

FINANCE UPDATE

Report of the Finance Director & Company Secretary

1. SUMMARY

- 1.1 This report updates the Board on the draft financial outturn for 2022/23; headline points to note are:
- Notification that the 2022/23 financial outturn, from the management accounts perspective, was a circa £0.2m surplus. Quarter 3 forecasted a breakeven position, (£0.5m deficit at Quarter 2); the budget had planned for a deficit of £0.63m.
 - After allowing for the technical pension adjustments made in the formal financial statements, based upon draft pension figures received from the actuary, there is a forecasted 'gain' (surplus) for the year of £40.36m. Again, materially impacted, by large swings in actuarial assumptions, resulting in the pension deficit figure reducing from £30.9m in March 2022 to a surplus of £9.2m at March 2023.
 - Underlying reserves, excluding the pension scheme total £22.4m, of which approximately £12m are usable reserves.

2. RECOMMENDATIONS

- 2.1 To note the management accounts surplus of circa. £0.2m for 2022/23 and the main variations against the original budget as per paragraph 4.2.
- 2.2 To note the key draft headline figures from the financial statements at March 2023:
- A financial outturn of a £40.36m 'gain' for the 2022/23 year as per paragraph 4.3
 - A March 2023 pension scheme valuation of a surplus of £9.2m as per paragraph 4.3
 - Underlying reserves of £22.4m and usable reserves of £12m as per paragraph 4.4

3. REASON FOR RECOMMENDATION

- 3.1 To keep the Board informed of the financial performance of Derby Homes in the year 2022/23; highlighting any major over, or, under spend areas.

4. MATTERS FOR CONSIDERATION

4.1 Management Accounts

At the time of drafting this report, the Accountancy team are in the process of finalising both the year-end management accounts and the draft financial statements for 2022/23.

Any material changes to the summary table in paragraph 4.2, will be supplied in a future update as necessary, but headline figures are detailed below.

The management accounts figure, (this is the outturn figure prior to FRS102 pension scheme adjustments, which are required in the formal financial statements), are showing a surplus of circa. £0.2m. At Quarter 3, a breakeven had been forecasted.

The circa. £0.2m surplus is around 0.3% of the £57.38m turnover.

4.2 Main variations against the original budget are listed below; figures in brackets represents additional costs above planned budget:

	£m
Budgeted loss for the year approved at 27 January 2022 Board	(0.629)
Day-to-day repairs – mainly damp and disrepair costs £150k, materials inflation £230k, increase in outstanding jobs commitments provision £388k, scaffolding costs £166k, Electrical contractor to assist with backlog £140k, groundworks contractor £90k, agency bought in to tackle jobs backlog £130k	(1.300)
Gas breakdowns and servicing – mainly staffing; apprentices and contractors being used to maintain service levels.	(0.263)
Water hygiene funding allocated no longer required; revised risk-based approach to monitoring pipework in properties.	0.164
Delayed repairs prior to painting works linked to procurement of new contractor.	0.431
Council tax adjustment on empty homes properties from 2021/22	0.101
Estates Pride revenue – fewer remedial works following path inspections and environmental schemes not yet developed.	0.165
Milestone House – DH contribution to redecoration of bedrooms.	(0.113)
Milestone House – mainly increased security costs.	(0.177)
Reduction in planned contribution to Locality working in 22/23	0.250
Management fee claim missed in 2021/22	0.098
Vacancies in posts throughout the year above budgeted levels	0.600
HRA Capital works – increased level of activity generating more overhead contribution	0.534
Job evaluation review consultancy not undertaken	0.100
Other variations (net)	(0.062)
2022/23 Management account surplus/deficit	0.177

4.3 Financial Statements 2022/23

A full report will be presented at the July Board meeting with the 2022/23 financial statements, but it is useful to note the material impact that, yet again, key assumptions used by the actuary in the preparation of the year-end pension scheme valuation, has on both, the reported 2022/23 surplus figure and on the March 2023 Balance Sheet.

In addition to the management account figures, the formal financial statements include notional adjustments made to the in-year employer pension costs, and the impact arising from movements in the overall pension scheme deficit, (linked to fund's performance, future assumptions etc); we call them the FRS102 pension adjustments.

As has been the case for a number of years, actuary amendments made to future assumptions around inflation, funds, returns and life expectancy, result in huge swings to the pension figures, masking the true operational figures that are internally reported in the management accounts.

Based on draft pension figures received from the actuary, there is bottom line gain, (surplus), for the 2022/23 year of £40.359m on the Statement of Consolidated Income (the Profit and Loss Account). This showed a £11.332m gain for 2021/22, and for 2020/21 a "loss" of £21.242m was reported.

The pension deficit figure reduced from £30.9m in March 2022, to a surplus of £9.2m at March 2023, (there was a £40.2m deficit at March 21).

The main reasons for the large pension swing are noted below. Comments are made in 'plain English,' rather than strictly in-line with the technical reasons to aid understanding of the main causes for the changes.

The two biggest factors contributing to this change are changes to key assumptions:

- Discount rate – this has increased from 2.75% to 4.75%, reflecting changes in the increase in interest rates and the thought that longer term investment returns will be significantly higher than previously forecasted. This improves the pension scheme valuation by £61.5m
- Other experience – an adverse swing of £11.3m. This reflects the impact of the September 2022 inflation figure of 10.1% and that current pensions and, therefore, the underlying base cost of current pensions were increased in-line with inflation. This level of inflation was way higher than previously forecasted. There are currently 200 active pensioners in the scheme.

To simplify it even more:

- Higher bank base rate interest rates = an increase in the discount rate = higher investment returns = "good" for the pension scheme.
- High UK inflation rates = increases to the current and ongoing cost of pensions to today's (200) pensioners = "bad" for the pension scheme.

So, the volatility currently being experienced in the UK economy. (Large increases in inflation and subsequent increases in interest rates), materially impacts on the accounting valuation of the Derby Homes pension scheme. If this changes. (Lower inflation and lower interest rates), over the next year or two, it is likely that the scheme will return to reporting a deficit position.

For a truer, less volatile pension scheme position, I would direct the Board to place greater consideration on the valuation used by the actuary in the March 2022 triennial valuation; reported to 26 January 2023 Board. The Derby Homes scheme was 104% funded, meaning its assumed current and future assets more than cover its assumed current and future liabilities; this is down slightly from the 106% in the March 2019 report. The March 2022 valuation confirms that the underlying pension scheme continues to be soundly funded.

- 4.4 Overall, the Balance Sheet remains strong. Omitting the £9.2m pension scheme surplus, (the pension scheme remains underwritten by the Councils HRA), the Company has a General Reserve of £22.4m.

Liquidity, (availability of cash), is very strong compared to the liabilities of the Company. This, along with the pension underwrite, gives the Board and Auditors assurance, when considering the going concern position of the company.

I would estimate that around £12m of the General Reserve is usable, this compares to £14.3m listed as the planned use of reserves, agreed by the Board in the January 2023 budget paper. The balancing figure on the use of reserves is the subsidy available towards the cost of new homes, so this changes from £3.3m to £1m, (reflecting the fact that in 2022/23 over £2m of properties were added to the Balance Sheet, mainly the staged payment for 12 bungalows at Osmaston).

5. OTHER OPTIONS CONSIDERED

- 5.1 This update has been prepared at the end of April, to give Board an early indication of the 2022/23 financial outturn. Results may vary following further work in preparation for the external audit and then following the external audit. Delaying an update to the Board was an option, to have greater assurance on the figures, but this was outweighed, by the benefit the Board has from oversight of the early draft figures produced by the Finance team.

IMPLICATIONS

6. FINANCIAL AND BUSINESS PLAN IMPLICATIONS

6.1 Management Accounts

A full review of the 2022/23 management accounts will be undertaken in Quarter 1 2023/24 and considered by the Senior Management Team. Analysis of over and underspending areas completed, to understand any underlying budget issues and remedial actions required within services.

7. COUNCIL IMPLICATIONS

7.1 Financial Statements

The financial statements for Derby Homes are consolidated into the financial statements of its owner, Derby City Council.

The Council underwrite any pension scheme deficit, which is necessary to ensure that the Board can express the opinion that Derby Homes remains a going concern.

The areas listed below have no implications directly arising from this report:

Consultation
Legal and Confidentiality
Environmental
Equalities Impact Assessment
Health & Safety
Risk
Policy
Personnel

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Background information: None

List of appendices None

This report has been approved by the following:

Managing Director	Maria Murphy	09.05.2023
Company Solicitor	Taran Lalria	09.05.2023
Governance (checked)	Jane Haywood	03.05.2023