

HRA Future Financial Framework

1. Executive Summary

- 1.1. This report considers the method for managing the council's debt and associated servicing costs between the HRA and GF. It also outlines the prudential indicators that are proposed for which the values will set along with the Treasury Management Strategy alongside the draft budget to Cabinet in December 2020. A summary of the proposals are;
1. **Debt Pool Option** – currently all council debt is managed in a single pool. We can continue with this approach, separate this into a two pool and manage the HRA and GF debt separately or use a three pool approach (existing debt is held in one pool and a pool each started for new GF and HRA debt). The recommended approach is to move to a two pool approach – this creates clear and immediate distinction between HRA and GF debt and gives the HRA the autonomy to pursue its own debt strategy. Full details of the proposals are outlined in section three.
 2. **HRA Debt Limits and Indicators** – although the HRA debt cap has been removed, it is essential that we have a framework for managing risk and to inform sound financial judgement. As a result, we are proposing to set limits and boundaries specific to the HRA. The indicators we are proposing to use are set out below (but the actual limits will be set with the Treasury Management Strategy at the December 2020 Cabinet). Full details of the proposals are outlined in section 4.3.
 - Authorised limit for gross external debt (i.e. the affordable borrowing limit)
 - Interest cover ratio (how many times the operating surplus covers its debt servicing costs.)
 - Debt maturity profile limits
 - Upper limits on variable and fixed interest rate exposure
 3. **Minimum Revenue Provision (MRP) Policy for HRA Debt Liability** – MRP ensures that provision is made over time for the replacement of assets. In the case of the HRA there is no statutory requirement to charge MRP, but by not doing so, no prudent provision for eventual repayment is made. We are proposing to set a voluntary MRP for new borrowing which will vary dependent on the type of asset. Full details are outlined in section five.

2. Background

- 2.1. In April 2012, fundamental reform changed the system of local authority housing finance. Under the provisions of the Localism Act 2011, the Government controlled HRA subsidy system - whereby Milton Keynes was a contributor of over 25% of annual rental income - was abolished. Instead housing authorities were given local control to retain all HRA incomes and operate their housing landlord service in consultation with tenants and leaseholders in exchange for a one-off debt settlement - effectively a commutation of 30 years' worth of future HRA subsidy in one go. For Milton Keynes Council, this calculation resulted in a one-off buyout settlement figure of £170.360m. However, these new freedoms and the increased housing investment opportunity they presented were severely limited by a restriction to how much councils were allowed to borrow, in the form of a specified HRA debt cap.
- 2.2. The Chartered Institute of Public Finance and Accountancy (CIPFA) were invited by the Government to prepare guidance on the treatment of debt and associated interest costs under the Self Financing regime. Three suggested options were put forward, with preferred option being the division of local authorities borrowing into two separate pools. However Government made it clear that no single solution would be imposed, and authorities were free to choose from the options put forward or pursue other methods provided they were a) broadly equitable and b) gave the HRA a greater degree of independence, certainty and control over its borrowing costs.

2.3. Milton Keynes Council commissioned its treasury advisors at the time to produce a report considering the needs of the council against the debt pooling options available. Considering the outcomes, Council was recommended and approved a single pool approach; effectively a continuation of current arrangements, whereby the council manages its overall debt as a single portfolio and apportions costs to the HRA and GF at a consolidated rate in proportion to the Capital Financing Requirements (CFR) of each.

3. HRA Debt Pooling Options

3.1. A key benefit of this single pool approach was its simplicity to manage debt in aggregate across the council. Up to April 2012, HRA asset management plans were still being developed to inform capital investment requirements and so it was not possible to structure HRA debt sufficiently to match this profile and benefit fully from an intuitive debt portfolio as would have been desired. Furthermore, at the time the council's capital spending plans funded by borrowing for both the HRA and GF were broadly similar in the medium term, so largely offset the impact on debt costs to each other.

3.2. However, in October 2018, the Government announced that it was scrapping the restrictive HRA debt cap.

3.3. Whilst the removal of the HRA debt cap gives rise to more capacity to invest in housing stock, and although currently accompanied by low market interest rates, it is not a panacea for unconstrained borrowing. The revenue financing costs of servicing new debt need to be sustainable over the long-term.

3.4. Borrowing activity is subject to the provisions of the Local Government Act 2003 which requires local authorities to have regard to the CIPFA Prudential Code when determining how much money it can afford to borrow. The objectives of the Prudential Code are to ensure within a clear framework, that the capital investment plans of local authorities are affordable, prudent and sustainable, and that decisions are taken in accordance with good professional practice. Section 5 below sets out a series of suggested HRA Debt Indicators with recommended limits/boundaries to monitor and manage HRA debt exposure.

3.5. With no statutory upper limit on HRA borrowing capacity other than affordability, then whilst broadly balanced now, capital spending plans funded by borrowing between the HRA and GF are likely to diverge. It is therefore now appropriate to re-evaluate the council's debt pooling arrangements. The options available include:

(i) Single Pool

3.6. This is the do-nothing approach. Continue with a single debt pool and apportion interest costs based on a consolidated rate in proportion to the respective Capital Financing Requirements of each fund.

3.7. **Main strengths;** simple to manage, HRA benefits from internal borrowing (effectively borrowing from GF cheaper than it could finance through external debt), HRA not required to adopt & follow its own treasury strategy.

3.8. **Main weaknesses;** interdependency between HRA and GF borrowing decisions influencing share of debt costs, lack of flexibility to follow independent debt strategies, inequitable sharing of interest from investment of cash balances. Broadly balanced impact only where borrowing plans continue to offset each other.

3.9. For 2019/20, the debt cost apportionment under the single pool approach is show in Table 1 below.

TABLE 1: 2019/20 Outturn single pool debt apportionments

COST/INCOME APPORTIONMENT	TOTAL £m	GF £m	HRA £m
Interest on borrowing	20.718	13.252	7.466
Debt management expenses	0.499	0.331	0.168
Interest income	(3.799)	(2.903)	(0.896)
TOTAL	17.418	10.680	6.738

- 3.10. **Conclusion;** whilst a single pool approach has served the Council well up to now, the development of robust HRA asset management investment plans and the ambitious housing regeneration and new build programmes means that HRA borrowing plans will significantly outweighs those of the GF, changing the broadly equitable position as it stands now. **This approach is not recommended.**

(ii) Two Pool

- 3.11. Change the basis of debt charges apportionment from single pool to two pool approach, subject to meeting the following underlying principles:
- there is no detriment to the GF;
 - any solution is broadly equitable for both the HRA and GF, and;
 - the HRA is given a greater degree of independence, certainty and control over its borrowing charges, subject to the council's overall risk management strategies.
- 3.12. **Main strengths;** HRA and GF can pursue different debt strategies without impacting the other, HRA becomes independent and takes on fixed certain costs in relation to existing debt for long term modelling, HRA virtually fully borrowed with straightforward internal borrowing recharge methodology for differences.
- 3.13. **Main weaknesses;** Internal borrowing risk reverts fully to GF, separate HRA and GF treasury management strategic approaches to be agreed, managed and implemented, HRA would face immediate refinancing decisions.
- 3.14. For the purpose of a two pool approach, the HRA should be fully funded to its Capital Financing Requirement (CFR) where possible. This is however unlikely to ever be the exact case and so in accordance with Table 2 below any residual differences are charged on two basis:
1. HRA Loans CFR - HRA actual borrowing is either:
 - a. less than the HRA loans CFR, this is referred to as an 'under-funded HRA Loans CFR' and the shortfall is treated as short term loans payable; or
 - b. greater than the HRA loans CFR, this is referred to as an 'over-funded HRA loans CFR' and the excess treated as short term loans receivable.
 2. In addition to this, the HRA may have cash-related balances (resulting from debtors, creditors and reserves etc), which are treated as creating either:
 - a. a cash overdrawn position; or
 - b. a cash in-hand position.

TABLE 2: Two pool approach internal recharge basis

<u>HRA Loans CFR:</u>	
EITHER: HRA Loans CFR under-funded / borrowing internally from GF	Average rate on GF external debt, or a pre-arranged formally agreed borrowing rate referenced to a PWLB equivalent rate.
OR: HRA Loans CFR over-funded / lending internally to GF	Average rate on external investments excluding any earmarked GF investments, or for earmarked HRA reserves an actual external investment rate.
<u>HRA Cash Balances:</u>	
EITHER: HRA Cash balances overdrawn / borrowing internally from GF	Average rate on external investments + 5.0%, or a pre-arranged formally agreed borrowing rate referenced to a market equivalent rate.
OR: HRA Cash balances in hand / lending internally to GF	Average rate on external investments excluding any earmarked GF investments, or for earmarked HRA reserves an actual external investment rate.

- 3.15. The first stage of a two pool debt approach would be to sub-divide the Council’s debt pool between the respective funds, in whole loans. There are many different potential compositions that may achieve the overall balances of the underlying principles set out above and we have allocated debt on a basis we consider to be the most broadly balanced option available in terms of average interest rate and maturity structure of the debt portfolio at 1st April 2020.
- 3.16. Note that treasury management practices dictate that loans are not directly linked to any particular item of spend. Those loans that could be largely associated with particular spend outlays have been assigned in whole to the respective fund’s; loans undertaken to fund the HRA Self-Financing buyout payment have been wholly attributed to the HRA, and those undertaken to part-fund the GF borrowing plans for the Residual Waste Treatment Facility wholly attributed to the GF. All other loans have been apportioned in a manner to achieve balance across the respective portfolios:
- 3.17. Table 3 below summarises the overall position for each fund. This highlights that across the respective proposed portfolios, tolerances are:
- i. average borrowing rates are within of 0.0128%,
 - ii. weighted average maturity is within 0.2 years,
 - iii. the HRA remains £1.193m under-funded with external debt, this amount instead being internally borrowed from the GF.

TABLE 3: Summary two pool approach to Council's debt portfolio at 1st April 2020

	TOTAL £m	GF £m	HRA £m
Capital Financing Requirement	714.007	484.300	229.707
Debt / Debt allocation	465.399	236.885	228.514
(Under)/Over Borrowing	(248.608)	(247.415)	(1.193)
Average interest rate	4.3444%	4.3381%	4.3509%
Weighted average maturity	22.8 years	22.7 years	22.9 years

- 3.18. Based on the 2019/20 interest apportionment outturn position, had the Council operated a two pool approach, £2.752m of net debt financing costs would have been re-apportioned from GF to the HRA:

TABLE 4: 2019/20 interest apportionment outturn – single pool v two pool

	TOTAL £m	GF £m	HRA £m
SINGLE POOL			
Interest on borrowing	20.718	13.252	7.466
Debt management expenses	0.499	0.331	0.168
Interest income	(3.799)	(2.903)	(0.896)
Total	17.418	10.680	6.738
TWO POOL			
Interest on borrowing	20.718	10.552	10.166
Interest on under-funded CFR	0.000	(0.052)	0.052
Debt management expenses	0.499	0.331	0.168
Interest income	(3.799)	(2.903)	(0.896)
Total	17.418	7.928	9.490
DIFFERENCE	0.000	(2.752)	2.752

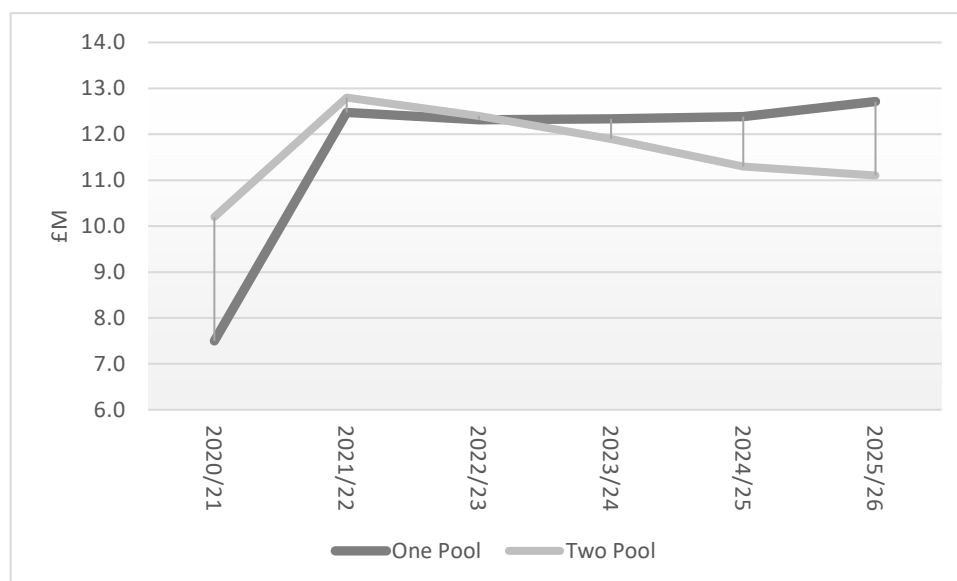
- 3.19. Table 5 compares the impact of the single pool versus two pool approaches against the latest approved 2020/21 budget and Medium Term Financial Plan (MTFP) assumptions:

TABLE 5: 20/21 Budget & MTFP net interest apportionment budget – single pool v two pool

	20/21 £m	21/22 £m	22/23 £m	23/24 £m	24/25 £m
SINGLE POOL					
HRA	7.270	7.320	7.320	7.320	7.320
GF	10.850	10.740	10.440	9.790	9.140
Total	18.120	18.060	17.760	17.110	16.460
TWO POOL					
HRA	9.320	9.430	9.260	8.955	8.360
GF	8.800	8.630	8.500	8.155	8.100
Total	18.120	18.060	17.760	17.110	16.460
DIFFERENCE					
HRA	2.050	2.110	1.940	1.635	1.040
GF	(2.050)	(2.110)	(1.940)	(1.635)	(1.040)
Key Assumptions:					
<ul style="list-style-type: none"> • No new HRA or GF loans undertaken based on capital programme approved by Council 26/02/2020. • HRA internal borrowing assumed @ 2.0%, but actual rate will depend upon prevailing interest rates and the agreed duration of any internal lending. 					

- 3.20. It is worth noting that under a two pool approach it remains possible to transfer loans between the GF and HRA, based on locally approved principles. This promotes managing treasury risk, such as refinancing risk, across the Council as a whole. For example, if the HRA no longer needed to carry a loan(s) as surplus balances accrued earlier than anticipated, and if the GF had a need to undertake borrowing, it would be possible to transfer a loan(s) between funds if mutually beneficial.
- 3.21. Modelling the impact on a one pool versus two pool approach on an illustrative additional £200m new borrowing requirement for the HRA in 2021/22 and holding other variables constant, the cost allocation benefits to the HRA are balanced over the medium term. But Chart 1 below demonstrates that in adopting a two pool approach, the HRA takes on a larger share of debt costs in the next two years (so conversely releases a larger early years benefit to the general fund) before maintaining a path below the one pool approach therein. This is achievable as adopting a two pool approach before the HRA undertakes any further significant borrowing allows a debt profile to be customised to the HRA Business Plan identified resource availability.

CHART 1: Profile of debt cost to HRA – one pool versus two pool



- 3.22. **Conclusion;** this approach creates clear and immediate distinction between HRA and GF debt and its associated servicing costs, would be straightforward to administer once implemented, and gives the HRA the autonomy to pursue its own unique debt strategy. **This is the recommended approach.**

(iii) Three pool

- 3.23. Under a three pool approach existing loan debt is kept as a single shared residual pool across both the HRA and GF, phasing out gradually over time as loans are repaid at maturity (or earlier), eventually leaving two pools remaining. Borrowing for new capital expenditure, additional loans to cover under-borrowing and any replacement of maturing loans would then be allocated to the two new separate pools, one for the HRA and one for the GF.
- 3.24. **Main strengths;** avoids the need to split existing loans pool, internal borrowing/under borrowings readily identifiable between funds as new/renewed debt is accounted for separately, future HRA debt charges are not affected by GF borrowing decisions as new debt is kept separately and vice versa.
- 3.25. Main weaknesses; difficult to administer (a number of recharges are required for old and new debt), HRA existing loans continue to carry a volatile consolidated rate of interest (CRI), HRA existing loans benefit from GF under borrowings so maintaining a form of cross-subsidy.
- 3.26. **Conclusion;** this compromise approach attempts to meet the requirements of both the HRA and GF without ever fully satisfying either until historic debt has been completely repaid or recycled into the separate pools (2065/66), is an administrative burden, and debt charges will remain uncertain through continued use of CRI. **This approach is not recommended.**

4. HRA Debt Limits and Indicators

- 4.1. This section sets out proposed changes to how the HRA Debt and Financing decisions will be managed in the future and how this will reflect the requirements of the CIPFA Code of Practice for Treasury Management. The limits and boundaries set out below are for illustrative purposes at this time and will be finalised as part of the Council's budget setting process later in the year.
- 4.2. In the earlier part of this document we have proposed a two pool approach to debt pooling between the HRA and GF. Given this and the recent changes to allow the HRA to follow self-regulated prudential borrowing

rules and abolishing the cap on HRA borrowing, local authorities are encouraged to develop local indicators to quantify risk and inform sound financial judgement.

4.3. Based on CIPFA’s HRA statistics to the year ended 31st March 2018 (latest release available at time of writing), there were 163 local authorities discharging housing landlord functions (the majority of which adopt a two pool approach). Set out below are a series of proposed indicators that we will be adopting to support the financial framework that will underpin future investment and borrowing decisions within the HRA. Where appropriate we have also included indicators against national and regional comparison.

- **Authorised limit for gross external debt (also termed the affordable borrowing limit);** gross borrowing (external debt plus other liabilities such as lease commitments, PFI etc) cannot, except in the short term, exceed the Capital Financing Requirement (CFR). The Council is legally obliged to set this limit each year.

In line with statutory guidance a lower operational boundary is also set as an early warning indicator should debt approach the authorised limit and, as the HRA is expected to be close to fully funded with borrowing, this will be set to match the forecast CFR.

TABLE 6: Operational Boundary & Authorised Limit

	2020/21 Forecast £m	2021/22 Forecast £m	2022/23 Forecast £m	2023/24 Forecast £m	2024/25 Forecast £m
HRA Capital Financing Requirement (CFR) – Budget February 2020	229.2	229.2	229.2	230.9	230.8
Illustrative additional borrowing requirement	0.0	200.0	196.0	192.0	188.0
Revised HRA CFR	229.2	429.2	425.2	422.9	418.8
Operational boundary	229.2	429.2	425.2	422.9	418.8
Authorised limit	249.2	449.2	445.2	442.9	438.8

- **Interest cover ratio;** the numbers of times over the HRA operating surplus covers its debt servicing costs (voluntary MRP and interest charges) . Debt as measured by the CFR measure of debt liability at 31st March.

TABLE 7: Interest Cover Ratios

Milton Keynes	National	Regional (South East)
x2.65	x3.44	x3.29

Based on CIPFA’s HRA statistics to the year ended 31st March 2018

Based on the cover ratio of 2.65 at 31st March 2018 above, this equates to approximately £0.38p in every £1 of the operating surplus is used to cover debt servicing costs.

- **Debt maturity profile limits;** these gross percentage limits are set to reduce exposure to large sums falling due for refinancing at the same time and encourage a balanced between short and long term certainty of interest cost for budget planning purposes, set as upper and lower limits;

TABLE 8: Maturity Profile Limits

	MKC 'Two Pool' Actual 2020/2021	Recommended Limit Ranges
Under 12 months	1.7%	Max. 10%
12 months to 2 years	2.9%	Max. 10%
2 years to 5 years	7.7%	Max. 20%
5 years to 10 years	10.0%	Max. 35%
10 years and above	77.7%	Max. 100% Min. 60%

Set too rigidly these limits will impede the HRA's ability to align its borrowing portfolio to underlying market conditions, for example to take advantage of short term interest savings. Set too loosely, these limits may lead to an imbalanced portfolio with the HRA exposed to significant refinancing and interest rate risk. The recommended limits above recognise that the HRA will inherit a borrowing portfolio with a maturity structure that is pre-determined and inflexible, but still aims to afford options for an appropriate balance between short term savings and long term stability for future borrowing decisions.

- **Upper limits on variable interest rate exposure;** this identifies a maximum limit for variable interest rates based upon net debt (gross debt less investment balances). This has been calculated at 10% of the authorised limit for external debt (rounded up to nearest £m), meaning that if the HRA borrowed to its full capacity and held no variable rate investments, a maximum of 10% of its borrowing portfolio could carry a variable interest rate.

TABLE 9: Limits on Variable Interest Rate Exposure

	2020/21 Forecast £m	2021/22 Forecast £m	2022/23 Forecast £m	2023/24 Forecast £m	2024/25 Forecast £m
Upper Limit	25.0	45.0	45.0	45.0	44.0

- **Upper limits on fixed interest rate exposure;** like the previous indicator but for fixed interest rates. These limits have again been calculated with reference to the authorised limit for external debt, meaning that if the HRA borrowed to its full capacity and held no investments, the entire debt portfolio may be fixed rate for planning/costing certainty.

TABLE 10: Limits on Fixed Interest Rate Exposure

	2020/21 Forecast £m	2021/22 Forecast £m	2022/23 Forecast £m	2023/24 Forecast £m	2024/25 Forecast £m
Upper Limit	249.2	449.2	445.2	442.9	438.8

5. MRP Policy for HRA Debt Liability

- 5.1. Local authorities, just like private businesses, must account for the depreciation of their assets to comply with accounting standards in presenting a true picture of an organisations net worth. In Local Government, legislative overrides counteract the cash impact of this charge to prevent this being charged to the taxpayer. But where local authorities fund capital expenditure by borrowing, the taxpayer has yet to be charged for it, and so statutory regulations require local authorities to set aside an annual amount – known as Minimum Revenue Provision (MRP) – which it considers prudent. Essentially, just like depreciation, MRP ensures that provision is made over time for the replacement of assets by having cleared the debts used to fund them. In

the case of the HRA there is no statutory requirement to charge MRP, but in not doing so, no prudent provision for eventual repayment is made.

- 5.2. Government guidance on MRP includes specified but not prescriptive methods for calculating MRP charges, with the overriding objective that such charges are prudent. Authorities are free to make Voluntary Additional Payments (VAP), effectively overpayments, to reduce debt liability quicker if they so wish. Voluntary overpayment above the minimum requirement or in the case of the HRA where not statutorily required can be clawed back in future years, if deemed necessary, provided the council discloses the annual and cumulative value of overpayments each year.
- 5.3. If the recommended option of splitting the council's loan portfolio into two pools as set out in Section 3 above is implemented, the primary options available to the council are:
1. Do nothing. No provision is made for reducing the HRA debt liability. Loans will have to be renewed upon maturity creating an ongoing refinancing risk and the HRA remains liable for financing the debt servicing costs indefinitely. If we continue to increase borrowing and do not adopt any Voluntary MRP policy this would leave the Council open to an increased and potentially unmanageable level of refinancing risk in the future. **This option is not recommended on the basis.**
 2. The Self Financing regime HRA debt settlement calculation was predicated on the affordability of the HRA business plan to fund it. The £170.360m buyout debt could be written down on an annuity basis by VAP over a proxy asset life of 40 years equating to an initial £1.410m annual charge, rising by 5% per year, with the potential for reversing in later years if deemed necessary. This gradually escalating of the VAP charge to recognises the long-term profile of the proposed maturity structure of the HRA debt pool and rising net surpluses available to repay debt in the later years of the business plan. No VAP for £59.347m historic debt liability pre-2012, but kept under reviewed as part of future HRA business planning process. **This option is not recommended.**
 3. Write down the full CFR, both self-financing and historic debt liability pre-2012, on an annuity basis by VAP over 46 years equating to an initial £1.362m annual charge, rising by 5% per year. The proxy write down period has been extended by 6 years to match the proposed HRA debt pool maturity structure so that debt does not exceed CFR in any given year. Providing no additional borrowing was undertaken by the HRA, the HRA would be debt-free by 2065/66. **This option is not recommended.**
 4. No voluntary MRP for historic HRA debt liability, for which loans are otherwise renewed upon maturity unless sufficient surpluses are identified within the HRA business plan to support repayments. For new HRA unsupported borrowing, straight line voluntary MRP be applied reflecting the consumption period of those assets as:
 - Land acquisitions: Nil, its value to the HRA is not expected to diminish;
 - Regeneration schemes: 2% per annum / write down over 50 years;
 - New HRA house build schemes: 1% per annum / write down over 100 years;
 - Build of houses to be sold on open market: Nil, the debt liability will be repaid from eventual sale proceeds;
 - HRA house open market acquisitions; on an estimated remaining asset life basis set under delegated authority by the Section 151 officer.This policy would ensure a more commercial financial approach to new self-financing HRA borrowing plans by requiring cash provision to be set aside for eventual debt repayment where appropriate, and allows the HRA flexibility to use its surplus funds to repay its debts or invest in further housing provision. **This is the recommended option.**

6. Treasury Management Strategy

- 6.1. In allowing the HRA to determine its own debt management arrangements, it will be appropriate going forward for the council to set independent HRA and GF borrowing and investment approaches within the

overall annual Treasury Management Strategy (TMS). With no immediate large-scale HRA borrowing plans for 2020/21 then the existing approved TMS remains relevant to both funds, but subject to the council choosing to change pooling method, separate approaches will be incorporated from 2021/22 onwards.

- 6.2. Risk associated with external loans will sit entirely with either the HRA or GF depending on which fund each loan have been earmarked to. This includes refinancing rate risk for example, being that maturing borrowings cannot be refinanced on terms that reflect the budget provisions made for those refinancing and/or that the terms are inconsistent with prevailing market conditions.
- 6.3. Similarly, risk associated with any external investment of earmarked HRA cash reserves sits with the HRA. This will include the risk of impairment in the event of the failure of an investment counterpart and may require an earmarked loss provision to be set aside, reassessed annually. Where risk cannot be earmarked specifically to either the HRA or GF, it will be apportioned fairly between the two using relevant available data. For example in the event of impairment of an investment, any losses will be apportioned between the two funds based on an estimated proportion of cash balances held if not readily identifiable as relating to a single fund.

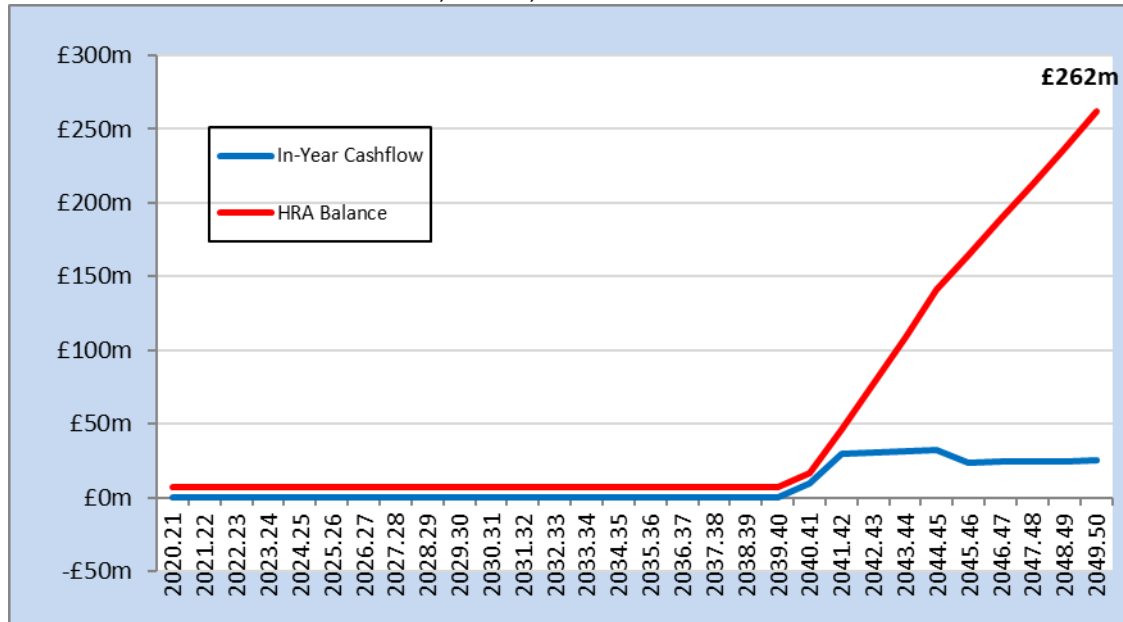
7. HRA Business Plan Model Impact

- 7.1. The HRA BPM, in both Baseline and potential future investment Scenario iterations, shows the current “One Pool” arrangement. The impact of a move to a “Two Pool” arrangement is illustrated indicatively here, but this is based on the draft HRA BPM and therefore is subject to change post consultation and as the plan is finalised.
- 7.2. In both iterations, assumptions have been included as outlined above:
 - Individual debts have been assigned to the HRA as summarised in Table 3 above
 - Interest rates for both new internal and external debts have been assumed at PWLB rates (estimated at 2.5%)
 - A Voluntary Repayment Provision (“VRP”) has been assumed on new borrowing at 1.5%
- 7.3. References to paying off debt in the BPM are subject to there being enough internal debt or external debt on short-term or variable terms to allow sufficient flexibility to do so, in accordance with usual Treasury Management practices.

(i) Baseline BPM

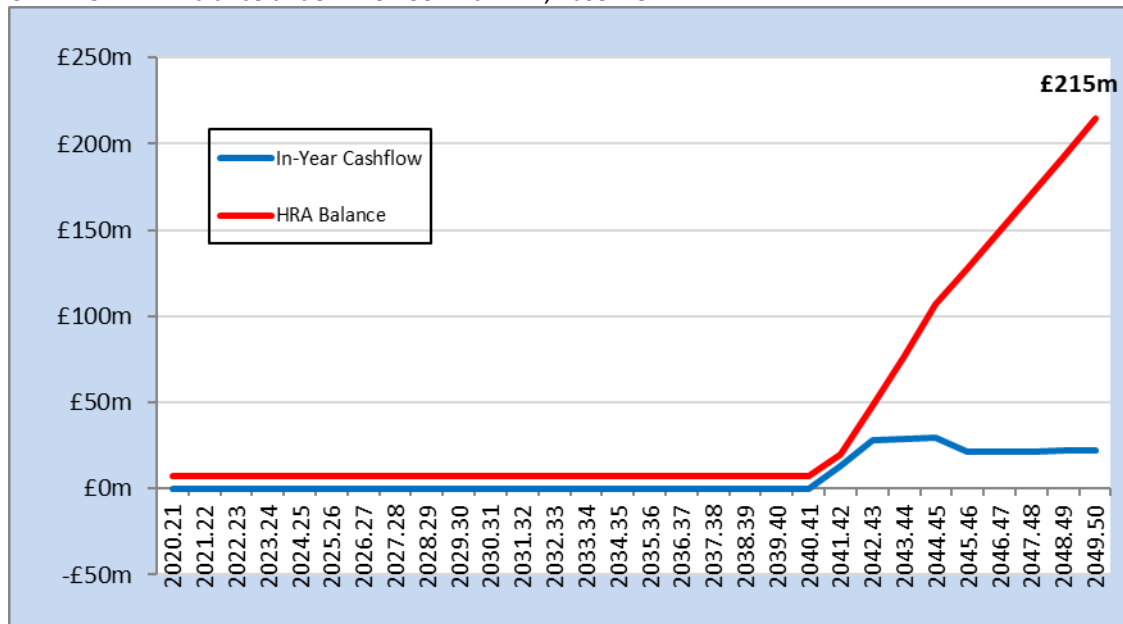
- 7.4. Under the existing “One Pool” arrangements, with no voluntary debt repayment, the Baseline BPM shows a balance of £262m in the HRA at the end of the BP period:

CHART 2 – HRA Balance under One Pool, no VRP, Baseline BPM



7.5. Under the recommended “Two Pool” arrangement, the balance would be £215m:

CHART 3 – HRA Balance under Two Pool with VRP, Baseline BPM



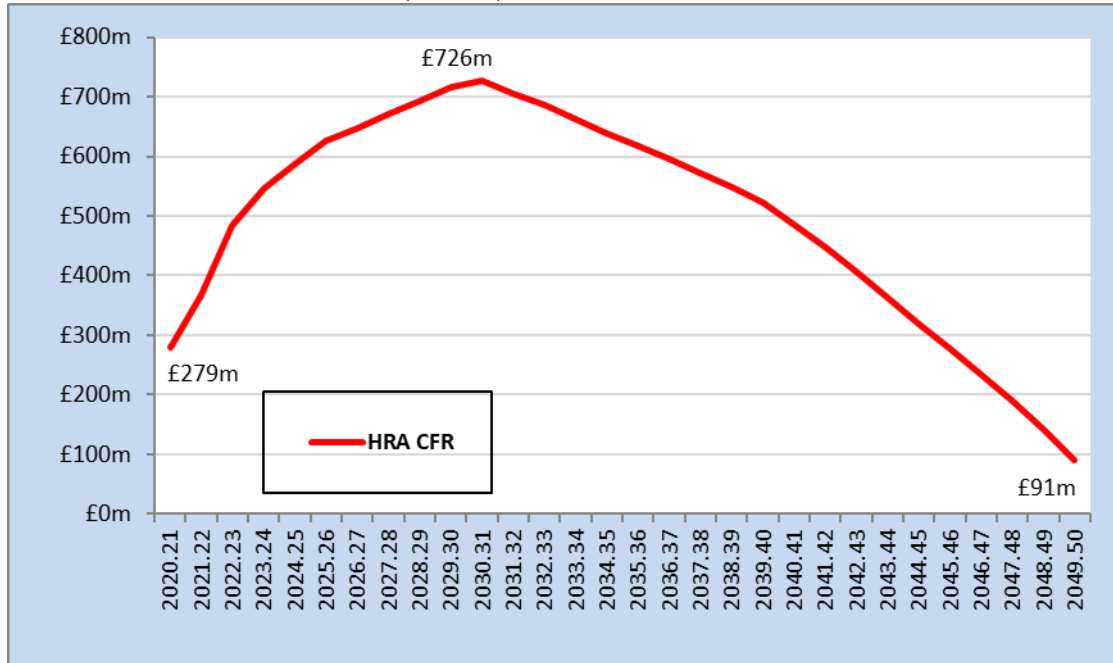
7.6. The change to the “Two Pool” arrangement would result in a £47m cost to the HRA over the BP period, since the amount of new borrowing at lower interest rates does not reduce the total interest payable over the period by more than the higher interest being paid on former internal borrowing, and does not enable more debt to be paid off.

(ii) Potential Future Investment Scenarios BPM

7.7. For illustrative purposes we have modelled the financial implications of the Potential Future Investment Scenarios BPM (Annex C) and the implication of borrowing under each of the debt pool options. This does not represent commitments or schemes approved and all are subject to value for money scrutiny, assessment of financial viability and full approval.

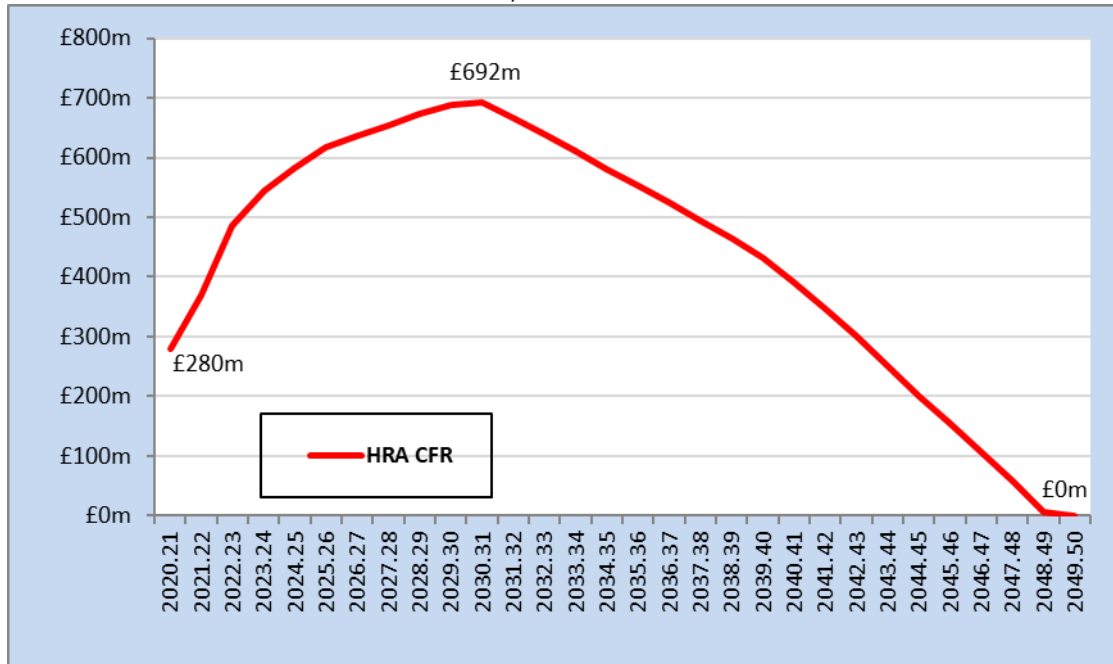
7.8. Under the existing “One Pool” arrangements the Future Potential Investment Scenarios BPM shows HRA balances of £7m, the prudent minimum, plus debt outstanding of £91m.

CHART 4 – HRA Debt under One Pool, no VRP, Scenarios BPM



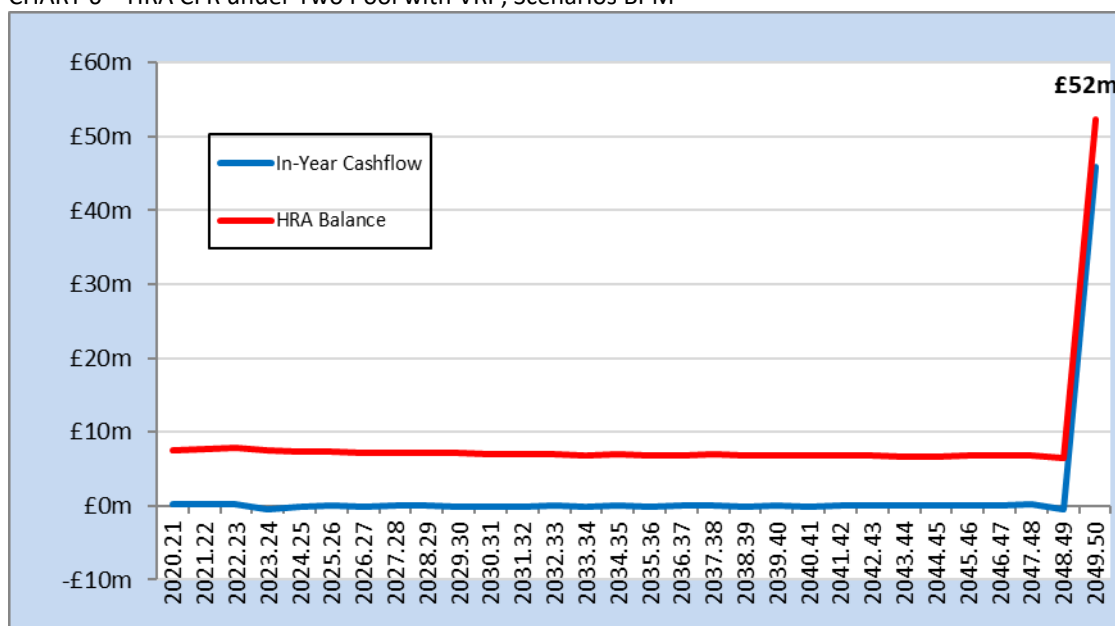
7.9. Under the recommended “Two Pool” arrangement, the HRA debt position would be:

CHART 5 – HRA Debt under Two Pool with VRP, Scenarios BPM



7.10. And the HRA Balances would be:

CHART 6 – HRA CFR under Two Pool with VRP, Scenarios BPM



7.11. The change to the “Two Pool” arrangement would result in a £136m benefit to the HRA over the BP period, with a £34m reduction in peak borrowing, since the large amount of new borrowing at lower interest rates would reduce the total interest payable over the period, and so enable more debt to be paid off.

7.12. The benefit to the HRA is the total benefit of new borrowing under the Two Pool arrangement; under the existing One Pool arrangement the benefit of this HRA borrowing would accrue in large part (unquantifiable without similar projections of General Fund borrowing requirements) to the General Fund. There is no actual cost to the General Fund, just a fairer allocation of future benefits.

(iii) Refinancing Risk

7.13. The BPM does not reflect any refinancing risk, which is the risk that when renewal of existing borrowing or new borrowing is required, interest rates may have risen to above those modelled.

7.14. This risk can be illustrated by assuming that £30m needs to be borrowed on 1 April 2025 for a 19 year period to reduce HRA under-funding, i.e., to better fund the HRA CFR with external borrowing. An interest rate of 2% higher than the current PWLB assumed would increase interest costs (and so debt outstanding at the end of the BP period) by £15m.