

Meeting	Officer New Homes Board	Item No.	
Report Title	Development Assumptions		
Report Of			
Class	Approval & Decision	Date	3rd November 2023

1. Purpose

1.1 It is recommended that:

Officer New Homes Board approves the financial assumptions, parameters and hurdles as described in this report and agrees that these will apply to all new investment decisions;

2. Executive Summary

2.1 This report sets the financial parameters for approving new developments.

3. Background

3.1 The financial assumptions used to assess the viability of new developments and acquisitions are reviewed approximately every year in the Autumn once it is clear what inflation will be applied to rents in the following April.

3.2 This paper sets out the revised financial assumptions and hurdles for new developments. It supersedes the assumptions set out in the previous assumptions paper dated 12th December 2022 which was approved by ONHPB at their meeting on 12 January 2023.

4. Applicability

4.1 The financial assumptions in this paper provide a consistent basis for forecasting the expected incomes and operational costs for all development schemes. The assumptions are to be applied to all development schemes going forward from the date of this paper.

4.2 This report supersedes all assumptions previously agreed.

5. Assumptions

5.1 Many financial assumptions remain unchanged since the previous year.

5.2 CPI has been published and the rent inflation to be applied on 1st April 2024 has been assumed at CPI plus 1% (7.7%) and at CPI (6.7%) for management, maintenance and lifecycle costs.

5.3 Information on predicted PWLB interest rates from Link have resulted in interest rates being lowered from 5% to 4.5% from 1st April 2026 to 31st March 2028.

5.4 These changes have resulted in improved NPV's for most of the new schemes.

5.5 Although house prices have fallen, this will be picked up as part of the regular valuations that are carried out on each scheme. Savills expect an average rise in HPI of circa 3% from 2024 to 2027 in London, therefore the 2% per annum HPI has been retained.

5.6 The key assumptions changes are detailed in the table below and are highlighted in **yellow**:

	ASSUMPTION	NEW ASSUMPTION – CHANGES IN YELLOW	NOTE																								
INFLATION	Social Rent Inflation (applies to target rent and LAR only)	<p>Assumptions page: Sets</p> <table border="1"> <thead> <tr> <th>Applied 1st of:</th> <th>Optimix Year</th> <th>Rate</th> </tr> </thead> <tbody> <tr> <td>Apr-23</td> <td>2024</td> <td>7.00%</td> </tr> <tr> <td>Apr-24</td> <td>2025</td> <td>7% to 7.7%</td> </tr> <tr> <td>Apr-25</td> <td>2026</td> <td>2.50%</td> </tr> </tbody> </table> <p>Rent Inflation Page: Sets starting rent</p> <table border="1"> <thead> <tr> <th>Applied 1st of:</th> <th>Optimix Year</th> <th>Rate</th> </tr> </thead> <tbody> <tr> <td>Apr-23</td> <td>2024</td> <td>11.10%</td> </tr> <tr> <td>Apr-24</td> <td>2025</td> <td>7% to 7.7%</td> </tr> <tr> <td>Apr-25</td> <td>2026</td> <td>2.50%</td> </tr> </tbody> </table>	Applied 1st of:	Optimix Year	Rate	Apr-23	2024	7.00%	Apr-24	2025	7% to 7.7%	Apr-25	2026	2.50%	Applied 1st of:	Optimix Year	Rate	Apr-23	2024	11.10%	Apr-24	2025	7% to 7.7%	Apr-25	2026	2.50%	CPI plus 1 applied to 24/25 increasing the rent assumptions from 7% to 7.7%
	Applied 1st of:	Optimix Year	Rate																								
	Apr-23	2024	7.00%																								
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Service Charge Inflation	<table border="1"> <thead> <tr> <th>Applied on 1st of:</th> <th>Optimix Year</th> <th>Rate</th> </tr> </thead> <tbody> <tr> <td>Apr-23</td> <td>2024</td> <td>5.00%</td> </tr> <tr> <td>Apr-24</td> <td>2025</td> <td>3.00% to 5%</td> </tr> <tr> <td>Apr-25</td> <td>2026</td> <td>2.00%</td> </tr> </tbody> </table>	Applied on 1st of:	Optimix Year	Rate	Apr-23	2024	5.00%	Apr-24	2025	3.00% to 5%	Apr-25	2026	2.00%	Service Charge inflation for 24/25 to be increased from 3% to 5%													
Applied on 1st of:	Optimix Year	Rate																									
Apr-23	2024	5.00%																									
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Shared Ownership Rent Inflation	<table border="1"> <thead> <tr> <th>Applied on 1st of:</th> <th>Optimix Year</th> <th>Rate</th> </tr> </thead> <tbody> <tr> <td>Apr-23</td> <td>2024</td> <td>13.10%</td> </tr> <tr> <td>Apr-24</td> <td>2025</td> <td>8.50% to 7.7%</td> </tr> <tr> <td>Apr-25</td> <td>2026</td> <td>4.00% to 2.5%</td> </tr> <tr> <td>Apr-26</td> <td>2150</td> <td>2.5%</td> </tr> </tbody> </table> <p>Creekside will still be at RPI plus half a percent</p>	Applied on 1st of:	Optimix Year	Rate	Apr-23	2024	13.10%	Apr-24	2025	8.50% to 7.7%	Apr-25	2026	4.00% to 2.5%	Apr-26	2150	2.5%	New Shared Ownership rental inflation to be set at CPI + 1, therefore reducing inflation for years 24/25 and 25/26										
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	TA Rent Inflation	<table border="1"> <thead> <tr> <th>Applied on 1st of:</th> <th>Optimix Year</th> <th>Rate</th> </tr> </thead> <tbody> <tr> <td>Apr-23</td> <td>2024</td> <td>0.00%</td> </tr> <tr> <td>Apr-24</td> <td>2025</td> <td>2.00% TBC</td> </tr> <tr> <td>Apr-25</td> <td>2026</td> <td>2.00%</td> </tr> <tr> <td>Apr-26</td> <td>2150</td> <td>2.00%</td> </tr> </tbody> </table>	Applied on 1st of:	Optimix Year	Rate	Apr-23	2024	0.00%	Apr-24	2025	2.00% TBC	Apr-25	2026	2.00%	Apr-26	2150	2.00%	LHA rates for TA have been assumed at 2% increase for 24/25, however no announcement has been made as yet, so this may need to change.
		Applied on 1st of:	Optimix Year	Rate														
		Apr-23	2024	0.00%														
		Apr-24	2025	2.00% TBC														
Apr-25	2026	2.00%																
Apr-26	2150	2.00%																
House Price Inflation	2.00% on 1st April 2023 onwards	No Change																
	Management Cost Inflation – All tenures	<table border="1"> <thead> <tr> <th>Applied on 1st of:</th> <th>Optimix Year</th> <th>Rate</th> </tr> </thead> <tbody> <tr> <td>Apr-23</td> <td>2024</td> <td>6.00%</td> </tr> <tr> <td>Apr-24</td> <td>2025</td> <td>4% to 6.7% (CPI)</td> </tr> <tr> <td>Apr-25</td> <td>2026</td> <td>2.00%</td> </tr> </tbody> </table>	Applied on 1st of:	Optimix Year	Rate	Apr-23	2024	6.00%	Apr-24	2025	4% to 6.7% (CPI)	Apr-25	2026	2.00%	Management inflation for 24/25 to be set at CPI, a move from 4% to 6.7% in line with the HRA business plan			
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		Apr-23	2024	6.00%														
		Apr-24	2025	4% to 6.7% (CPI)														
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	Maintenance Cost Inflation– All tenures	<table border="1"> <thead> <tr> <th>Applied on 1st of:</th> <th>Optimix Year</th> <th>Rate</th> </tr> </thead> <tbody> <tr> <td>Apr-23</td> <td>2024</td> <td>10.10%</td> </tr> <tr> <td>Apr-24</td> <td>2025</td> <td>6% to 6.7% (CPI)</td> </tr> <tr> <td>Apr-25</td> <td>2026</td> <td>2.00%</td> </tr> </tbody> </table>	Applied on 1st of:	Optimix Year	Rate	Apr-23	2024	10.10%	Apr-24	2025	6% to 6.7% (CPI)	Apr-25	2026	2.00%	Maintenance inflation for 24/25 to be set at CPI a move from 6% to 6.7% in line with the HRA business plan Applies also to sinking fund			
		Applied on 1st of:	Optimix Year	Rate														
		Apr-23	2024	10.10%														
		Apr-24	2025	6% to 6.7% (CPI)														
Apr-25	2026	2.00%																
OPERATIONAL COSTS	Management Cost – Social Rent	£463 per unit inflated from 2023/24. This was inflated from £400 by applying 3% inflation for 3 years and 6% in 23/24	No Change															
	Management Cost – Shared Ownership	Removed as LBL view the charge as 100% recoverable	No change															
	Maintenance Cost – Social Rent	£722 per unit inflated from 2023/24. This was inflated from £600 by applying 3% inflation for 3 years and 10.1% for 1 year	No Change															

	Maintenance Cost – Shared Ownership	<p>£500 per unit</p> <p>This is not inflated from the previous assumption and remains at £500.</p>	No Change
	Sinking Fund – Social Rent	<p>Rebuild cost increased to £3,158 per m2 including inflation for 23/24</p> <p>This was inflated from £2,625 by applying 3% inflation for 3 years plus 10.1% for 1 year</p> <p>0.8% and 1.0% rates are unchanged as are the starting years.</p>	No Change
FINANCING	Development Interest	<p>5.00% on borrowing and 0.00% on surpluses</p> <p>Note: Schemes completed by March 2023 remain on the previous assumptions of 3.8%</p>	No Change
	Long term Interest	<p>All tenures: 5.00% to 31st March 2026 and then 4.5% to March 2028</p> <p>All tenures: 4.00% on 1st April 2028 going forward</p> <p>Note: Schemes completed by March 2023 remain on the previous assumption of 3.8%</p>	Long term interest rate to reduce from 5% to 4.5% from 1 st April 2026 to end March 2028
	Discount Rates	<p>All tenures: 5.00% to 31st March 2026 and then 4.5% to March 2028</p> <p>All tenures: 4.00% on 1st April 2028 going forward</p> <p>Note: Schemes completed by March 2023 remain on the previous assumption of 3.8%</p>	Long term discount rate to reduce from 5% to 4.5% from 1 st April 2026 to end March 2028

6. Financial Hurdles

All HRA schemes

- 6.1 Private sale, shared ownership and market rent all need to achieve a positive NPV.
- 6.2 LAR/Social Rent Units do not need to achieve a positive NPV.
- 6.3 The overall scheme NPV does **not** need to be positive, but the scheme NPV can only be negative up to £10k per person that is housed LAR/Social rent. ¹
- 6.4 The cost to value of rented tenures and also of the whole scheme must not exceed a cost to value ratio of 105%. The purchase of individual street properties are permitted up to 115% cost to value.
- 6.5 Shared ownership cost to value to increase from 100% to 107%, providing it produces a positive NPV.
- 6.6 Private sale should have a cost to value which does not exceed 85%.
- 6.7 As a principle, it is possible to present a few schemes together so that one can help cross subsidise the other. If this is to happen, the weaker scheme should not proceed before the stronger scheme that supports it is committed.

7. General Fund

- 7.1 Schemes that remain in the general fund are required to have a positive NPV unless agreed by exception (ie Housing Acquisition Programme which will reduce Temporary Accommodation costs).

8. Non-Residential Units

- 8.1 There are no specific financial hurdles proposed for non-residential units.
- 8.2 This is because planning consents can dictate that an element of non-residential accommodation is required on a scheme irrespective of financial viability.
- 8.3 Schemes with non-residential accommodation still need to meet their overall scheme hurdles however.

9. Exceptions

- 9.1 Schemes that fail to meet the above hurdles will only be considered by exception.
- 9.2 If large schemes are put forward that do not meet the hurdles then the viability of the HRA model may need to be retested.
- 9.3 This retesting of the HRA with additional unviable schemes included is likely to result in reduced capacity to fund the development programme.

¹ For example, if a scheme houses 40 people in LAR, then the NPV can be negative up to £400,000 on the scheme as a whole. The actual NPV for the LAR units may be negative by more than £400,000 if there is cross subsidy from private sale or other tenures.

10. Recommendations

- 10.1 Officer New Homes Board are asked to approve the financial assumptions, parameters and hurdles as described in this report and agree that these will apply to all new investment decisions.