Housing, Homelessness and Fair Work Committee

10.00am, Thursday, 2 September 2021

2022/23 Housing Revenue Account (HRA) Budget Consultation

Executive/routine	**Executive**
Wards	**All**
Council Commitments	

1. Recommendations

1.1 It is recommended that Housing, Homelessness and Fair Work Committee:

1.1.1 Agrees to seek tenants' views on the Housing Revenue Account (HRA) budget strategy and potential mitigations of the one-year rent freeze for inclusion in the 2022/23 HRA budget report;

1.1.2 Notes the potential impact on delivery of the five-year HRA capital programme of rising construction costs, materials and skills shortages and Covid safe operating practices; and

1.1.3 Agrees to receive a report on the outcome of the consultation and the 2022-32 HRA Budget Strategy in January 2022.

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Executive Director of Place

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Report

2022/23 Housing Revenue Account (HRA) Budget Consultation

2. Executive Summary

2.1 The 30-year Housing Revenue Account (HRA) Business Plan 2022/23-2051/52 is the financial framework that underpins the Housing Service. The plan is reviewed annually in consultation with tenants and a five-year Capital Programme and one-year Capital Investment Budget is approved by Council.

2.2 Tenants have previously prioritised the acceleration and expansion of affordable housebuilding, investment in homes to make them more modern and easier to heat, delivered alongside accessible and responsive local services. The report sets out the long term ambitious strategy that seeks to deliver on new build and net zero carbon commitments and move to a holistic area-based approach that takes account of existing and new buildings, easy access to well-designed green, open spaces, local amenities, and connectivity to the wider community through sustainable, affordable travel.

2.3 The business plan is rolled forward annually, this includes a review of the assumptions taking into account delivery to date, revised income and expenditure and wider market impacts. On 18 February 2021, the City of Edinburgh Council approved a composite motion from the Conservative, Green and Liberal democrat groups which agreed '*that there be no rent rise in 2021/22'.* The one-year rent freeze has meant a reduction of £2.014m in projected gross rental income in 2021/22. Unless income is increased in future years to compensate this equates to a £93.921m reduction over the lifetime of the business plan. In addition the review of assumptions, including the impact of Brexit and COVID-19 on increases in material costs and supply chain volatility, has increased the overall gross deficit to £113.412m.

2.4 The report sets out options to mitigate the impact of the reduction in income and increases in costs. These options will be put to tenants as part of the annual budget consultation. Appendix 1 sets out the options that have been developed with the help of Edinburgh Tenants Federation (ETF), Tenant Information Service (TIS) and the Housing Service Improvement Plan working group.

3. Background

3.1 On 2 February 2021, Finance and Resources Committee approved the 2021-2031 HRA budget Strategy which included a plan to invest £2.8bn over ten years to deliver Council commitments, including the delivery of new homes, net zero carbon emissions by 2030, funded by a 2% rent increase. The report was referred onto the City of Edinburgh Council for approval.

3.2 The Council also approved the three-year Council Business Plan: Our Future Council, Our Future City which brought together the Council's strategic priorities into a single plan. Over the coming years the focus of the Council Business Plan will be on the following key priorities: ending poverty and preventing adverse outcomes such as homelessness and unemployment; becoming a sustainable and net zero city; and making sure wellbeing and equalities are enhanced for all.

3.3 On 18 February 2021, the City of Edinburgh Council approved a composite motion from the Conservative, Green and Liberal Democrat Groups which agreed *'the recommendations by the Executive Director of Place in the Housing Revenue Account Budget Strategy for 2021/31 and the outline 10-year HRA capital programme 2021-31, subject to agreement that there be no rent rise in 2021/22'*.

3.4 On 18 March 2021, Committee received a report setting out the impact of the one-year rent freeze on the 2021/22 revenue budget, and the potential mitigations that need to be put in place in 2022/23 to secure the 10-year capital investment programme to deliver Council commitments.

3.5 On 3 June 2021, Committee agreed a revised two-year capital investment programme, following consultation with Elected Members. The 24-month programme included an assessment of the impact of further restrictions due to COVID-19 on timescales and the re-profiling of slippage from 2020/21.

4. Main report

4.1 The HRA is funded from tenants' rents, fees and service charges for services provided to tenants and assets held on the HRA account. The HRA is self-contained and has no direct impact on the Council's General Fund budget. Each year tenants are consulted on the HRA budget strategy and their investment priorities.

Current and future priorities

4.2 Since 2015 the majority (over 80%) of tenants who responded to previous budget consultations have supported the investment plan, funded by a 2% rent increase, identifying the following priorities:

4.2.1 Building new affordable homes;

4.2.2 Investing in making existing homes easier and cheaper to heat;

4.2.3 Improving core housing services, such as day to day housing management, and repairs and maintenance of Council homes, as well as wider estate management; and

4.2.4 Reducing the cost of living through the delivery of a variety of different services, including, for example, an energy advice service, a tenant discount scheme, and community food growing.

4.3 Last year's consultation also sought views on the changing focus of the investment strategy from investing in the interiors of homes, to buildings and neighbourhoods. It generated a similar profile of responses, with 76% of tenants confirming support for the investment plan funded by a 2% rent increase, with a further 22% supporting increasing rents beyond 2%, if priorities could be delivered more quickly.

4.4 The 2021- 2031 HRA budget Strategy approved at Finance and Resources Committee on 2 February 2021 is very ambitious. It seeks to maximise investment and improve performance, whilst not passing the costs directly onto tenants by ensuring there is an affordable and stable rent strategy. A significant amount of the investment programme seeks to ensure homes meet and, where appropriate, exceed Government compliance targets (Scottish Housing Quality Standard (SHQS), Energy Efficiency Standard for Social Housing (EESSH) and EESSH2), health and safety compliance and Council led city wide targets (20,000 new affordable homes and net zero carbon) are met. In addition, the Housing Service is driving forward an improvement plan (HSIP) that seeks to increase satisfaction, improve performance and reduce cost by up to 12% of operating expenditure by 2025/26. It is also seeking to address the mixed tenure challenges through the Mixed Tenure Improvement Service pilot.

4.5 The net zero carbon agenda accounts for almost £0.7bn until 2030. The Council's target is extremely ambitious and is a whole 15 years earlier than that from the Scottish Government. This causes issues in terms of aligning funding to help cover costs.

4.6 The Scottish Government's EESSH2 target is also extremely ambitious, with a target for all Social Landlord homes to meet a minimum Standard Assessment Procedure (SAP) score of 81 by 2032. EESSH2 can in some circumstances be achieved by simply adding a low carbon technology in to a home. This approach does not address underlying building fabric and energy usage issues and ultimately leads to a performance gap where the anticipated energy savings in reality are not being realised by the tenant. As such the Council will be adopting a holistic whole house fabric first approach to meet and exceed EESSH2 where possible. This approach will seek to design out poor performance, effectively save energy as predicted and align energy retrofit and asset management. There is no clear funding strategy for this from Scottish

Government for Council owned homes, which means it falls to rental income to cover the majority of the borrowing costs for the investment.

4.7 Progressing whole house retrofit across mixed tenure blocks will be an additional challenge due to the increase level of investment required by private owners in those blocks. Currently the Scottish Government Home Energy Efficiency Programme for Scotland Area Based Schemes (HEEPS:ABS) programme can help to unlock mixed tenure challenges by supporting owners to invest in energy efficiency measures in their homes. However, this will only go some way to addressing the issue. It is estimated that it could cost on average between £25,000 - £40,000 (depending on the property archetype) for whole house retrofit per flat. The cap for HEEPS:ABS funding per household is £7,500 (£12,000 if homes are seen to be in extreme fuel poverty), so a significant gap remains.

4.8 The core Scottish Government funding programme for the development and delivery of large-scale low and zero carbon heat in buildings projects known as the Low Carbon Infrastructure Transition Programme (LCITP) is not yet fully defined in terms of how this fund will be structured over the coming years. Currently it is difficult to know how this fund will be administered and over what time period. The Council will continue to liaise with Scottish Government to maximise funding opportunities.

4.9 The commitment for the Council to deliver 10,000 of the 20,000 new affordable homes by December 2027 is included within the Business Plan. It is assumed that 50% of these homes will be for social rent, paid for and retained on the HRA. Scottish Government, in conjunction with COSLA, have been working to review grant benchmark levels. The new benchmark proposed to increase baseline grant subsidy for Council social rented homes from £57,000 to £71,500, with further subsidy for additional quality measures for advanced energy efficiency, open space, working space etc. With the Council's new build homes committed to high quality standards (e.g. already built to 'Silver Standard Active' and piloting a design brief to achieve net zero carbon), it is expected that Council homes could attract grant subsidy of around £80,000. Whilst this increase is welcomed, it is mostly offset by a significant increase in costs, following a review of core assumptions. Also, unless overall funding increases, fewer homes could be delivered. Officers continue to work with Scottish Government to mop up any underspends across the national programme and to increase overall funding allocation for Edinburgh.

Reviewing the Business Plan

4.10 Each year the 30-year financial model is reviewed (the HRA Business Plan) and rolled forward. A detailed review of assumptions is carried out. Assumptions are benchmarked against peers and where relevant, include market and industry standards.

4.11 This year's review of the business plan financial assumptions is taking place against a notably challenging background; including recent significant COVID-19 and Brexit related materials costs and supply volatility, a national and international focus on construction as a key economic recovery vehicle resulting in world-wide materials shortages, skills shortages across the construction sector, particularly around low carbon solutions and a sudden step to an extremely buoyant construction sector and housing market.

4.12 There are some assumptions that have improved the financial position, some that have not changed and others that have had a negative impact. These are set out in detail in the financial section of the report. Overall, the impact of increasing capital investment costs as a result of COVID-19 and Brexit, when compounded by the reduction in income (as a result of the rent freeze), has resulted in a baseline business plan that shows a gross deficit of £113.412m, starting in 2028/29 and lasting until the end of the business plan. During the deficit period (24 years) there is an annual average of £4.726m of expenditure above income. All reserves are exhausted by year six.

Funding the Strategy

4.13 In order to bring the HRA business plan back into a healthy position a variety of different options need to be considered:

4.13.1 **Increase income -** a rent increase of 5.0% would be required in 2022/23. This would be an average weekly increase of £5.11 across all homes.

4.13.2 **Deliver investment over a longer period of time -** The 2021/22 HRA Budget Strategy sought to build 10,000 new Council led homes by 2027, achieve net zero carbon by 2030 and bring existing homes and neighbourhoods up to similar standard of new build over the next 20 years. If the whole house retrofit programme was delivered over the same timescale as that of Scottish Government (by 2045), this would substantially reduce borrowing requirements and return the business plan to surplus.

4.14 Cost reductions were considered but have been removed from the final options. The Housing Service Improvement Plan assumes a 12% reduction in annual expenditure by 2025/26. This is already an ambitious improvement programme. It is therefore not realistic to assume that a further reduction in revenue expenditure could be achieved through efficiencies alone. A 5% reduction in the overall capital investment programme would bring the HRA back into a stable position, however it is more realistic to explore delivering investment over a longer period of time rather than reducing the overall number of new homes built or those brought up to net zero carbon standards. The consultation takes into account long standing priorities of tenants and political commitments and presents options for delivering these outcomes over different timeframes based on the level of rental income that can be raised.

4.16 The HRA business plan and associated rent levels are reviewed, consulted on and ultimately approved by Council each year. Keeping tenants at the heart of service design remains critical, however, the short-term view of funding against a long-term view of investment is challenging and has its limitations. It can take on average around three years to build a home from inception to completion (acquiring land, design and planning, procurement and construction). Similarly, large scale refurbishment/regeneration projects can take around 12 months to design, procure, seek statutory approvals and carry out construction. In addition to this, a longer-term rent strategy provides certainty and stability to tenants, so they are not impacted by sudden changes in the market year to year. It also provides opportunities for improved treasury management. The more certainty that can be given in the medium to long term capital programme can enable officers to maximise favourable borrowing opportunities.

4.17 Back in 2007, the Council agreed to a five-year rent structure to deliver the SHQS. This year, as part of the consultation, tenants will be asked if they would be open to a longer-term rent strategy that locked in rent increases over the next three to five years. Regardless of whether a long-term rent strategy is preferred, tenants' views would continue to be sought annually through a regular process of tenant engagement and customer insight.

4.18 A ring-fenced contingency was established in 2017/18 to mitigate the impact of lower than expected income recovery and/or unexpected increases in expenditure. The HRA business plan assumes a £15m contingency fund will be built up by the end of 2022/23, rising to £25m by 2026/27. Depending on the rent strategy and associated mitigations adopted for 2022/23 (as set out in Appendix 1) this contingency would never drop below £10m throughout the lifetime of the HRA business plan. If rents were not increased in 2022/23 and mitigations not employed the contingency and reserves would be exhausted by year five (2026/27) and the business plan would have a £196.343m deficit, starting in 2027/28.

The Consultation

4.19 The consultation has been designed and developed in conjunction with the Tenant Information Service, Edinburgh Tenants Federation and the Housing Service Improvement Group (formerly the Rent Matters Working Group) made up of individual tenants as set out in Appendix 1.

4.20 Officers and tenants have met three times since July 2021 to help plan and deliver this year's consultation. The group have helped to shape the core messages and questions that have made up this year's consultation, with a focus on using plain English and including relevant information to help ensure the consultation is as accessible as possible.

4.21 The group felt it was important to establish whether tenants get some help with their rent and whether that impacts on the way in which they vote. They also felt the use of figures was more meaningful to tenants than percentages which have been used in previous years. In addition, the group have supported the continued inclusion of free text boxes alongside multiple-choice questions, to allow tenants to expand on their answers. This feedback has been reflected in this year's questions.

4.22 The group also helped to develop the way the budget consultation questions are presented to tenants. Every tenant will receive a letter inviting them to respond to the budget consultation. This will include a table illustrating what the various rent options would mean by property type, along with supporting information to help bring the HRA Budget Strategy to life and make it real for tenants.

4.23 Colleagues from Communications have helped to develop the design for the consultation and the associated promotional materials. This year, there was a particular focus on the design of the letter to tenants, to make this eye catching and distinctive from other Council communications. It was also important to ensure a balance between written information and visual depictions.

4.24 Last year's budget consultation was adapted in response to the Covid pandemic, which meant it was not possible to carry out face-to-face promotion such as roadshows in local council offices and door knocking. However, the range of other promotional platforms used for the consultation meant that every tenant was still given an opportunity, and a variety of options, to participate. National feedback from tenant participation organisations and forums indicates a continued trend away from face-to-face as the default option for tenant engagement. The last eighteen months have led to increased awareness of and confidence in the use of other methods, including digital, with many tenants engaging differently and in ways they hadn't previously considered. The national picture indicates that this will continue to be built on, with tenants offered a range of ways to engage.

4.25 Assuming the report is approved, the consultation will launch on Monday 6 September and run for ten weeks. It will be promoted in a range of ways, including individual letters posted to every tenant; an online consultation; social media; text messaging; communications to Registered Tenant Organisations; email footers for Council officers; and through word of mouth.

4.26 In addition to the above methods, tenant focus groups will be carried out and the consultation questions will also be included in the annual Tenants Survey. The Tenants' Survey is carried out by an independent third party, procured by the Council. The Council provides a random sample of tenants contact details, weighted by locality. As was the case last year, this year's survey will again be carried out via telephone. The survey will run alongside the budget consultation between September/ October 2021 and will capture 1,000 survey responses (a statically robust sample size). Tenants will be surveyed from all property types and from all localities.

5. Next Steps

5.1 Assuming the report is approved, the consultation will launch on Monday 6 September and run for ten weeks.

5.2 Workshops will be held with elected members on investment priorities and different options for funding the strategy.

5.3 Officers will continue to work with Scottish Government to maximise funding opportunities for new affordable homes and energy efficiency measures.

5.4 The outcome of the consultation and draft budget strategy will be presented to Housing, Homelessness and Fair Work Committee in January 2022.

6. Financial Impact

6.1 The 2021/22 HRA Budget Strategy, funded by annual 2% rent increases, presented at Council on 18 February 2021 set out a healthy 30 year business plan. It projected a small deficit of £25.300m between years 9 and 21 (2029/30 and 2041/42); with an average annual deficit of £1.9m over these 13 years; less than 1.2% of average annual expenditure. The deficit only related to in year expenditure exceeding income, there was enough in reserves to completely offset it. The HRA was in net surpluses of £84.3m over 10 years and £137.0m over 30 years.

6.2 The rent freeze in 2021/22 increased the overall deficit by 179% from £25.300m to £70.594m, lasting two years longer (2029/30 – 2043/44). The reserves and ringfenced contingency were exhausted by year 13 (five years into the deficit period), only recovering in year 30 of the plan.

6.3 The Business Plan is reviewed annually and is rolled forward based on the previous year's outturn and approved rent levels. Key assumptions have been updated. A summary of the key changes is set out below:

6.3.1 **Investment in existing homes and estates** – the core capital investment assumption on existing homes and estates has increased by c.9% over the first ten years of the Business Plan (before inflation). The increase is mainly due to using more informed assumptions for Whole House Retrofit investment based on the design principles and stock condition work currently underway.

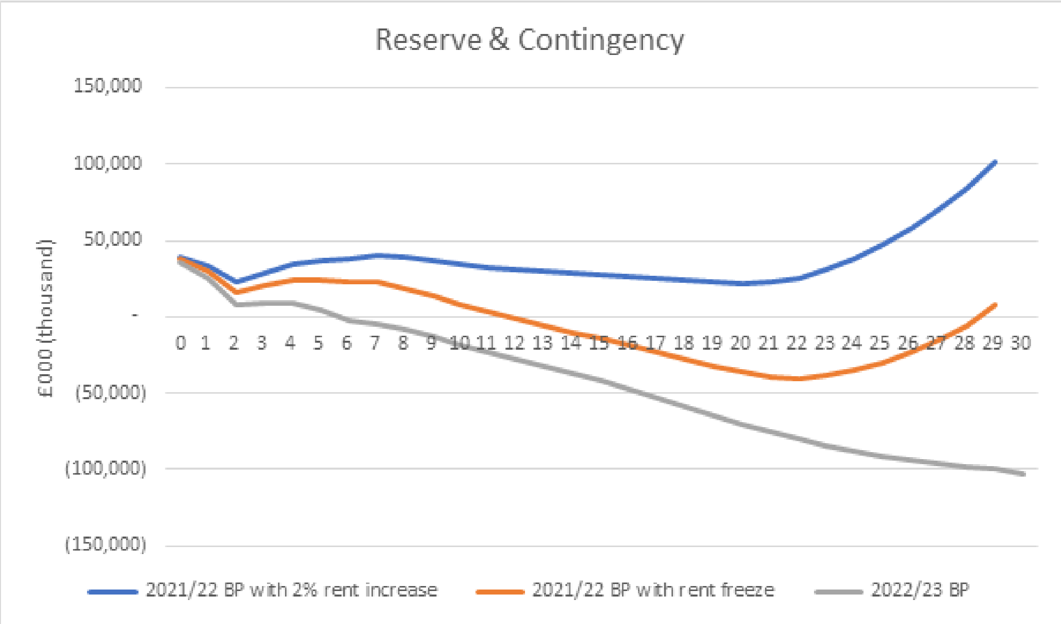
6.3.2 **Investment in new building development** – the investment on building new homes has increased by c.20% (before inflation) as a result of higher development costs to achieve net zero carbon measures, automatic fire suppression systems and wider place making, as well as increased material and labour costs; though the increased costs is partly offset by the increased grant subsidy assumption as discussed in paragraph 4.9.

6.3.3 **Tenants claiming Universal Credits (UC) and rent arrears** – an increased number of tenants are expected to make claims for UC and/or accumulating higher amounts of rent arrears due to reduced or loss of household income as a result of Covid, affecting rental collection.

6.3.4 **Inflation and resources to deliver the capital programme** – the inflation applied to capital investment has been increased based on market intelligence/ industry projection, anticipating the impact of COVID-19 and Brexit on increasing material and labour costs. Resources have also been increased to deliver the ambitious capital investment programme, both internally and through the commission of external consultants to help progressing the WHR strategy and area-based regeneration.

6.4 The overall impact of the changes has resulted in the deficit further increasing to £113.412m, starting in 2028/29 and last to the end of the business plan); with an average annual deficit of £4.726m over these 25 years. The reserves and ringfenced contingency are exhausted by year six.

6.5 The graph below sets out the original 2021/22 budget strategy (funded by 2% rent increases), the revised BP with 0% rent increase in 2021/22 and 2% thereafter and the revised impact on reserves and contingency as a result of the review of the core business plan assumptions.



6.6 If a rent freeze was agreed for a further year (2022/23, followed by 2% thereafter) the HRA business plan would sink further into deficit (£196.343m from 2027/28 until the end of business plan), with the reserves and ringfenced contingency exhausted by year five (2026/27). Elongating capital investment would not be enough to bring the plan back into surplus; it would either require significant rent increases or a further reduction in housing management. This could not be achieved through efficiencies alone and would require the withdrawal or reduction of housing services.

6.7 The HRA business plan seeks to drive forward an ambitious investment programme, whilst also keeping rents affordable. The HSIP aims to make the housing service as efficient as possible, as well as levering in external funding from government to reduce the cost of investment passed onto tenants.

6.8 A small deficit can be managed on a programme of this scale and longevity. All the options set out in the consultation (Appendix 1) ensure that the Business Plan is not in deficit in the first 10 years, with it returning to surplus over the 30 years and retaining a small contingency balance throughout. In any given year the average deficit is no more than £2m (less than 1% of operating expenditure). The first 10 years of the programme seeks to meet the Council's new build commitment (10,000 homes) and significantly improve existing stock, including a large majority of the Net Zero Carbon retrofit target. Financial planning becomes less accurate in the medium to long term. It is likely there will be cost savings in the retrofit investment due to improving technology and as the sector grows and matures, providing a more cost competitive market.

7. Stakeholder/Community Impact

7.1 Each year the views of tenants are sought on the HRA budget strategy, investment plan, services and associated rent levels. In addition to helping to plan the annual budget consultation, the Housing Service Improvement Group have a role in monitoring and shaping the HSIP.

7.2 There is a regular programme of tenant engagement and customer insight. This includes regular satisfaction surveys, focus groups, tenant panels, tenant led service inspections and scrutiny, resident and community meetings.

7.3 As part of the current Service Level Agreement with ETF work is underway to jointly develop a revised Tenant Scrutiny Framework. The scrutiny framework will support the delivery of the Tenant Participation Strategy objectives and will detail roles and responsibilities of all key partners; accountability structures; how tenant's views are gathered and how these influence decisions taken in relation to housing service including HSIP.

7.4 The annual Tenants' Survey is carried out by an independent third party, procured by the Council. The Council provides a random sample of tenants contact details, weighted by locality.

7.5 As part of ongoing work to develop our approach to the delivery of neighbourhood management and improvements, further engagement on the future approach to Neighbourhood Environment Projects (NEPs) will be carried out with tenants' groups, Neighbourhood Networks and elected members to explore how communities can be best supported to influence how the investment in their local neighbourhoods is prioritised.

8. Background reading/external references

8.1 Housing Revenue Account (HRA) Budget Strategy 2021/22, Housing, Homelessness and Fair Work Committee, 5 November 2020.

8.2 Housing Sustainability Update, Housing, Homelessness and Fair Work Committee, 5 November 2020.

8.3 HRA Budget Strategy 2021-31, City of Edinburgh Council,18 February 2021.

9. Appendices

9.1 Appendix 1 – 2022/23 DRAFT Budget consultation questions.

Appendix 1 – Rent Options

The consultation has been designed and developed in conjunction with the Tenant Information Service, Edinburgh Tenants Federation and the Housing Service Improvement Group (formerly the Rent Matters Working Group) made up of individual tenants.

The proposed rent options for this year's budget consultation are set out below.

Question: *The rent freeze in 2021/22 means that we have less money available to invest in Council homes and neighbourhoods. In order to be able to afford all the investment already committed to, we would need to deliver the investment over a longer period of time. We are considering five options for rent increase in 2022/23. If we increase the rents by a higher amount, we will be able to deliver the investment in line with the original timescale. If we increase the rents by a smaller amount, the investment will take longer than originally planned.*

Please select the option you support below and let us know your view on the rent increase options.

Rent increase option for 2022/23	Average fortnightly rent increase	Make all homes net zero carbon	Gross deficit	Deficit years	Lowest contingency balance
1.8%	+ £3.68 per fortnight	Take eight years longer than original timescale	£5.857m	2036/37 to 2040/41 (5 years)	£12.486m
2%	+ £4.08 per fortnight	Take seven years longer than original timescale	£11.720m	2036/37 to 2042/43 (7 years)	£12.883m
3.0%	+ £6.13 per fortnight	Take five years longer than original timescale	£8.257m	2035/36 to 2043/44 (9 years)	£10.226m
4.0%	+ £8.17 per fortnight	Take two years longer than original timescale	£11.401m	2032/33 to 2043/44 (12 years)	£11.943m
5.0%	***+ £10.21 per fortnight***	***Original timescale by 2030***	***£13.431m***	***2029/30 to 2042/43 (14 years)***	***£12.731m***