;
- social rent should be fairer and less confusing for tenants;
- there should be a closer link between rent and the qualities which tenants value in properties; and,
- differences between the rent set by local authorities and Registered Social Landlords (RSL) should be removed.

4.3 Rent Restructuring

4.3.1 Changes were implemented to rent restructuring in accordance with DCLG's proposals in 2006/07. The impact of this is to increase rents as now proposed following a Housing Association model attempting to converge to average public sector rents rather than local authority rents based on public sector house values which are higher than local authority house values. The net effect of this is that we are converging to a target estimated to be approximately 13.7% higher than was previously the case over the remaining 4 years of rent restructuring.

4.3.2 The full application of rent restructuring would see rents rise in Leeds by 7.3% in 2007/08 compared with 5.85% in 2006/07, although this was capped at 5%. Assuming no changes in inflation rates then rents would also rise by around 7.0% in 2008/09.

4.4 DCLG limitation on rent rises

4.4.1 DCLG have informed Authorities, they want to limit average rent increases & de-pooled service charges to no more than 5 per cent for each of the years 2006/07 & 2007/08. It is expected that this limitation will be removed in 2008/09. However, the Government compensates authorities through a new subsidy allowance named the Rental Constraint Allowance (RCA). For 2007/08, the RCA is projected to be £6.8m.

4.4.2 Applying rent restructuring would mean an average rent rise of 7.3% and therefore rents have to be reduced to reflect the 5% cap from the theoretical position. In common with many other local authorities and reflecting guidance from the DCLG it is appropriate to implement a pro-rata reduction on all rents such that the 5% limitation is reached.

4.5 Overall changes in rents

4.5.1 Rental income from housing stock is budgeted to increase by £7.2m offset by a reduction of £2.6m through changes in property numbers; this figure does not include the RCA of £6.8m.

4.5.2 This reflects changes in individual rents following the application of the sixth year of the Government's rent restructuring policy, the basis of which is partly determined

by the value of properties & the number of bedrooms in each property. Individual tenants are protected from large increases in rent in that the formula only allows rents to rise by inflation + a half % (4.1%) +/- £2.00 per week.

4.5.3 The application of this formula means that average rents will rise by 5%, and represents an average rent increase of £2.59 over 48 weeks, although the effects on individual tenants will vary according to the restructuring formulae.

4.5.4 The comparative figures are:

	<u>2006/07</u>	<u>2007/08</u>		
Actual Rent (average)	£51.92	£54.51	+5%	+£2.59

4.5.5 Rentals from garages (currently £5.00 per week) fall outside the rent restructuring rules and normally rise in line with average rental increases. It is proposed to increase garage rents by 5% to £5.25 per week.

4.6 Service Charges

4.6.1 Service charges, which fall within the constraints of rent restructuring, are subject to the same 5% limitation as rents.

4.6.2 It is the intention of the Government's rent restructuring policy that service charges will be disaggregated by the end of the ten year implementation programme (2010/2011) and that rental income will reflect purely management & maintenance of properties. This is not currently the case and will need to be kept under review between now and the end of rent restructuring.

5.0 **Housing Subsidy**

5.1 Housing subsidy is a notional calculation based on what the Government estimates we ought to spend on housing management and maintenance plus capital financing costs, offset by our guideline rental income & assumed mortgage interest receivable. Where this is negative we have to pay money to DCLG. Leeds is a negative subsidy authority.

5.2 Allowances by property compared with the current year are:

<u>Housing Subsidy</u>	<u>2006/07</u>	<u>2007/08</u>	<u>change</u>
	£	£	£
Guideline rent	(2,460.77)	(2,645.18)	(184.41)
Rental Constraint Allowance	27.04	113.53	86.49
Management allowance	514.08	537.68	23.60
Maintenance allowance	954.02	985.87	31.85
Management & maintenance	1,468.10	1,523.55	55.45
Negative subsidy per property	(965.63)	(1,008.10)	(42.47)
Major Repairs Allowance (MRA)	554.68	581.10	26.42
Total allowances	(410.95)	(427.00)	(16.05)

5.3 The overall impact on subsidy, after allowing for changes in property numbers and unit allowances is as below:

	<u>Final</u> <u>Determination</u> <u>2006/07</u>	<u>Final</u> <u>Determination</u> <u>2007/08</u>	<u>Change</u>	
	£K	£K	£K	%
Management & maintenance	88,612	93,168	4,556	5.1
Guideline rent & RCA	(143,938)	(151,739)	(7,801)	5.4
	(55,326)	(58,571)	(3,245)	5.9
Capital allowances	23,858	21,659	(2,199)	(9.2)
	(31,468)	(36,912)	(5,444)	17.3
ALMO allowances	21,417	34,839	13,422	62.7
PFI	6,097	6,097	0	0.0
	(3,954)	4,024	7,978	201.8
MRA	32,655	34,702	2,047	6.3
	28,701	38,726	10,025	34.9

5.4 Subsidy trigger (2006/07).

5.4.1 Subsidy includes a variation in the basis of calculation of property numbers whereby if stock changes by 10% or 3,000 properties over two years, subsidy is based on average stock in the year whereas if we fail to hit that trigger, subsidy is based on property numbers at the start of the previous year (i.e. 1 April 06 for 2007/08). Property numbers need to fall by at least 1,378 to meet this trigger in 2006/07.

5.4.2 The current projections for 2006/07 are for sales of 607 properties (510 actually sold between 1 April and 31 December) compared with a total of 1,191 sold in 05/06. Additionally, demolitions of 415 are projected and other changes of 114; sales of 603 properties are currently projected for 2007/08.

5.4.3 There are a number of factors affecting RTB sales, including:

- Property valuations are increasing generally.
- Decency work is being undertaken and it may be that potential applications are held up awaiting completion of this work. This will have an impact on valuations as well.
- The maximum discount in this region is £24,000 for both flats and houses, meaning that any increase in valuations is met by the potential purchaser.
- Discounts are also affected by the amount of expenditure on a property in the years prior to sale. Only approximately half a dozen RTBs are affected by this each year, although with expenditure on decency this may increase.
- From 18 January 2005 new tenants have to have a five year qualifying period. This is most likely to have an impact from 08/09 onwards as these tenants would have been entitled to exercise RTBs under the old rules at that point.

- 5.4.4 The RTB sales are a major factor in achieving the subsidy trigger. As a result of the reduction in RTB numbers this year, for the reasons outlined in 5.4.3., it is projected that the subsidy trigger will not be achieved. This will result in an increase in negative subsidy of £2.3m.
- 5.4.5 Whilst the failure to hit the subsidy trigger will increase negative subsidy by £2.3m, there will be a partial offset through an increase in the MRA of £1.369m; MRA resource is related to housing capital expenditure.
- 5.4.6 A specific provision of £2m was established in 2005/06; at that time it was considered that there was a significant risk of the subsidy trigger not being met. It is now proposed to release this reserve.

6.0 ALMO Management Fees

- 6.1 The Management Fees to the ALMOs are divided into three elements: one for repairs; one for management costs; and a third category for grounds maintenance was introduced in 2005/2006. The principles for allocating repairs & management budgets to the ALMOs was established in 2003/2004, broadly based on the national housing subsidy model, and the allocation of grounds maintenance is based on land area.
- 6.2 The total repairs budget for the ALMOs takes account of the percentage increase given by the Government for repairs, adjusted for the reduction in stock. The ALMOs management costs are allocated in accordance with a formula, which follows the same factors which the Government use to allocate resources to Local Authorities and thus, in effect, treats each ALMO as if it were a mini HRA. The formula allocates resources to each area based on the numbers of properties, factors which acknowledge the additional costs associated with flats, and the extent of crime and social deprivation in an area.
- 6.3 Discussions have been held with ALMO Chief Officers and the budgets as shown in appendix 1 have been broadly agreed in principle with individual ALMOs. The net effect is, on average, growth of 4.5% per property (equivalent to 3.5% in total fees on a cash basis), although this masks differences between ALMOs as a result of changes in stock numbers, stock profiles, relative crime & deprivation statistics and dampening.
- 6.4 Disaggregation
- 6.4.1 There are no further areas planned for disaggregation at this point.
- 6.5 Totals delegated to ALMOs
- 6.5.1 Overall, including the Major Repairs Allowance & additional revenue support following the achievement of 2 star status by the ALMOs, approximately 84.7% of controllable expenditure (excluding negative subsidy & capital charges) is devolved directly to ALMOs. Excluding both MRA & the additional revenue support 74.5% of controllable expenditure is devolved.

6.6 Performance Incentives

6.6.1 A number of performance incentives have been put in place to reward ALMO performance, especially in relation to contributions to a successful CPA assessment. Additional Performance Incentives are in place for arrears & voids management.

6.7 ALMO Reserves

6.7.1 The change from 6 to 3 ALMOs is due to take place on 1 April 2007. Reserves at that point will be transferred back to the Council and redistributed to the new companies. Discussions are ongoing with ALMO Chief Executives as to the precise methodology of this redistribution, which will be designed to ensure that the new companies have sufficient working balances. This will be the subject of a separate report to Executive Board shortly.

7.0 **Risks**

7.1 The following section sets out the significant risks which, should they materialise would affect the budget. The HRA maintains a level of reserves in order to meet the impacts of such risks should they crystallise.

7.2 These risks are reviewed throughout the year as to likelihood and action taken to mitigate any impact wherever possible.

- In year changes to subsidy regulations &/or rent compensation criteria.
- ALMOs are not able to fully validate the base data used in the subsidy claim.
- ALMOs may incur additional costs that require additional financial support from the HRA.
- The costs of implementing the new ALMOs may exceed expectations with a call on HRA resources.
- The level of additional support required by the ALMOs may not be sustainable in the long term future.

8.0 **Recommendations**

8.1 Executive Board is asked to recommend to the Council the adoption of the resolutions below -

- (i) that the budget be approved and to meet the DCLGs requirement to keep average rent increases to 5% pro rata reductions in all tenants rents are applied to the rent restructuring figure of 7.3%.
- (ii) that service charges are increased in line with average rent rises;
- (iii) that the charges for garage rents be increased to £5.25 per week.
- (iv) that the reserve of £2m established to cover the risk of not meeting the subsidy trigger be released and a virement of £1.369m be actioned to reflect the increase in MRA as detailed in paragraph 3.2.3 above.

Housing Revenue Account
Draft Budget - 2007/2008

Summary Budget

	<u>2006/07 OE</u> £000s	<u>2006/07 LE</u> £000s	<u>2007/08 OE</u> £000s
Employees	9,192	9,613	9,755
Premises	1,694	2,085	1,721
Supplies & Services	11,747	12,716	15,080
Transport	221	239	231
Internal charges	5,888	6,102	7,938
Provisions	4,815	4,466	3,435
Capital	24,572	24,572	21,029
	<hr/> 58,129	<hr/> 59,793	<hr/> 59,189
internal income	(265)	(543)	(886)
rents	(148,375)	(150,789)	(153,872)
recharges to ALMOs	(9,084)	(9,822)	(8,571)
other income (inc. service charges)	(4,374)	(4,841)	(5,334)
	<hr/> (103,969)	<hr/> (106,202)	<hr/> (109,474)
Housing Subsidy	32,166	33,755	36,917
ALMO Allowances	(21,086)	(22,580)	(34,839)
PFI allowance	(6,097)	(6,097)	(6,097)
	<hr/> (98,986)	<hr/> (101,124)	<hr/> (113,493)
contribution to pensions Reserve	638	638	(41)
contribution to PFI Reserve	2,142	2,252	801
contribution from ALMO distrib. reserve	0	(1,946)	0
contribution from Subsidy trigger reserve	0	(2,000)	0
	<hr/> (96,206)	<hr/> (102,180)	<hr/> (112,733)
 <u>Payments to the ALMOs</u>			
Management fees	74,370	74,301	76,844
Distribution of ALMO reserve	0	1,946	
Performance incentives	750	2,552	1,050
SCA Allowances	21,086	22,580	34,839
	<hr/> 0	<hr/> (801)	<hr/> 0
 <u>Reserves</u>			
General Reserves b/f	2,970	3,410	4,211
C/fwd variation at 2005/06 outturn	40	0	0
In year projected outturn	0	801	0
Budgeted deficit	0	0	0
	<hr/> 3,410	<hr/> 4,211	<hr/> 4,211