Rochford District Council

Options for the Future Management and Ownership of the Council's Housing Stock

Report to Rochford Housing Options Appraisal Board and Rochford District Council

Reference: Rochford Options
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Contents

1 Introduction

Background and purpose of this report

1.1 In response to the government's requirements Rochford District Council is undertaking a housing stock options appraisal in accordance with ODPM guidance issued in June 2003.

1.2 The key objective of the Options Appraisal is to provide clear information and advice to the Council on the future management and ownership of its housing stock in the context of the Council's strategic housing objectives.

1.3 The Council established the Rochford Housing Options Appraisal Board (RHOAB) to oversee and manage the Options Appraisal, to undertake investigations into the practicalities and potential of the Options, and to report to the Council accordingly.

1.4 RHOAB appointed Graham Moody Associates to provide it with technical and financial advice on the appraisal and to assist in fulfilling the government's requirements.

1.5 This is report to the Board sets out the technical and financial analysis of the Options in Rochford. It examines the Options for the future in relation to the Council's housing aims and objectives, taking into account the need for affordable housing in the District, the condition of the Council's housing stock, tenants' aspirations and Council policies.

Layout of this report

1.6 After this brief introduction we have set out this report as follows:

- Section 2: Government policy for social housing
- Section 3: Stock Condition and Tenants' Aspirations;
- Section 4: The Housing Revenue Account "As Is";
- Section 5: The Arms Length Management Option;
- Section 6: The Private Finance Initiative;
- Section 7: Voluntary Housing Transfer;
- Section 8: Comparing the Options; and
- Section 9: Conclusions.

Acknowledgements

1.7 We are grateful for the ready support and assistance of the Council's housing and finance staff throughout the Options Appraisal process.

2 Government policy for social housing

2.1 In this section of our report we set out some key aspects of government policy for Council housing. We then describe the way in which local authorities account for council housing and associated properties and services, together with how the government provides and distributes subsidy for council housing. We also describe the sources of capital for investment in council housing, and identify the key factors that we shall need to consider in examining the sustainability of the Council's Housing Revenue Account.

2.2 The housing finance system in detail is fairly complicated. In what follows we have set out the main components of the system that are important for the options appraisal, simplifying or omitting many minor matters.

Key government policies for council housing

2.3 The government published a Housing Green Paper "Quality and Choice: A Decent Home for All" in the spring of 2000. The outcome setting out the government's policies for housing was published in December 2000 in "The way forward for housing" and was subsequently confirmed in the ODPM's Communities Plan published in February 2003. "The way forward" sets out far-reaching proposals across all housing tenures, aimed at changes in services, investment, management and ownership, and rents.

2.4 We have picked out the key points in those papers for Council housing investment and rents, and for the future management and ownership of Council housing.

Decent homes

2.5 The government has pledged that all Council tenants will have the opportunity of enjoying a decent home by 2010. In making this pledge, the government acknowledged that to achieve this around £19 billion needed to be spent on Council housing in England.

2.6 The definition of what constitutes a "decent" home is as follows:

- Homes must meet the statutory fitness standard of the day;

- Homes must be in a reasonable state of repair (where this is defined as where no key building elements[1], and not more than one other internal component, are old and because of their condition need

[1] External envelope components, electrical systems and central heating boilers.

replacing or major repair);

- The heating system provides a reasonable degree of thermal comfort.
- Homes offer modern facilities and services, where this is defined as lacking no more than two of:

  i) a reasonably modern kitchen (20 years old or less);

  ii) a kitchen with adequate space and layout;

  iii) an appropriately located bathroom and WC; and

  iv) a bathroom less than 30 years old;

  v) adequate insulation against external noise (where external noise is a problem); and

  vi) adequate size and layout of common areas for blocks of flats.

2.7 Delivering the Decent Homes Standard is of major concern to government. This is evidenced by many Ministerial statements and government publications on the subject, the government requirement for local authorities to produce detailed plans showing how they will achieve the Standard for their HRA homes, and exhortations to explore the additional investment options as set out below.

The strategic housing role

2.8 The government has made it clear that it favours the separation of authorities' strategic and landlord responsibilities for housing, as it believes that this will strengthen both roles. The government's belief is that those who are elected to serve their local communities should be concerned with the full range of strategic issues surrounding the housing needs of their communities, rather than focusing more narrowly on the day-to-day management of council housing.

2.9 The Green Paper elaborates upon the local authority strategic housing role in the context of its assuming ever-greater importance across all policies and being central to achieving the government's objectives.

2.10 It continues to say that those responsible for day-to-day management of housing can concentrate on delivering a high quality service and achieving Best Value in service delivery. For stock that remains in local authority ownership, the government wants to ensure that there are opportunities for the separation of local authorities' strategic and landlord functions, and the creation of new management organisations, more focused on and better able to respond to the needs and aspirations of tenants.

Tenant empowerment

2.11 A major theme of the government has been to promote steps to involve social housing tenants in the management of their homes and generally to empower tenants, as major funders of social housing, as customers and decision makers. Local authorities have been required to develop Tenant Participation Compacts, assisted by government grant aid, which are seen as a major step in empowering tenants to have a real say in their housing services.

2.12 The Best Value regime and service inspections undertaken by the Housing Inspectorate are parts of the government's overall intentions to improve significantly the quality and responsiveness of housing management services alongside the major investment involved in achieving the Decent Homes Standard.

2.13 The government believes that while local authorities are beginning to respond to these new regimes, meeting tenant priorities requires organisational cultures that actively seek tenants' views through a variety of channels and build these into decision-making processes. Stock transfer, the Private Finance Initiative, and the creation of Arms Length Management Organisations all provide opportunities for further improvements in housing management and tenant participation.

The government's social rent policy

2.14 The government announced its rent policy for social housing as part of its wider housing policy statements in "The way forward for housing". At the same time a range of guidance on rent setting was published for both local authorities and RSLs. These included specific instructions to local authorities seeking to pursue transfer on the rent assumptions to be used in developing the transfer price and Business Plan, and instructions to RSLs to prepare plans showing how they will implement the government's policy.

2.15 Importantly for local authorities, and following further consultation, the government has confirmed its intention to use the HRA Subsidy system to facilitate rent policy implementation, and has taken steps to encourage local authorities to adopt much the same arrangements as RSLs for service charges to be levied alongside the social rent.

2.16 The essence of the government's policy for social housing rents is that:

- Whether the landlord is a local authority or RSL, rents should be based upon a combination of relative affordability[2] and relative housing value[3] in the ratio 70:30, modified to reflect a higher rent for larger homes by using a bedroom weight[4].

- A maximum tolerance or flexibility of + or -5% from rent policy levels will be permitted to allow landlords to reflect the circumstances of particular properties, but overall the average rent should be at the policy level;

- Average RSL and Policy rents should increase in real terms by 0.5% per annum (from 2001/02);

- Local authority rents should increase to converge with RSL rents on the above formula basis, with the process of convergence commencing in April 2002. Rent convergence between local authorities and RSLs should be achieved by March 2012 (i.e. for most local authorities and RSLs this would be with the annual rent increase in April 2011). A limit of RPI plus 0.5% plus £2 per week from convergence alone (i.e. ignoring other factors such as pressure on the HRA) should be observed.

- Local authorities applying to transfer their housing must show how the government's policy would be implemented and base the transfer price and Business Plan upon achieving 100% of formula rents within this timetable.

- There are a number of additional points worth noting in relation to both HRA retention and housing transfer contexts. Firstly, government has confirmed that to encourage local authorities to implement its rent polices it will increase both the notional rent (used to calculate HRA subsidy) and the limit rent (used to cap rent rebate subsidy) to its target policy rents over the convergence period. This will involve significant subsidy withdrawal from HRAs, and government has committed to replacing some of this in the form of increases in Management and Maintenance Allowances (referred to as "re-basing").

2.17 The broad effect of these changes will be that local authorities that can contain their revenue budgets to within the Allowances plus service charges and any surpluses from other HRA assets (such as garages) will be able to keep rents to target levels. Those that cannot will need to either increase rents above government policy (for which any sanctions

[2] Based upon county earnings compared with the national average.
[3] The valuation basis is existing use with vacant possession at January 1999 levels. There will be periodic updates on the valuation date at times that have yet to be announced.
[4] Bedsit – 80%; 1 bedroom – 90%; 2 bedrooms – 100%; 3 bedrooms – 105%; and 4 or more bedrooms – 110%.

are not clear but no rent rebate subsidy would be paid on the excess), or to cut back on services. It is significant that Management and Maintenance Allowances are paid primarily on a per unit basis, so that continuing RTB sales, where it is difficult if not impossible to make pro rata cost savings, will make it progressively difficult to manage within subsidy Allowances.

2.18 On convergence the government's aim is that social rents on similar homes in the same area should be the same, no matter who is the landlord - a local authority or RSL. This will tend to reduce the emphasis in transfer consultation of considerably lower rents under transfer, and increase the importance of increased investment in homes and neighbourhoods.

2.19 Despite the above, local authorities with problems balancing their Housing Revenue Accounts can be expected to increase their rents faster than others to help balance their accounts and protect service budgets. In effect these authorities would need to implement a "convergence" rent increase driven by government policy, and a "local" increase reflecting the difference between the local costs of management and maintenance and the government's subsidy allowances. Any "local" increase above government guidelines would not attract Housing Benefit subsidy, so that to generate an additional £1 income in Rochford, where approximately 62% of tenants' rents are met by Housing Benefit, rent income would need to increase by about £2.60p.

2.20 The basis of valuation to be used in the rent formula is January 1999, although this will be updated periodically in future reviews[5]. At this date the average English local authority home's open market value was £41,350 compared with the average English RSL figure of £49,750, reflecting in part the older local authority stock and also lack of investment in it. It is apparent that even on "convergence" (i.e. with the same rent formula applying) rent for local authority homes including those transferred to new landlords will on average be lower than "traditional" RSL rents because of the lower values.

2.21 When the government introduced its rent policy it promised that it would be reviewed after three years. This review was completed in 2004 and consultation carried out in the autumn. The government proposed to adopt precisely the same formula[6] for both local authority and RSL rents, and to increase the weighting for larger homes (3 bedroomed and above) increasing their rent levels.

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[5] See note 3 above.
[6] Currently the formulae for LA and RSL rents are slightly different, which would prevent absolute convergence between the two.

2.22 In the event implementing the changes was deferred for a year, although we expect the same or similar proposals to be introduced commencing with financial year 2006.07. In our analysis we have assumed that the local authority and RSL formulae will be brought into line as proposed, but have not assumed that the higher rents for larger properties will be introduced.

Options appraisal

2.23 As part of implementing the Decent Homes Standard, government requires all local authorities that own housing stock to undertake an Options Appraisal in accordance with ODPM guidance and to complete the process to the satisfaction of the local government office concerned by July 2005. The ODPM guidance, published in June 2003, sets out details of what needs to be included to comply with government requirements, and in particular puts tenants at the centre of the process with the support of an Independent Tenant Adviser.

2.24 In undertaking the Appraisal authorities must consider how to meet tenants' aspirations for investment and services, rather than just the Decent Homes Standard, and must demonstrate that the option they choose is both sustainable and deliverable – meaning that sufficient capital and revenue resources are available in the long term, and that the option has support from tenants.

2.25 Authorities and their tenants must consider four options for the future ownership and management of their housing stock, including where appropriate, mixtures of them. The four options are:

- The status quo or "as is" option;
- Arms Length Management Organisation (ALMO);
- The Private Finance Initiative (PFI); and
- Voluntary housing transfer (Transfer).

2.26 The last three of these Options represent ways of securing additional investment in local authority housing. They are described in later sections that deal specifically with them and how they might apply in Rochford.

2.27 There has been much speculation and lobbying on government to introduce a fourth additional investment option, so that local authorities would be able to access additional resources "as is" where, for example, they are high performing or tenants had rejected other alternatives. We believe that the definitive position on this is that contained in the letter from the Deputy Prime minister to all Council Leaders of 29 October

2004, where he states clearly that there will not be such a fourth option.

2.28 In considering the options available it is worth remembering that although the government has increased public spending, including on council housing, the Chancellor of the Exchequer has made it clear that the government will continue to limit public sector borrowing. The Public Sector Borrowing Requirement, now re-named the "Public Sector Net Borrowing Requirement"[7] is still an important economic measure, which the government appears determined to control. As part of this continued restraint on public sector borrowing, the government expects the largest part of the investment in council housing to come from private finance solutions – PFI and Transfer, with the vast majority of private finance from Transfer.

2.29 In its own review of progress in meeting the Decent Homes Standard[8], ODPM has indicated that it assumes Transfers will take place at 100,000 homes per annum. Our work undertaken for the Institute of Public Policy Research's investigation into the future of social housing and subsequently updated for the Chartered Institute of Housing indicates that Transfers at much less than this rate would leave significant backlogs of disrepair after 2010.

The Housing Revenue Account

2.30 Council housing finance is highly regulated and proscribed through various housing acts and regulations. These require day-to-day income and expenditure on council housing to be accounted for in a special account - the Housing Revenue Account (HRA), which contains what are primarily landlord services.

2.31 The HRA is a part of the Council's General Fund, where other services are accounted for, but it is ring-fenced from it. This means that the HRA may not subsidise the rest of General Fund nor the General Fund subsidise the HRA.

2.32 It is, however, quite in order for legitimate charges for services to be made between the HRA and the General Fund. For example, if the council's legal services staff (usually accounted for in the General Fund) assist with recovering rent arrears through the courts, the HRA may be charged a reasonable amount for those services.

2.33 The HRA incorporates revenue items (i.e. day-to-day income and expenditure), including what are called "capital charges", which are the charges for money the HRA has borrowed, and is where government

[7] There are also some changes in what the measure includes, although these are not relevant to council house spending.
[8] "The decent homes target implementation plan", ODPM, June 2003

subsidy for council housing is accounted for. This subsidy falls into two components, Housing Revenue Account (HRA) Subsidy and Housing Benefit Subsidy, and we describe these in later paragraphs.

2.34 The cash flows in the HRA will look like the table below:

Housing Revenue Account	
Expenditure	**Income**
Management	Rent
Maintenance	Service charges
Miscellaneous	Miscellaneous
Housing Benefit payments to GF[9]	
Capital charges	HRA Subsidy
Major Repairs Reserve	
Total	Total

2.35 Councils have a statutory duty to set their budgets and rents to balance the HRA, avoiding any deficits. Council's usually set their budgets and rents annually in January for the next financial year (starting in April), following the government's announcement of subsidy the previous December.

2.36 In relation to the items in the HRA, management and maintenance budgets pay for day-to-day housing operations, and "capital charges" is the interest payable on HRA loans. It is worth noting that local authorities do not have to repay their loans until the "due date" agreed with the lender, and can then take out new loans to the same amount.

2.37 Miscellaneous expenditure and income refers to the management and maintenance cost of and charges for items such as garages, shops and community centres.

2.38 The other items in the HRA are not so straightforward, and we describe them in the following sections.

Rents and service charges in Rochford

2.39 As we have indicated in paragraph 2.14 et seq., rent should be set in accordance with government guidance to converge with formula rent levels by April 2011.12.

2.40 At the same time as implementing the government's rent policy, local

[9] Housing Benefit is paid directly to tenants' rent accounts and so is included in the Rent income. Housing Benefit payments to the General Fund represent the Housing Benefit paid on rents that are above the Government set limits. See paragraph 2.44.

authorities are expected to introduce, separately from their rent, charges for a range of services that are not common to the whole of the HRA, but are provided to particular properties only – service charges. The main service charge items are caretaking, cleaning and grounds maintenance for blocks of flats, the costs of which are included in management budgets.

2.41 On the assumption that government will implement its rent policy as noted in paragraph 2.22, we have used the Council's January 1999 stock values to calculate the target rents for RSLs in April 2011, and projected Council rents so that they converge to this RSL rent level. This approach avoids difficulties in estimating HRA rent increases year on year, which are the subject of Ministerial decision, by assuming that the key objective of "converged" RSL and local authority rents being broadly the same for equivalent properties is achieved[10].

2.42 Rochford's rents are on track to achieve convergence with RSL rent levels, our projections indicating that they will need to increase by an average of c. 2.5% per annum above inflation up to and including 2011.12. Excluding inflation this would mean the average Council rent increasing from the 2005.06 average of £56.76 to approximately £65.66p in 2011/12. These target rents would be the same if the housing stock were to be managed "as is", through an Arms Length Management Organisation, PFI operator or under Voluntary Transfer.

Housing Benefit and Housing Benefit Subsidy

2.43 In common with private sector tenants, council tenants with low or no income are eligible for Housing Benefit payments in accordance with a national scheme. For Council tenants[11] Housing Benefit meets the full rent charged provided that household income is below a threshold, after which the benefit payable reduces until the full rent is payable by the tenant.

2.44 Housing Benefit Subsidy is paid by government to the HRA (via the General Fund) and meets the full amount of Housing Benefit payable to tenants. Nevertheless, where an authority's average rents are above a government-set level called the "Limit rent", the HRA must repay to the General Fund the cost of Housing Benefit payments on the excess[12]. The government sets Limit rents for each authority each year. Limit rents are increasing towards the government's policy rent levels and are

[10] We have discussed this approach to rent projections with ODPM officials, and they have noted that it appears reasonable at a broad level.
[11] There is a maximum rent level above which Housing Benefit is not paid in full for private sector tenants, although in practice this does not apply to housing associations.
[12] Rochford's average rent is slightly below its Limit Rent so no such repayments are necessary.

due to converge with them in 2011.12.

2.45 Thus, if rents are above the Limit rent, tenants continue to receive Housing Benefit, but the HRA pays the General Fund the Housing Benefit on the excess. In net terms, the HRA receives no income for that part of the rent above the Limit rent from tenants in receipt of Housing Benefit.

Housing Revenue Account Subsidy

2.46 Each December the government announces the arrangements for calculating the amount of subsidy HRAs will receive in the following financial year. HRA Subsidy is calculated as the amount to balance a "notional" Housing Revenue Account, where the main costs are Management, Maintenance and Major Repairs Allowances, together with Notional Capital Charges, and income consists of the Notional Rent. That is:

HRA Subsidy equals Management, Maintenance and Major Repairs Allowances plus Notional Capital Charges less Notional Rent income.

2.47 We describe each of these in the following paragraphs.

Management, Maintenance and Major Repairs Allowances

2.48 Management, Maintenance and Major Repairs Allowances are all calculated by government according to pre-set formulae based upon national research into the "need to spend" on each of the items concerned. The "need to spend" calculations exclude most costs related to service charge items, and take into account the types of dwelling in the HRA – size, age etc, the relative costs in the local authority area, and local characteristics such as the level of crime. They are calculated essentially on a unit dwelling basis, and the amount of subsidy is based upon the number of dwellings at the start of the previous financial year.

2.49 The government recognises that nationally the need to spend[13] on management and maintenance is greater than the total amount of subsidy available, and reduces the amounts calculated to reflect its resources. As a consequence, in 2005.06 subsidy meets only about 58% of the "need to spend" maintenance calculation, while the corresponding amount for management is c. 166%. Apart from the so-called "re-basing" increases noted below, there are no indications that the national budgets for Management and Maintenance Allowances will grow in real terms.

[13] The "need to spend" is calculated by separate formulae for each of management and maintenance set out in the ODPM subsidy calculations and accompanying documents.

2.50 As rents increase towards policy levels, the HRA subsidy system works so as to withdraw income from the "national" HRA. Government has stated that it will return this loss to HRAs by funding additional Management and Maintenance Subsidy. This process, referred to as "re-basing", means that there is likely to be about 2% per annum real growth in Management and Maintenance Allowance budgets until 2011.12

2.51 The "need to spend" models produce a total management and maintenance cost of some £4.4 billion across all English local authorities for 2005.06, compared to a budget of less than £3.4 billion, so that even with the benefit of real growth from re-basing, there will still be a significant shortfall in subsidy payments against the "need to spend" unless government provides further real increases for the HRA Subsidy system.

2.52 The Management and Maintenance Allowances are revenue payments, but the Major Repairs Allowance, as its name suggests, is reserved for capital items.

Notional capital charges

2.53 Subsidy paid in respect of capital charges is calculated by applying the local authority's average borrowing rate to the government's assessment of the authority's HRA debt. This need not be the same as the actual HRA debt, and is often more than it. The position in Rochford is that the actual debt is some £10.4 million, while the subsidy debt is some £12.7 million. This difference represents an additional net income to the HRA of about £120,000 pa.

Notional Rents

2.54 Each year the government sets the notional rent on an individual local authority basis, taking into account the characteristics of the dwellings in the HRA. Notional rents are moving towards policy rents, and are due to converge with them in 2011.12.

2.55 In the subsidy calculation, notional rents are reduced by 2% to allow for void and bad debt losses.

Major Repairs Reserve

2.56 Each year local authorities are required to transfer from their HRA to a "Major Repairs Reserve" an estimate of the amount by which their HRA assets will depreciate in the year, and will need capital spending to renew or replace them. The Major Repairs Reserve is an account where monies to be spent on capital items within the HRA are kept.

2.57 For most authorities the amount of depreciation is the same as the Major Repairs Allowance, so that the amount paid under that subsidy heading is just transferred to the Major Repairs Reserve each year, and is not available for HRA revenue expenditure.

Bringing the HRA Components Together

2.58 In this section we make some assumptions about the various components of the HRA in order to show how all the above items fit together.

2.59 If we assume that:

- The Council keeps its rent levels within the Limit rents and does not increase them above government policy levels, and the Council's void and bad debt losses are at the government allowance of 2%, then once rents have converged the actual rent collected will equal the notional rent less void etc allowance, and the amount of Housing Benefit payments will equal the amount of Housing Benefit subsidy;

- The Council's actual HRA debt is equal to the government's assessment; and

- The amount transferred to the Major Repairs Reserve equals the Major Repairs Allowance.

2.60 The net HRA position from paragraph 2.34 can then be shown as:

Housing Revenue Account	
Net Expenditure	**Net Income**
Management less service charge costs	Rent income
Service charge costs	Service charge income
Maintenance	
Housing Benefit payments to GF	
Miscellaneous	Miscellaneous
Capital charges	Housing Element Subsidy =
	• Management Allowance
	• Maintenance Allowance
	• Major Repairs Allowance
	• Capital charges subsidy
	• Minus notional rent
Total	Total

2.61 If we net off the equal amounts of rent income and notional rent; service charge income against corresponding costs; HB payments to the General Fund and to tenants; actual and notional capital charges, then the expenditure and income items left can be shown as:

Housing Revenue Account	
Net Expenditure	**Net Income**
Management less service charge costs	Management Allowance
Maintenance	Maintenance Allowance
Miscellaneous	Miscellaneous
Total	Total

2.62 We see that broadly the net outcome of the HRA Subsidy system is to remove rent income from the HRA except for the Management and Maintenance Allowances, while making the amount of the Major Repairs Allowance available for capital spending.

2.63 **What is apparent[14] is that in order to balance the HRA local authorities must contain their management and maintenance expenditure within their corresponding HRA Subsidy Allowances plus any net miscellaneous income.**

2.64 Those that cannot will need to either increase rents above government policy (in which case no Housing Benefit subsidy would be received on the excess and the government may take other sanctions), or to cut back on services. It is significant that Management and Maintenance Allowances are paid primarily on a per unit basis, so that continuing RTB sales, where it is difficult if not impossible to make pro rata cost savings, will make it progressively difficult to manage within Allowances.

2.65 The outcome of our analysis of the HRA is set out in section 4.

2.66 A diagram summarising the HRA and subsidy system is shown at Appendix 1.

Capital Availability

2.67 Capital resources for investment in the HRA "as is" can come from five main sources:

- The Major Repairs Allowance;

[14] Note that there are potential additional resources resulting from actual void and bad debt losses being less than government's 2%, and from the subsidy debt being more than the actual debt. In our experience these are relatively small amounts in most cases. In Rochford they are less than 3% of HRA income, totalling around £150,000 in 2005.06 when income from rents and miscellaneous charges is over £5.8.

- Capital receipts, primarily from Right to Buy sales;
- "Supported Capital Expenditure";
- Revenue Contributions to Capital; and
- Prudential borrowing.

2.68 The Major Repairs Allowance is described briefly in paragraph 2.48. It takes into account the need to keep the "average" council home in repair based upon the five-yearly English House Condition Survey. The 2005.06 Allowance for Rochford is £655.40p per dwelling.

2.69 Right to Buy (RTB) receipts are the monies received from tenants purchasing their homes under the Right to Buy less the cost of administering the sales. The Council is permitted to retain and spend 25% of its RTB receipts on capital investment, the balance being paid into the National Housing Pool for redistribution by government.

2.70 The Council may use a proportion of its receipts from other disposals for investment in its housing stock, the proportion varying according to The Local Authorities (Capital Finance and Accounting) (England) Regulations 2003. Under current regulations it is likely that the proportion would be 100%.

2.71 HRA "Supported Capital Expenditure" (SCE) is an amount of capital investment made available each year on an individual local authority basis for HRA investment, and upon which government will meet future interest charges. From the HRA's point of view it is in effect "free" borrowing. The newly established Regional Housing Boards will allocate SCE to their local authorities, taking into account the balance of investment needed in local authority housing and to provide new affordable housing.

2.72 In 2005.06 Rochford's SCE allocation is £311,000. In the Eastern Region there is a very large need for new affordable housing, and as a consequence the proportion of the Regional Housing Board's budgets allocated to HRA investment is likely to decrease.

2.73 "Revenue Contributions to Capital" is the direct funding of capital items from revenue budgets. We can see from paragraph 2.63 that as the government's rent policy is implemented, the ability to fund capital items in this way will depend upon whether day-to-day management and maintenance expenditure can be kept within the Subsidy Allowances together with any net miscellaneous income.

2.74 Prudential Borrowing is a new arrangement introduced from April 2004, where local authorities that have "free income" streams may borrow against them. In this context "free income" must be examined very carefully over the long term, since any over-borrowing would lead to having to cut service budgets to meet loan repayments. Within the HRA we can see from the conclusion at paragraph 2.63 that this would need to come from net miscellaneous income or under-spending on management and maintenance against Subsidy Allowances.

2.75 If there is "free income" in the HRA, it may be used for Prudential Borrowing or Revenue Contributions to Capital. If it is earmarked to repay Prudential Borrowing, it cannot be used for Revenue Contributions as well, and vice versa.

Summary

2.76 A major part of the options appraisal analysis will be concerned with addressing over the long term two key questions:

- Does the Housing Revenue Account balance? and
- Is there sufficient investment to meet and maintain the Council's housing standards and aspirations?

2.77 If the answer to the first questions is "no", then either service budgets must be reduced to balance the HRA or Transfer pursued.

2.78 If the answer to the second question is "no", then the Council will need to either reduce its investment aspirations, or pursue one of the additional investment options of ALMO, PFI or Transfer.

2.79 In what follows we have assumed that the Council would not wish its HRA investment to fail to meet the Decent Homes Standard (DHS), which in itself is fairly basic, and have taken the HRA's minimum investment requirement at the Council's landlord responsibilities plus those additional works needed to achieve and sustain the DHS.

3 Housing Need, Stock Condition and Aspirations

3.1 Before considering the Options for the future and how they might work in Rochford, we first of all consider the need for affordable housing in the District, the need for investment in the Council's housing stock and for increased investment and service budgets to meet the tenants' aspirations.

The Need for Affordable Housing in Rochford

3.2 Rochford District Council formally commissioned David Couttie Associates (DCA) in August 2004 to carry out a District-wide Housing Needs Study, as a joint survey with Basildon, Castle Point, Southend-on-Sea and Thurrock District Councils.

3.3 The Thames Gateway South Essex Sub-Region is seeking to undertake a comprehensive and robust housing market and needs assessment to obtain high quality information about current and future housing needs across the Sub-Region and also at Local Authority level.

3.4 The overall aims of the survey were to:

- Determine the levels of housing supply and demand in the District;
- Support the annual HIP bid and development of the Housing Strategy;
- Provide robust information at a local level in accordance with PPG3, to guide the location of new provision and support policies in the Local Developmental Framework;
- Co-ordinate housing and community care strategies.

3.5 The full report has been made available to the RHOAB, which also had the benefit of a presentation of the survey methodology and results from DCA.

3.6 Key findings of the survey are:

- 91.6% of households live in accommodation suitable for their needs. Satisfaction ranges from 96.1% in the owner occupied sector to 82.2% in the Housing Association rented sector;
- Flats and terraced houses average cost is £118,294 and £170,224 respectively and affordability is a major issue, particularly for new forming households;

- 67% cannot afford private rental and home ownership is beyond the reach of 75% of concealed households, even though nearly 40% of them earn over £25,000 pa.

- The social stock is only 8%, less than half the national average of 19.3% and provides only 102 re-let units each year;

- Annually 393 affordable housing units are needed, 281 more than existing supply from relettings, a new supply requirement significantly greater than current delivery levels;

- There is a requirement to develop a more balanced housing stock in both sectors with a need for more small units, flats and terraced houses, particularly in the private sector;

- The total population is projected to reduce but the retired age group will increase by 15.2% by 2011. There is an inextricable link between ageing and disability. Of the 5,463 households with a support need, 67% are over 60 and 58% of them have a walking difficulty.

3.7 For this housing options appraisal the most significant findings are those in relation to the need for additional affordable housing and the projections of increasing numbers of elderly people in the District.

3.8 These findings need to be seen against the results of enquiries into the lettings of vacancies in the Council's sheltered housing schemes. There are 438 sheltered housing units under management, some 25% of the total HRA stock. Of the 122 applicants on the "active"[15] register, 68 are owner-occupiers and 80 are from outside the District.

3.9 The Council widened the criteria for letting its sheltered housing stock in 2000 to enable vacancies to be reduced. Since then the Officers have estimated that approximately 80% of lettings have been to residents outside the District, and almost all of those from within the District were former owner-occupiers.

3.10 It is apparent that the Council's sheltered housing is not serving local housing needs particularly well, and as a consequence the Officers are undertaking a scheme by scheme review of the sheltered stock with a view to determining the best future use of it. This review will seek to develop an overall strategy for the future of the Councils' sheltered housing assets, seeing them in the context of the wider overall housing needs of the District, and including the possibility of re-shaping their use for other younger in-need households.

[15] The full register comprises "active" and "deferred" parts, the latter containing those have registered an interest in sheltered housing but do not currently want an offer of it.

The HRA Stock Condition Survey and Aspirations

3.11 Sound current information about the investment needs of the Council's housing stock is fundamental to the Options Appraisal. In order to provide this information in autumn 2004 King Sturge were commissioned to undertake a condition survey of the Council's stock and related assets and to report accordingly.

3.12 The survey methodology followed good practice guidance as issued by ODPM, and provides a statistically accurate basis for assessing the Council's need to invest to secure a sustainable asset management strategy that achieves and maintains the Decent Homes Standard.

3.13 In addition to reporting on this minimum investment requirement, and in accordance with the Board's instructions, King Sturge also reported on the investment costs needed to achieve higher standards reflecting tenants' and residents' aspirations for improvements to their homes and estates, and referred to as the "Bronze", "Silver" and "Gold" standards. Descriptions of what is involved in these standards are set out at Appendix 2.

3.14 Important findings from the survey are that overall the stock is in reasonably good condition, as is borne out by the low level of current disrepair. Nevertheless, many components are approaching the end of their economic life and will require replacement within the short to medium term. This is reflected in the Decent Homes findings below.

3.15 In terms of the Decent Homes Standard, the survey found that approximately 10% of the stock was non-decent – well below the national average for local authority homes of 40% or more. There was also an estimated 55% of homes that would become non-decent by the end of 2010 unless major works were undertaken to them in the interim.

3.16 The overall 30-year expenditure, excluding costs related to leaseholders, identified is shown in 5-year bands in the Table below.

	Years 1-5	Years 6-10	Years 11-15	Years 16-20	Years 21-25	Years 26-30	Total
Catch-up Repairs	£648,827	£0	£0	£0	£0	£0	£648,827
Future Major Works	£9,411,369	£6,458,290	£4,837,058	£8,104,859	£8,940,593	£4,486,428	£42,238,597
Improvements	£12,703,560	£2,253,556	£973,035	£1,243,597	£2,303,753	£313,033	£19,790,534
Estate works	£700,000	£700,000	£200,000	£200,000	£200,000	£200,000	£2,200,000
Contingent Major Repairs	£475,000	£475,000	£475,000	£275,000	£275,000	£275,000	£2,250,000
Cyclical maintenance	£1,545,000	£1,545,000	£1,545,000	£1,545,000	£1,545,000	£1,545,000	£9,270,000
Disabled adaptations	£375,000	£375,000	£375,000	£375,000	£375,000	£375,000	£2,250,000
Response & Void Property Repairs	£3,100,000	£3,100,000	£3,100,000	£3,100,000	£3,100,000	£3,100,000	£18,600,000
Total	**£28,958,757**	**£14,906,846**	**£11,505,093**	**£14,843,456**	**£16,739,346**	**£10,294,461**	**£97,247,958**

3.17 The "Improvements" row is sub-divided in the following Table, which shows the additional cost for increasing the level of improvements from one row to the next.

Status	Year 1-5	Years 6-10	Years 11-15	Years 16-20	Years 21-25	Years 26-30	Total
Total recommended improvements	£2,278,373	£2,500	£2,500	£2,500	£37,500	£2,500	£2,325,873
Total Other Considerations	£2,000,000	£2,000,000	£0	£0	£0	£0	£4,000,000
Total Bronze Standard Cost Effect	£816,488	-£740,244	-£151,765	-£150,403	-£373,147	-£713,667	-£1,312,739
Total Silver Standard Cost Effect	£1,636,000	£400,000	£575,000	£400,000	£841,000	£400,000	£4,252,000
Total Gold Standard Cost Effect	£5,972,700	£591,300	£547,300	£991,500	£1,798,400	£624,200	£10,525,400
Total	**£12,703,560**	**£2,253,556**	**£973,035**	**£1,243,597**	**£2,303,753**	**£313,033**	**£19,790,534**

3.18 In the Improvements Table above please note that:

- "Total recommended improvements" comprises improvements needed to reach the Decent Homes Standard together with recommended (and relatively minor) expenditure on improvements to thermal insulation and the estate environment.

- "Total Other Considerations" relates to the sheltered stock and allows for the conversion of bed-sitting rooms to 1 bedroomed flats (budget of £2 million), and which would be needed in future whether the schemes are used for elderly or younger "general needs" households, and for improvements to the schemes to make them more "disabled friendly" (further budget of £2 million).

3.19 The cost tables assume a constant number of dwellings in management at 1,762, the number at the time of the Survey. The cost base is 3rd Quarter 2004 prices and there is no allowance for management and administration, professional fees or future inflation.

3.20 The financial appraisal that follows assesses whether these standards are achievable under the various options, and whether more or less can be done.

4 The HRA "As Is"

4.1 The government requires all local authorities that have not transferred their housing stock to prepare a long-term (30 year) financial model of their Housing Revenue Account, which shows how robust both their revenue and capital (investment) plans are over the longer term. We have developed such a model for Rochford HRA in conjunction with the Officers.

4.2 The model projects the HRA revenue and capital cash flows in detail, and produces a range of accounting outputs for the HRA. As discussed previously, however, what we shall be examining is the two key issues of:

- Is the HRA in balance? We measure this in two ways by asking:
    - Whether the HRA meets minimum balance or reserve levels specified in the model; and
    - Whether on an annual basis the HRA balances.
- Is there sufficient capital resource to meet the Decent Homes Standard by 2010.11?

4.3 In the rest of this section of our report we first of all set out what we have called the "base case", and then turn to examine "what if" questions to assess how robust or sensitive the HRA position is to changes in key assumptions and whether additional capital resources can be generated to add to the base case level of HRA investment.

The Base Case Housing Revenue Account

4.4 The base case HRA model is founded upon initial budgets that replicate the Council's 2005.06 budgets (so that year 1 is 2005.06), and project the various income and expenditure components until 2034.35 (year 30). The basis of the projections reflects the following major items:

- **Implementation of the government's rent convergence and service charge policies**. The model assumes that the Council implements government formula rents achieving convergence in 2011.12, and that rents continue to grow by 0.5% pa in real terms thereafter. Service charges are already levied as appropriate.

- **Management and Maintenance subsidy allowances** moving to meet their stated target levels plus national average real growth of 2% pa until 2011.12, with no real growth thereafter. The Major Repairs Allowance is assumed to grow with inflation only, in line with government policy statements.

- **Management budgets grow in real terms by 1.0% pa and are not reduced in respect of Right to Buy losses**. Once RTB losses reach significant numbers it will be possible to make savings, e.g. by restructuring and reducing staff, a matter that we refer to later.

- **Maintenance budgets grow in real terms by 1.0% pa and are not reduced in respect of Right to Buy losses.** This is a more than prudent assumption since some savings will be made in respect of the RTB stock. We consider this later when examining the ability of the HRA to generate revenue contributions to the capital programme.

- **Major building works requirements are fully funded**, covering the full range of the Council's responsibilities as landlord together with works required to reach and sustain the Decent Homes Standard together with the improvements identified for the sheltered schemes. Major works applying to dwellings (but excluding works to estates, garages etc and sheltered improvements) are assumed to reduce pro rata with RTB losses. Underlying building works costs are assumed to grow by 2.5% pa in real terms for the next two years in line with recent patterns.

- **Right to Buy levels initially reflect recent levels but reduce as cumulative losses reduce the saleable stock**. In 2005.06 we have assumed 18 RTBs, reducing to 10 by 2013.14 and remaining at that level. Values are assumed to grow at 2% pa in real terms, considerably less than recent experience, and the current discount remains at its current cash £34,000 level. 75% of RTB receipts are paid to government and the 25% available to the Council is earmarked for General Fund investment in accordance with Council practice.

- The Council's allocation of **Supported Capital Expenditure** (i.e. new HRA borrowing where the government provides subsidy on interest payments) remains at the 2005.06 level of £311,000 in cash terms. Given the pressure on building new affordable homes in the Region, this assumption may be seen as optimistic.

- **Revenue Contributions to Capital** are not made. Instead and in order to test the long term revenue viability of the HRA, in-year balances are accumulated against later long term losses.

- **The HRA balance requirements have been set at £225 per dwelling at 2004.05 prices.** They represent a minimum reserve that the HRA must have to guard against unforeseen expenditure, e.g. repairing burst pipes following a snap freeze.

- **Inflation** runs at 2.5% pa throughout.

4.5 The outcome to the key questions concerning the HRA is set out below.

Revenue	
Does the HRA meet minimum balance requirements?	No
If not, year when first in deficit	25
Is the HRA in balance annually throughout?	No
If not, year when first in deficit	16
Capital	
Is there sufficient capital to meet the investment needs?	No
If not, what is the deficit to 2010.11?	£11.9 million

4.6 Appendix 3 contains charts showing long-term projections of:

- The HRA in-year and cumulative operating position; and
- The investment need, base case resources available and the investment gap.

4.7 The first year the HRA is in deficit is 2020.21, and it is in increasing deficit thereafter. The reasons for this are that growth in actual management and maintenance costs are outstripping Management and Maintenance subsidy, which we have assumed will be capped to inflation only growth from 2011.12 (year 7), and that management and maintenance costs are not reduced for RTB losses. In reality maintenance savings can be realised on RTB losses (but perhaps not at the full pro rata budget amount), and government may add real growth to subsidy allowances if actual costs do grow in real terms.

4.8 In addition, as RTB losses accumulate, it will be possible to make repair and maintenance and staff savings in the HRA and move to balance the in-year position. In this respect it is worth noting that on our RTB assumptions, the total rented stock will have declined from 1,750 at the start of 2005.06 to 1,564 at 2020.21.

4.9 The fact that the HRA has sufficient balances for 24 years yet is in deficit from year 16 is possible because the HRA is in considerable surplus in the early years, having built up a total of more than £6 million by year 16. In-year deficits use this balance until by year 25 there is not enough to meet the minimum balance requirement.

4.10 While the HRA is reasonably robust in revenue terms, there is very a significant capital resource gap in the base case – some £11.9 million. We have undertaken a range of variations to the base case assumptions to test whether this gap might be closed without needing to pursue one of the three additional investment options.

HRA Sustainability and Investment Gap Analysis

4.11 Projecting income and expenditure over a 30-year period is obviously an activity that is bound to "get it wrong" in at least some if not the majority of assumptions. The purpose of sensitivity analysis is to test whether the mainstream or base case option is robust in the sense of whether changes to the assumptions produce significant changes to the key outcomes.

4.12 We have therefore undertaken sensitivity tests to examine the HRA's robustness in relation to the revenue position (adverse tests) and in order to assess whether additional capital resources might be found to enable an "as is" solution to meet the DHS:

Testing the revenue position

1 The real growth in HRA Subsidy does not materialise.

2 Real growth in management and maintenance costs increases to 1.5% pa.

3 RTB numbers double.

Testing the capital position

4 The Council uses its usable RTB receipts for HRA investment.

5 RCCOs are made while continuing to meet the minimum HRA balance requirement.

6 4 and 5 combined; and

7 Consideration of prudential borrowing.

4.13 The results of the above sensitivities are set out in the Table at Appendix 4, with notes commenting on the outcomes beneath.

Conclusions

4.14 Overall we are of the view that the base case and sensitivity analysis as above demonstrates that the HRA's revenue position is satisfactorily robust.

4.15 Despite the revenue position, the HRA is in significant capital deficit. Even with the combined optimistic assumptions as at sensitivity number 6 above, the amount of investment available fails to meet the DHS by some £6.0 millions. Nor is prudential borrowing a solution to the problem for the reasons set out at Appendix 4.

4.16 From this analysis and assuming that the Council wishes to fulfil its landlord responsibilities and achieve the Decent Homes Standard, we have concluded that continuing to manage the HRA under current arrangements is not sustainable, and that one of the government's "increased investment" options must be pursued.

5 The Arms Length Management option

Introduction

5.1 This section covers the arms length management organisation or ALMO option for the future of the Council's housing stock. It outlines the origination of ALMOs, how they work, and their pros and cons in the Rochford situation.

Background

5.2 Paragraph 2.8 et seq. outlines the government's views (as set out in the 2000 Green Paper) on the separation of local authorities' strategic and landlord functions, and its belief that better landlord and strategic housing management will be secured by separation.

5.3 The government has proposed that this separation be achieved by establishing a new Company to undertake the Council's landlord functions, controlled or influenced by the Council but at run at arms-length from it. Tenants would remain Council tenants, with rents set by the Council, but the Company would be responsible for providing landlord functions, including repair and maintenance, major works programmes, rent collection and arrears recovery, and general tenancy management.

5.4 Under these arrangements the Council ultimately controls and "owns" the Company, but management is undertaken by a Board of Directors. ODPM guidance is that the Board should include tenants, local authority nominees and independent members with relevant experience of social housing, regeneration, social cohesion, finance or other ALMO responsibilities. No one group should be in a majority on the Board, and it may help to demonstrate the ALMO's operational independence from the local authority if the Chair is not a local authority nominee. Tenant Board members should be elected by their fellow tenants to ensure that they are genuinely representative.

5.5 In this way tenants would be more involved and empowered than is possible under the traditional local authority Committee system, helping to achieve one of the government's aims, and some of the "disenfranchisement" of tenants that has happened under the move to a cabinet-style system in many authorities would be redressed.

5.6 In consultation with local authorities the government has developed a template for ALMOs, covering company form, governance, the extent of delegation and service delivery arrangements, which it expects will be followed. In outline:

- The Council continues to set rent and service charges in accordance with government policy, to set its budgets to balance the HRA, to determine its Housing and HRA Strategies and policies (in consultation with tenants and the ALMO), and to set service delivery standards and targets.

- The ALMO undertakes the management of the stock, but within the Council's policies it is able to determine service delivery arrangements and procedures. The ALMO receives a fee for these services, often with a performance related element, and is free to vary procedures, procurement methods, etc to achieve best value.

5.7 The ALMO would be "not for profit", i.e. it would not pay profits to shareholders, but would use any income over expenditure to improve tenants' services. Existing housing staff would transfer to its employment under the TUPE regulations.

5.8 If the ALMO achieves a 2-star or better rating from the Housing Inspectorate, additional borrowing resources might be available. Achieving this performance rating does not however guarantee additional investment, as ALMO spending is a direct cost to the public purse and the ODPM budget for this purpose is cash limited.

5.9 ODPM has allocated significant resources to support HRA investment via ALMOs, with the current budget for 2005.06 to 2007.08 inclusive totalling more than £2.6 billion. Further ALMO budgets will be the subject of future government decisions. While we believe that ODPM will allocate sufficient ALMO budgets for authorities choosing this option through their Options Appraisals, because this is public sector spending budgets are likely to be under pressure. The government guidance points out that even if an ALMO achieves excellent service standards, additional investment is not guaranteed.

5.10 Applications for the additional ALMO investment are invited in what have to date been annual Rounds, with competing applicants in a Round assessed in part in relation to the additional cost per decent home achieved. To date four rounds of ALMOs have been announced, and bids for the fifth Round closed on 28 January 2005 with the outcome including provisional capital allocations currently expected.

5.11 We note that the means of accessing additional investment is through the government granting additional Supported Capital Expenditure allowances to the HRA.

A Rochford ALMO?

5.12 Our analysis of the "HRA As Is" position indicates that the Council will not be able to achieve the Decent Homes Standard within its current resources. Subject to meeting the government criteria and taking other consideration into account, there is therefore the prospect of receiving additional ALMO funding to meet the investment gap. We examine the position below.

Capital resources

5.13 While our base case HRA analysis indicates an investment gap to 2010.11 of some £11.9 million, this figure includes the improvements needed to bring the sheltered stock into demand and the HRA is projected to make significant surpluses during this period. Improvements of the type identified in relation to the sheltered schemes are specifically excluded from ALMO bids, which are focussed narrowly on the Decent Homes Standard, which would reduce the investment gap to some £8.9 million (at outturn prices).

5.14 In addition, while there would be some additional revenue expenditure needed to set up and operate an ALMO (see paragraph 5.16 et seq.), government would expect net HRA balances to be used to help offset the investment gap. Allowing for the additional revenue budgets as set out below, we have assessed the investment gap net of sheltered improvements and HRA contributions at some £7.6 million at outturn prices.

5.15 ODPM's bidding guidance currently allows authorities to bid for an additional 5% to permit a degree of investment in environmental or sustainability works, so that an ALMO bid would probably be in the order of £8 million. The additional £0.5 million would not be sufficient to fund the works identified as needed to put the sheltered schemes into demand, so that other means of funding that investment, probably via RSLs, would need to be found.

HRA and General Fund revenue resources

5.16 In setting up an ALMO it is necessary to establish separate strategic and operational housing organisations, and advice on legal, organisational and financial issues would be necessary. In an organisation such as the Rochford housing service, where from senior staff undertake both strategic and operational functions, the separation needed would almost inevitably increase staffing costs. In addition there is a need to establish separate arrangements for budgeting and control purposes and for the ALMO's statutory accounting and audit requirements.

5.17 There are further complications in Rochford's case in that there is no distinct "housing service", with important aspects of tenant services being provided along with other General Fund services, for example in the repairs and maintenance and major works areas. In establishing an

ALMO and its arrangements for service provision, care would be needed in order to minimise increases to both HRA and General Fund costs. Taken together with the performance considerations noted at paragraph 5.21 et seq. below, entering into agency arrangements, to include the provision of General Fund as well as HRA services, with an existing high performing ALMO or Housing Association might provide a cost-effective way forward.

5.18 The precise extent of the additional cost to the HRA to establish and run an ALMO could only be determined after developing the ALMO arrangements in detail and comparing costs with current arrangements, which is beyond the remit of this study. Nevertheless from the experience of other authorities we would expect bought in setting up costs to amount to around £50,000, and the additional on-going revenue costs to total up to £100,000 per annum.

5.19 One of the "freedoms" that an ALMO would need to have to qualify for additional resources is that of choosing where to purchase support services. Where the Council currently provides these, e.g. legal services, a choice to purchase them from elsewhere would lead to diseconomies of scale and increased General Fund costs. This is because the General Fund would lose the opportunity to make a charge to the HRA for services purchased elsewhere, and in the short term the Council would not be able to reduce its costs to compensate for this loss.

5.20 This would be unlikely to take place immediately. Any change to a new supplier of services would be unlikely to take place during the initial period following its establishment as the ALMO would be pre-occupied with achieving 2* or better rating and delivering the major works programmes. It would nevertheless be sensible to agree with the ALMO a joint Best Value programme to review support services and over a timescale that gives both parties time to adjust to change and in so doing minimise the impact on the General Fund.

Performance

5.21 The most recent Inspection of the housing service was in June 2003, when the Audit Commission assessed Rochford District Council's Housing Service as a whole as providing a 'fair', one-star service that had poor prospects for improvement. From discussions at the RHOAB it appears that steps to implement all the changes indicated by the Inspection have not been undertaken. In these circumstances and with the subsequent tightening of the Inspection regime, the prospects of achieving a 2* rating are uncertain.

5.22 In view of this situation, RHOAB has commissioned a Mock Housing Inspection by the Housing Quality Network, which is currently under way, in order to inform the Board of the prospects of achieving an improved rating, and so the risks involved in pursuing an ALMO solution.

Governance

5.23 A key advantage of an ALMO is to empower tenants to make decisions, rather than to be consulted, upon service delivery through their Board representation. Additionally the presence of independent board members, selected for the business skills they can bring to the table, and with the Board's attention focussed on improving operational services, decision making and service delivery can be expected to improve.

5.24 At the same time the strategic side of the organisation and the Council's decision-making processes would be able to concentrate on the Council's major strategic priorities, with housing management and service delivery issues determined by the ALMO within overall Council policy.

Three star freedoms

5.25 The government has indicated that additional freedoms might be granted to ALMOs achieving a three star inspection rating, including escaping annual government subsidy etc determinations (although not the overall contribution to the national housing pool that authorities like Rochford make), and being able to compete for Social Housing Grant to provide new affordable housing within the HRA. Decisions on these benefits have yet to be made and are speculative at this stage. Until there are firm announcements, we suggest that they are discounted in assessing whether an ALMO is the right answer for Rochford.

Conclusions

5.26 While an ALMO brings with it the possibility of bridging the Decent Homes investment gap there are the following uncertainties/ disadvantages:

- There would be only limited additional investment over the Decent Homes Standard. It would not be possible to meet the Bronze, Silver or Gold aspirational standards.

- There would be insufficient resources to resolve the problems of low demand for the sheltered schemes. A different solution would therefore need to be found, probably involving transfer to an RSL or RSLs.

- There appear to be uncertainties in being able to achieve the necessary 2* standard at least in the short term. The current Mock

Inspection will inform this comment.

- Additional revenue costs could be absorbed by the HRA, but those impacting on the General Fund would need to be managed positively to avoid a Council Tax increase.

6 The Private Finance Initiative

Introduction

6.1 This section covers the Private Finance Initiative or PFI option for the future of the Council's housing stock. It covers the origin of PFI for Council housing refurbishment, how PFI works, and its pros and cons in the Rochford situation.

The Private Finance Initiative and Council Housing

6.2 The Private Finance Initiative is a way of involving private sector organisations in providing services to Council tenants under a long term contract. The PFI contractor or operator would usually establish a new company for the purposes of the contract – called a Special Purpose Vehicle or SPV, and negotiate a contract with the Council to provide housing refurbishment, repair, maintenance and management services to specified standards over a long period, probably 30 years.

6.3 The SPV itself would not normally undertake any works or services directly, but would subcontract to specialist contractors or service providers. These sub-contractors would usually be companies that came together to bid for the PFI contract, and they would normally own the SPV between them.

6.4 Typically the PFI operator would need to spend heavily in the early years to bring homes up to a modern standard, and would then get this money back by spreading the cost over the full contract period, similarly to the way hire purchase agreements and mortgages work. The PFI operator would need to maintain service quality against the Council's specification in order not to lose any of its payments through poor performance.

6.5 While tenants would continue as Council tenants with rents set by the Council, the new landlord services company - the PFI operator, would be private sector controlled, not involving Council or tenant representatives in any significant decision-making role if at all. The company would be set up to make profits for its shareholders and would be controlled by them. The arrangements are shown diagrammatically in Appendix 5.

6.6 If the contract between the Council and the PFI operator is arranged in the right way, the PFI operator's spending on housing refurbishment and improvements does not count as public expenditure. Also, providing that the PFI scheme provides good value for money and satisfies other government requirements, government subsidy can be paid to help meet the PFI operator's charges.

6.7 This way of providing more investment for Council housing is relatively new, and its development has been a long process. Government set up a pathfinder process where 8 local authority PFI projects were given government approval in order to test whether the mechanism, which had been successfully used for health services, prisons and education premises, might work for Council housing.

6.8 After more than 5 years since the original Pathfinder schemes received the Government's go ahead, there are just four projects (at Islington, Manchester, Reading and Leeds) that have completed the course, although others are expected to do so within this calendar year. Additionally, the first of these contracts was entered into just 2 years ago and the initial refurbishment phase has not yet completed. There is therefore no substantial track record against which to measure HRA PFI schemes.

6.9 The development of the Pathfinder process has involved breaking new ground and tackling legal issues. Future projects should not take anything like as long, and following consultation with public and private sectors, government and the 4ps have issued guidance and documentation aimed at standardising and streamlining the process soon. Even with these benefits, contract procurement time (after achieving government approval of the Outline Business Case) is not likely to be less than two years, so that PFI projects will still be more time and cost consuming that traditional building works procurement processes.

6.10 ODPM invited expressions of interest in a further round of HRA PFI in January 2005 and is due to announce the successful applications. This indicates that the Government has confidence in the ability of PFI to develop into a useable tool, and ODPM has been allocated total budgets of some £1.6 billion to promote housing PFI for assisting in delivery of decent homes and providing new affordable housing

6.11 We worked with the 4ps and DETR (as then named) to develop the policy framework for HRA PFI, with 5 of the 8 Pathfinders to help develop their schemes and to secure government financial support, and have continued to work with them in the procurement stage. Of the four contracts that have been procured we advised Manchester, Reading and Leeds on the development of and business case for their projects, continuing with the Manchester and Reading projects to contract signature.

6.12 In our experience PFI is affordable where "spend to save" applies – initial investment bringing about significant savings in maintenance and possibly management, and where there are "development gains" – where income from land or other property sales to the private sector offsets PFI charges. Additionally:

6.12.1 The cost of running the SPV, purely as an organisation that arranges service delivery through its sub-contractors, is not likely to be less than £100,000 per annum – and several of those we have been in negotiation with have proposed costs significantly more than this.

6.12.2 Government will not approve continuation of HRA self-insurance arrangements, but insists on the SPV taking out separate insurance for the PFI stock, including risk on increases in the cost of premia. This usually is costly and offers poor value for money since the insurance is for:

- a relatively small number of homes;
- stock that the Operator has no experience of managing
- Usually the Authority's relevant records are less than comprehensive, and
- Original construction methods and materials used are not known with certainty and there is no recourse should they be defective.

6.12.3 These difficulties with insurance are particularly the case where the stock is to be refurbished rather than rebuilt. Recent cases have involved annual costs of around £200 per unit more than the HRA equivalent. It is in large part because of issues like these that new HRA PFI schemes are likely to involve a significant proportion of rebuilding rather than refurbishment.

A Rochford PFI Scheme?

6.13 Taken together this suggests that to gain economies of scale the stock in a PFI contract needs to be 1,000 units or more; the stock needs to be in long term demand; and to be located in a compact estate/ area or number of such so as to support management and maintenance efficiencies, and preferably rebuilding rather than refurbishment is involved for much of the stock. Additionally the Treasury has recently indicated that PFI schemes with values under £20 million are unlikely to provide value for money and will not receive Government support[16]. It is also worth noting that PFI is not expected to be a whole HRA solution.

6.14 From our discussions with Officers and review of the Council's stock condition survey information, we do not believe that fertile ground exists for PFI schemes within the Council's HRA. Essentially investment backlogs are not currently bad enough for PFI to be cost-effective or reasonably affordable within the HRA. A degree of remodelling or

[16] Exceptionally, the threshold for General Fund schemes to provide new affordable housing via RSLs is £10 million.

rebuilding of the sheltered stock is likely to be needed to achieve long term demand, but the volume is too small to reach PFI Value for Money thresholds.

Conclusions

6.15 Overall the condition and size of the Council's HRA precludes the Private Finance Initiative from providing an appropriate or affordable route to access the additional investment needed.

7 Voluntary Housing Transfer

Introduction and Overview

7.1 In this section of our report we describe the Large Scale Voluntary Transfer (LSVT) option, which we refer to as "Housing Transfer" or just "Transfer".

7.2 Housing Transfer is the process whereby a Council transfers the ownership of all or part of its housing to an independent "not for profit" housing association with the approval of tenants. The housing association must be registered with (and therefore regulated by) the Housing Corporation.

7.3 The transfer process in outline is as follows:

- The Council undertakes an options appraisal together with tenants and other stakeholders.
- If Transfer is the preferred option, the Council applies for a place on the government's Transfer Programme.
- The Council and tenants select the new landlord. This will usually be a new housing association, and may be either "stand alone" or part of an existing housing association group. (See paragraph 7.10 et seq. for more detail).
- The Council, the new housing association and the tenants develop the detail of a range of benefits and protections for tenants if the transfer proceeds – increased investment in their homes and estates, rent guarantees, improved services, preserved rights, greater tenant involvement in decision making, using part of the transfer receipt to provide more social housing.
- The Council and the new association consult tenants and leaseholders on the benefits of transfer and the Council holds a secret ballot of all tenants, including joint tenants. Leaseholders are usually also invited to express their opinion but in a separate exercise.
- If the majority of tenants voting is in favour of transfer, the Council and association proceed to develop/ negotiate the terms of transfer, and the new association sets about registering with the Housing Corporation and raising the money to finance its business plan.
- Subject to satisfactory consultation (including the ballot), negotiations with the association and its registration with the Housing Corporation, the Council applies to the Secretary of State for permission to transfer, and the transfer process completes.

- The housing association becomes the tenants' landlord, and sets about delivering the consultation commitments given by the Council. The Council monitors progress to ensure that its promises are delivered.

7.4 The time scale for pursuing transfer is lengthy. From a decision to pursue transfer to the ballot would normally take 9-12 months, with a further 6-9 months post ballot. Overall the time taken is not likely to be less than 18 months. Applications for places on the Annual Transfer Programme are usually required in the December with the outcome announced the following March, although it is expected that the next round of applications will be held over summer 2005 to cater for authorities completing their Options Appraisals in the first part of 2005. Successful applicants are then given two financial years in which to complete the transfer process.

7.5 Under the transfer contract, the new housing association landlord will deliver the services promised by the Council in the consultation process.

7.6 Both the Council and its tenants must agree to the transfer, and the approval of the Secretary of State must be obtained.

7.7 The earliest voluntary housing transfer took place in December 1988 from Chiltern Borough Council to the Chiltern Hundreds Housing Association. To date more than 900,000 council homes have been transferred in approximately 200 large scale voluntary transfers.

The Transfer Association

7.8 The transfer association must be registered with the Housing Corporation, which regulates all housing associations registered with it.

7.9 To achieve registration the association must satisfy a range of conditions including:

- Rents must be set at levels affordable to people in low paid employment, and under the government's rent policies. In particular Transfer associations must show how their rents converge to government targets;

- High standards in the quality of housing, repair and maintenance and management services must be maintained. The association's Business Plan must show that it can deliver the consultation promises made by the Council and that it is financially robust in the long term.

- The Housing Corporation expects new transfer association Boards to consist of 1/3:1/3:1/3 Council: Tenant: Independent[17] nominees/ people, and for there to be effective mechanisms for tenant involvement. These proportions may change but if the association is "stand alone", the Corporation will usually insist that there is a minimum of 1/3rd Independents and that no group is in a majority. Arrangements for a new association within an existing Group structure may admit a tenant majority on the Board.

- All registered housing associations must be "not for profit".

- The association must be independent from control by other organisations, including the Council and other public sector bodies, although tenant and Council nominees have a majority on transfer Boards (see above).

7.10 The government has stipulated that existing housing associations should be given the opportunity to be involved in transfers, and expects Council and their tenants to arrange a competition between them and the option of setting up a new local and independent association. The nearby transfer authorities of Chelmsford and Maldon District Councils illustrate the differences. Chelmsford (approximately 6,900 homes) set up its own local transfer association, while Maldon (approximately 2,000 homes) transferred to a subsidiary of an existing Housing Association Group.

7.11 Government guidance is available on the selection process, but in essence the main issues are:

- "Deliverability": the acceptability of other than a "home grown" housing association to tenants. Most often tenants will favour a local association, although the size of Rochford's stock suggests that this should be a new association within an existing Group rather than a "stand alone" organisation.

- Tenants will often have heard of poorly performing associations and will tend to favour the "devil they know". The selection of a Group partner is especially important, including the full involvement of tenant representatives in the process.

- Local focus and accountability: and a perception that this would be lost if the new association were part of a Group covering a wider area. When setting up a new association within an existing Group, it is usual to seek "financial ring fencing" of the transferred assets to the new association, which would be established within Housing Corporation constraints to focus its work for the benefit of the local authority community.

[17] In this context independent means neither a Council person nor a tenant.

- Independence: joining a Group structure means the association's Board losing ultimate control, although the circumstances when this could happen would be similar to those where the Housing Corporation would step in if independent.

- The Transfer Price: where a Group would assist with the transfer process, and where using Group services (free of VAT) and low margin Group-borrowing facilities could lead to a higher transfer price. Our experience is that Group services are not always more effective than local ones, that Group borrowing facilities are not always available, and where they are they are not always lower than what is available in the market. It is important that these issues are tackled in the selection of the Group partner as otherwise the prospect of a higher transfer price can be illusory.

7.12 Of all these and many other issues, the most important is the first – deliverability. If tenants perceive the transfer to be to an unknown landlord they will tend to vote against it more than if they can see their existing "team" taking over the service, particularly if they are reasonably satisfied with their existing services. It is for this reason that most large scale transfers have been to a new independent association, unless the stock size does not warrant the overhead costs, tenants have prior experience of the Group (as e.g. in East Hertfordshire and Bexley LBC), or where there are compelling reasons for joining a Group, such as financial support to a business plan.

7.13 Taking into account the size of Rochford's HRA, it is unlikely that a new "stand alone" association would have the economies of scale to support cost-effective service delivery, and the Housing Corporation would be reluctant to register such an organisation. On the other hand the size of the stock is more than sufficient to warrant the establishment of a new housing association within an existing Group structure, where economies of scale may be gained (but see the final bullet point in paragraph 7.11 above).

7.14 Overall we believe that a new association within a carefully selected Group partner represents the way forward for Rochford if Transfer is selected as the option. It would be essential to select the Group partner carefully and with the full involvement of tenant leaders/ representatives, and for the Group selected to have their and Council Members' full support.

Tenant Benefits and Protections

7.15 While individual transfers differ in the tenant benefits and protections offered, those that might be possible in Rochford include:

- A rent guarantee for 5 years after transfer, which limits the amount of future rent increases. The government's rent policies mean that local authority and housing association rents will be broadly the same (on a like-for-like property basis), so that this is becoming a less frequent part of the transfer offer. If a guarantee were offered, the government would not permit it to prevent convergence by 2011.12, so that while such a guarantee could defer rent increases, this would only be for a temporary period.

- Spending on homes and estates to provide good modern and safe conditions, as identified by a stock condition survey and tenant and resident consultation. This is usually the main attraction of transfer, as this amount of investment is not usually available to the Council. It would provide standards much better than the bare Decent Homes Standard as set by the government.

  In Rochford we have demonstrated that the Council cannot afford to fulfil its landlord responsibilities and achieve the Decent Homes Standard. The Decent Homes Standard is not particularly high and we have assumed that the Council and tenants would aspire to at least the Silver Standard under Transfer together with budgets to tackle the improvements needed to the sheltered schemes.

- Improvements in housing management services, again determined in consultation with tenants and residents. Although no particular service improvements have been identified to date in Rochford, we have included a notional 5% increase on management budgets (an annual total of some £60,000) to provide for the likelihood of issues arising in developing a Transfer proposition.

- Tenants become "assured" tenants, and the new tenancy agreement would be written to give tenants broadly the same rights that they enjoy with the Council. The Right to Buy is preserved under current law, and most existing rights not also embedded in the law would be written into the new tenancy agreement.

  There are sometimes some minor differences, so that for example succession rights are often improved, while the Right to Manage is sometimes lost. Where the Right to Manage is an issue, arrangements are usually made to provide an equivalent for groups of tenants wishing to take over their own service delivery.

  A point often overlooked in discussing tenants' rights is that unless contained in law, a Council landlord may, after serving due notice and undertaking consultation, change its tenancy agreement. A housing association cannot do this, as the tenancy agreement can only be varied with the individual tenant's consent.

- The opportunity for tenants to take a full part in the management of their homes, with tenant nominees with full voting rights on the new landlord governing body – the Board. Tenants' nominees should have at least one third of the places on the Board, and this may be increased in certain circumstances (see paragraph 7.9).

7.16 Perhaps most importantly, for a Voluntary Housing Transfer to take place the Secretary of State must give his consent. He may only do so if a majority of tenants are in favour, and tenants' wishes are usually measured through a secret ballot following detailed consultation on the benefits etc as above.

Impact upon Leaseholders

7.17 Leaseholders are consulted in the transfer process, but unlike the Council's tenants, do not have a vote at the ballot.

7.18 Under transfer the leaseholders' freeholder changes to the Transfer Association, but the terms of the lease stay the same. Leaseholders therefore pay the same share of works undertaken to their blocks and estates as they would have done under retention by the Council, but because the new landlord will be spending more than the Council – the major reason for the Transfer, leaseholder recharges are correspondingly more.

7.19 Transfer Associations usually develop a range of ways in which leaseholders may make stage or delayed payments for such works, usually in the form of a loan or via a charge on their property (which would need to be paid on sale).

The Transfer Business Plan and the Transfer Price

7.20 As we have set out in section 2, under Council ownership the government takes from Rochford's HRA the surplus of rent income over Management, Maintenance and Major Repairs Allowances and interest on supported borrowing.

7.21 By contrast, under Transfer the Housing Association landlord keeps the full rent income and can use it to provide the full investment needed in the housing and estates as well as day-to-day services. This makes a very significant difference to the resources that are available locally as opposed to being contributed to the National Housing Pool.

7.22 The Transfer association develops its Business Plan by projecting forward the rent and other income (taking into account rent convergence and any rent guarantee), and also projecting its costs - investment in the stock, management, repair and maintenance etc. The Plan is a long-term document and will extend over at least 30 years.

7.23 Typically during the early years, when the key promises made about investment in homes and estates are being honoured, income is less than expenditure, and borrowing takes place to fund the building works programmes and interest payable on loans. In later years building works costs will reduce once the promised higher standards have been achieved, and income will exceed expenditure enabling the initial loans to begin to be repaid.

7.24 If the amount of income is more than enough to pay for the Business Plan costs, which is the case in Rochford, the association can afford to pay the Council what is called the "transfer price" from these surpluses. It does this by taking out a loan, usually from a bank or building society, on completion of the transfer. This is then repaid over the Business Plan period along with the further loans to fund the investment in the stock.

7.25 This way of valuing housing under transfer is called Tenanted Market Value (TMV). In effect TMV values the housing stock as a social housing operation, where rents are kept to government target levels, consultation promises are kept, and good standards of management and maintenance are provided. As such it does not reflect the "bricks and mortar" or open market value of the stock.

7.26 We have developed illustrative cash flows for the Council's housing stock and related assets under transfer, assuming transfer completion at the beginning of 2006.07, and have set out the resulting projections at Appendix 6 including a graph showing how the initial loans are repaid over time. We have assumed that the new landlord would invest in the stock at the level of the Silver Standard and would also undertake the improvements identified for the sheltered schemes.

7.27 **Assuming this level of stock investment, we have developed an illustrative transfer price of £7.1 million for the housing stock and associated assets.** This reflects the assumptions about costs and tenant benefits as set out below, and equates to about £4,120 per dwelling, including HRA garages.

7.28 We have incorporated the full investment required for the Silver Standard and the improvements to sheltered schemes, and have increased the management budget by an additional 5% for service improvements to be determined as noted in paragraph 7.15 above. We have also included VAT as 6% on management costs (reflecting the high proportion of salary and related costs that do not attract VAT) and 17.5% on building works costs, and allowed 10% increase in management costs for diseconomies of scale. The economic assumptions are those used in the HRA Business Plan model.

7.29 We have called this transfer price "illustrative" because it would change with stock numbers, with the costs of the package of tenants' benefits -

investment in the stock and improved services, and with changes to the economic assumptions – notably building works and management cost inflation. For example if the Gold Service standard were to be assumed, then the transfer price would fall to approximately -£1.5 million, representing the need for a dowry payment rather than a positive receipt for the Council. Broadly, the transfer price changes by approximately £1 million for a change in RPI-linked income or expenditure of £75,000 per annum.

7.30 If a transfer was to be pursued by the Council, it may be that different priorities and aspirations would emerge and be included in the ballot offer, changing the assumptions and Transfer price. It is therefore important to remember that the Transfer price is sensitive to changes in the assumptions, and that developing a Transfer business plan must secure a robust position for the new landlord so that it is able to deliver consultation promises in the face of adverse circumstances.

Setting up costs and use of the Transfer Receipt

7.31 The illustrative Transfer price of £7.1 million represents the Council's gross receipt, from which a range of deductions are made.

7.32 The first call on the Transfer receipts is the Council's setting up costs. These comprise the range of consultation and advisory costs in the pre-ballot period, and the continuing cost of establishing the new landlord and securing funding post-ballot.

7.33 In the pre-ballot period the costs are at risk against the ballot outcome. Given that the Council has a very recent stock condition survey, the total external costs are to do with lead, legal and communications advisers' fees and the cost of consultation as follows.

Pre-Ballot Cost Estimates

Service	Fee Estimate
Lead adviser	£45,000
Legal advice	£30,000
Independent Tenant Adviser	£30,000
Communications advice	£30,000
Consultation material including the ballot offer document	£35,000

Service	Fee Estimate
Total Estimate	£140,000

7.34 There would also be a range of internal costs including a project manager and substantial staff time needed to support the transfer process. The staff resource needed is not likely to be less than 2 full time equivalent senior officers, although pre-ballot this would need only one dedicated person together with the involvement of a number of senior staff.

7.35 Should the transfer ballot not be successful, the costs fall to be met by the HRA (consultation and related costs – say £110,000 of the total) and the General Fund (selection of housing association Group partner/ setting up the new landlord – say £30,000). It is also the case that the housing association partner might be willing to fund part of the pre-ballot costs at risk of a successful outcome.

7.36 Post ballot there would be further adviser and consultation/ information costs, and the cost of fund arrangements to underpin the Transfer Business Plan. We have estimated these as follows, although much would depend upon the extent to which the housing association partner was prepared to assist with costs.

Post-Ballot Cost Estimates

Service	Fee Estimate
Lead advisers (new landlord and Council)	£150,000
Legal advisers (new landlord and Council)	£200,000
Tenant support (ITA continuation)	£25,000
Board development	£30,000
Communications consultant	£10,000
Consultation/ communication material	£15,000
Business Plan audit	£15,000

Service	Fee Estimate
Funders Valuation	£15,000
Funding advice	£25,000
Miscellaneous "infrastructure" – IT systems, policy manuals & documents	£100,000
Irrecoverable VAT	£85,000
Fund arrangement fee (estimated at 1.25% of peak debt)	£280,000[18]
Total Estimate	£950,000

7.37 The total pre- and post-ballot setting up costs is some £1.1 million, which leaves a transfer receipt net of setting up costs of £6.0 million.

7.38 The next priority for use of the receipt is to redeem the HRA debt, including any early redemption premia, so as to enable the HRA to be closed. At the assumed time of transfer completion (beginning of 2006.07) the HRA debt is projected to be some £10.7 million excluding early redemption premia, less than net receipt.

7.39 This situation is referred to as "overhanging debt", and the government has made arrangements to assist authorities in this position to redeem their HRA debt and complete the transfer process. This would need a minimum transfer price to be agreed with ODPM at the time of the Council's transfer application, so that a significant amount of work in developing the Transfer offer, determining the extent of investment needed to secure the long-term demand of the sheltered stock and selecting the partner housing association Group would need to have been completed in order to provide the necessary "price certainty".

7.40 Note that it is only after HRA debt redemption has been secured that any balance of the transfer receipt becomes available for spending by the transferring authority, and then ODPM takes 20% of the net price for the homes only as a "transfer levy". In Rochford's case the transfer price itself would not provide any capital resources for the Council, although there are other financial benefits for the Council which could be used for enabling additional affordable housing as noted below.

[18] Fund arrangement fees are a transaction cost, incurred only on the transfer completing.

Post Transfer RTB Sales

7.41 The illustrative transfer price excludes consideration of post-transfer RTB sales. Transferring tenants have a preserved RTB and so sales continue once transfer has completed. Receipts are shared between the Council, the new landlord retaining sufficient to compensate for the loss of net rent income and sales costs. The sharing mechanism is subject to negotiation, but we have estimated that the Council's share would be between £95,000 and £105,000 per sale in the early years following transfer, which are for the full benefit of the Council. If RTB sales continued at say, 10 per annum (about half their recent level), this would mean a further receipt of around £1,000,000 per annum.

VAT shelter

7.42 Since 2002, when ODPM altered the regulations calculating the Transfer Levy, a device known as a VAT shelter has been possible for positive value transfers. This makes it possible for charitable LSVT Housing Associations, which most Transfer Associations aim to be, to reclaim most of the VAT paid on the initial building works programmes.

7.43 The VAT shelter mechanism is still "settling down" but is working satisfactorily for several Transfer Authorities and Associations that have approached the mechanism in the right way. Because the mechanism is still relatively new, and for non-charitable Associations has been the subject of some uncertainly, neither the Housing Corporation nor funders like to see it built into the transfer price.

7.44 The arrangements used to recoup the VAT vary according to agreement between the transferring authority and the new landlord. The saving may be part factored into the price and the balance accrue to the Association; not taken into the price but paid in part to the Council part retained by the Association as it arises; or paid into a Community Fund for spending in consultation with the Council and other stakeholders.

7.45 Whatever the mechanism, providing that the Transfer Association is charitable, there is a potential additional amount of resources available locally which we have estimated to amount to more than £4.25 million over the first 10 years.

Regeneration

7.46 There would also be the possibility of establishing the transfer association as a housing and regeneration organisation, with objectives aimed at helping local people into work, improving health and education generally and tackling social exclusion in partnership with the Council and others. The point here is to harness the full financial benefit of the

Council's housing stock for the community in the long term.

7.47 This is possible because transfer Business Plans are invariably conservative in their assumptions, largely because of the new association seeking to avoid undue risk and that funders, wishing to be sure of their loans being repaid on time, insist on their using higher than expected interest rates. These conservative assumptions are built into transfer financial arrangements, and can be expected to lead to surpluses of income over expenditure being generated from the Business Plan.

7.48 This feature of transfer means that a transfer association can help to secure the long-term benefits of the housing stock for the local community. This is in contrast to the new HRA subsidy system, where any HRA "surpluses" (as calculated using government yardsticks and allowances) must be paid into the National Housing Pool for central government decision-making.

Effect upon the volume of social housing

7.49 As noted above tenants who have the RTB at the time of transfer enjoy a Preserved RTB afterwards. By contrast new tenants after transfer do not have the Right to Buy[19]. It is therefore the case that there would be fewer RTBs under Transfer than the other options, which all involve HRA retention and continuation of the Right to Buy.

7.50 We have projected the position using the "base case" assumptions on RTBs and compared the results in the chart at Appendix 7. After the full 30-year Business Plan period there are more than 100 additional homes in social renting under Transfer than under retention.

7.51 In a high need area such as Rochford this is a considerable additional benefit that Transfer has over the other options.

Impact upon the General Fund

7.52 Transfer also needs to be analysed in terms of its effect upon the Council's General Fund, where the impact can include:

- **Strategic and enabling costs**: After transfer a range of housing functions remains to be undertaken by the Council – the strategic and enabling role, homelessness duties, housing advice and Housing Register, and private housing functions. Most of these costs are part funded from the HRA, so that additional General Fund costs would

[19] Tenants of non-charitable associations enjoy the Right to Acquire, under which tenant benefits are reduced and the discounts available are reimbursed by the Housing Corporation and ring-fenced for re-provision of the stock lost.

be incurred on transfer.

In respect of the Housing register, experience shows that it would be cost-effective to manage the Council's housing register duties through a contract with the transfer landlord, who in any event will operate its own waiting list and allocations systems, and we have built the cost of this into the new landlord's Business Plan so that they are included in the transfer price.

- **Residual Council costs**: These costs stem from the separation of housing management from the remainder of the Council's activities, reflecting costs that are currently shared between the HRA and the General Fund where saving the HRA's share of the costs in full would be difficult, at least in the short term.

  Such diseconomies of scale are in part due to the Housing Corporation's requirement for transfer landlords to demonstrate their independence from their sponsoring council by, at the latest after the first year following transfer, occupying distinct headquarters office accommodation, and by using Council services only under Best Value or competitive arrangements. In addition to diseconomies in staffing costs the Housing Corporation's policies would create surplus space in the Council's headquarters building, which it might be difficult to lease to other organisations.

  A further residual cost would be in relation to HRA contributions to pension fund deficits. These currently cost some £65,000 pa and would fall on the General Fund after Transfer and closure of the HRA.

  On transfer we estimate that the additional General Fund costs would amount to some £165,000 pa for say up to 4 years. However some resources would be available after transfer to reduce or remove this short term impact on the General Fund.

  Following a decision to proceed, the transfer process would probably take 18 months or more to complete and during the first year following transfer the Council is permitted to provide services to the new landlord as part of the transfer arrangements. Thus the Council has a period of some 2½ years to reorganise its business in a way that would minimise any additional costs resulting from the transfer. It is therefore the case that in practice these costs could be significantly reduced by appropriate action once the decision to proceed with transfer has been taken. Indeed, discussions with the Officers indicate that they could be reduced to manageable levels.

- **VAT**: Currently the Council provides a range of services, primarily in the leisure area, the charges for which are exempt from VAT.

However, the Council is able to reclaim the VAT paid in respect of these services as the amount involved is small in relation to VAT paid to provide non-business services such as Council housing, and is deemed to be de minimis by HM Customs and Excise. On transfer of the housing stock the Council's reduced purchases would lead to the de minimis threshold being breached, and in some transfers this has resulted in loss of the VAT reclaims. We understand however that such losses are not likely to be incurred in Rochford's circumstances.

Impact on Staff

7.53 The government is committed to ensuring that staff involved in all transfers are treated fairly and consistently and their rights respected in accordance with the Transfer of Undertaking (Protection of Employment) Regulations 1981 (later amended), which are commonly known as 'TUPE'. In broad terms, TUPE protects employees' terms and conditions (except occupational pension arrangements) when the business or undertaking in which they work is transferred from one employer to another. This includes subsequent transfers from one contractor to another and from a contractor back to the first employer.

7.54 Under TUPE, employment with the new employer is treated as continuous from the date of the employee's start with the first employer. Terms and conditions cannot be changed immediately as a consequence of the transfer although changes for economic, technical or organisational reasons may be negotiated later, as indeed they may with the Council as employer.

7.55 Pensions are not normally included in the rights transferred under TUPE but the government has issued a code of practice to local government bodies on pensions and TUPE. New contractors are now required to allow staff ongoing access to the Local Government Pension Scheme or to an alternative good-quality pension or a stakeholder pension. These provisions reflect the usual arrangements under large scale voluntary transfer, where the new association will normally enable transferring staff to continue to enjoy their pre-transfer pension benefits.

7.56 These arrangements would mean that staff primarily involved with managing and maintaining the Council's housing stock or providing support services to the Housing Department would, for the main part, have the right to transfer to the new landlord on comparable terms and conditions, including pension arrangements.

7.57 The new landlord will usually develop an organisational structure that enables it to undertake the majority of its housing and business management functions in-house, and will need to recruit to its support functions – finance, legal etc. Although many of the staff who currently provide these services will not have the right to a TUPE transfer (the threshold for which is usually taken in housing transfer as 50% of time on transferring services), the Council and new landlord will develop a recruitment protocol effectively ring-fencing new posts to the staff affected (subject to competency assessment), and offering the same employment protection rights as for TUPE staff.

7.58 Voluntary housing transfer usually results in there being more net staff afterwards than before, due in part to there being a new organisation to run and new service commitments to be provided. There are generally more jobs between the Council and the new landlord, so that there should be few, if any, compulsory redundancies providing the necessary reorganisation is approached flexibly.

Conclusions

7.59 Voluntary housing transfer offers the Council and tenants prospective benefits through enhanced services and investment in tenants' homes and estates, restraining rent increases to government target levels, and providing the Council with an enhanced enabling ability through the benefit of post-transfer RTB receipts sharing and VAT shelter arrangements. At the same time tenants' rights are protected.

7.60 There are potential costs to the General Fund, but discussions with the Officers have indicated that these might be reduced to low levels if positively managed from the outset.

7.61 Despite the significant financial advantages of transfer over retention, many authorities and their tenants have concerns about the lack of accountability of housing associations. While it is true that the Council no longer controls the stock directly, ownership and management arrangements under transfer offer a clear majority of ownership and control exercised between Council and tenant Board Directors.

7.62 Voluntary transfer of the Council's housing stock offers the possibility of:

- Enhanced services and investment beyond what HRA retention can provide;
- Rent no higher than government target levels;
- Protection of tenants' rights;
- Ownership structures which permit "community" accountability through a majority shareholding being held between the Council and the tenants;
- Significant post-transfer receipts through RTB shares and VAT

recovery; and

- A potential "break-even" position for the General Fund.

8 Mixed options

8.1 Mixed options are combinations of different "mainstream" options ("as is", ALMO, PFI and Transfer) applied to different part of the HRA. The main reasons for including mixture options in an options appraisal are that:

- Different groups of tenants may wish to pursue a particular option, separately from the balance of tenant wishes. For example, an authority has some estates managed by Tenant Management Organisations (TMOs), and analysis shows that "as is" is possible if management costs are restricted and the savings ploughed into stock investment. These budget restrictions are too limiting for the TMOs, who wish for increased budgets to improve general management, caretaking and grounds maintenance, and who want to break free from Council restrictions and set up a Housing Association for transfer. In this case the Authority could examine the impact of transfer on the remaining HRA, and if manageable allow the TMOs to pursue transfer.

- Different parts of the stock – geographic or by type, age or other characteristic, may be different in their investment requirements so that by solving their needs, different options may open up for the balance of the stock. For example suppose that an Authority had an amount of Pre-Reinforced Concrete (PRC) dwellings, which need extensive structural and refurbishment works, but the balance of the stock had been kept in good condition and could be maintained using MRA only. Suppose also that the investment needs of the PRC stock mean that the "normal" capital resources would not cover the Decent Homes requirements of the whole stock. In this case "as is" is not viable and on a whole stock basis either ALMO or Transfer would need to be pursued to attain the DHS throughout the stock. If, however, a Transfer or PFI solution was applied to the PRC stock, then "as is" becomes possible for the remainder of the HRA.

8.2 These motivations are not exhaustive, but following discussion with the RHOAB and ITA, and examination of tenant feedback to date, we know of no other reasons to consider them in Rochford. We consider their applicability in the next section.

Mixed options in Rochford?

8.3 First of all, we are not aware of any indication from the work of the Board, the ITA, the Council's aspirations survey, the test of opinion or the general work of the Council in serving its tenants that any group of tenants desires a separate option from the mainstream.

8.4 Secondly, the stock condition survey indicates that the condition of the stock is generally reasonable, and no particular estate, period of construction, stock type etc is believed to need significantly more investment in relation to disrepair issues than any other sufficient to warrant a different option.

8.5 In particular we have examined the investment requirements of the general needs versus the sheltered stock to investigate whether transfer of the sheltered stock might open up an "as is" solution for the general needs or vice versa. At stock survey prices the investment net of improvements per unit to 2010.11 (the Decent Homes target year) is £8,650 for general needs and £7,770 for sheltered.

8.6 The corresponding capital resources available per unit are £4,900 per unit assuming that Supported Capital Expenditure allocations per unit are maintained. Revenue contributions possibly in the order of £1,600 to £1,700 would also be available, but it can be seen that the investment gap remains substantial at £2,000 plus per general needs and £1,200 per sheltered unit.

8.7 The possibility of transferring the general needs stock to provide an "as is " solution for the sheltered stock is further confounded as sheltered stock retention would require the additional improvement investment of some £4 million identified to secure demand for the homes. It is also unlikely that maintaining a HRA with only 400 dwellings would be financially viable.

8.8 The one possibly viable mixture solution available to the Council would be the transfer of its sheltered stock (to gain the improvement investment required), while the general needs stock was managed through an ALMO. This way forward would:

8.8.1 Reduce the HRA stock to around 1,350 homes, damaging its viability and ability to generate revenue contributions to capital;

8.8.2 Involve investment to the Decent Homes Standard only for the general needs stock; and

8.8.3 Introduce the uncertainties associated with achieving the required 2* rating as set out in section 5.

Conclusions on mixed options

8.8.4 The above analysis suggests that "mixtures" are not particularly relevant to Rochford, although the possible mixture of transfer of the sheltered stock and ALMO for the general needs homes warrants further consideration. This option is considered within the comparisons in the next section.

9 Comparing the Options

9.1 In considering the options available to the Council we have discounted "as is" and PFI for the reasons set out in the preceding sections.

9.2 We have therefore compared an HRA ALMO option (which could apply only to the general needs homes) with Transfer (which could apply only to the sheltered schemes). The comparison on key criteria is summarised in the table overleaf.

Criterion\ Option	HRA ALMO	Transfer
Rents	Rents converge to government policy levels.	
Tenants' rights	No change. The tenancy agreement may be changed in relation to non-statutory matters by the Council after consultation.	Minor changes for transferring tenants (possibly Right to Manage). Right to Acquire replaces Right to Buy for new tenants. The tenancy agreement may not be changed in relation to non-statutory matters without tenant's individual approval.
Investment in existing homes and estates/ improvements in services	Investment to DHS with little extra for environmental works or other improvements. In particular there would be no resources to secure demand for the sheltered schemes. No budgets for improvements in services	Full investment to Silver Standard and necessary investment in sheltered schemes. Budgets for service improvements incorporated.
Increased enabling resources for the supply of affordable homes	None	Possible enabling budget **from general needs stock transfer** over the first 10 years from: • share of RTB receipts of c. £1 million pa; and • potential VAT shelter benefit of c. £4.25 million Sheltered scheme transfer produces no RTB receipts and VAT recovery is reduced to about £1.4

Criterion\ Option	HRA ALMO	Transfer
		million.
Additional social housing	RTB continues to erode the general needs stock base, possibly reduced with measures in the Housing Act 2003.	Loss of RTB on lettings to new tenants means fewer RTBs. The base case projections indicate that after 30 years there would be over 100 more homes than under retention.
General Fund	The ALMO option would bring about organisational changes and a rigorous testing of the value for money from central recharges.	Effects set out in section 7. Net cost would need to be managed down in the run up to Transfer.
Tenant Empowerment	The ALMO option would empower tenants in decision making in delivering services and the HRA business plan but within resources set by the Council.	Tenants empowered through Board membership at least equal with Council Members and Independents. Full control of resources within Business Plan "prudence" and RSL Group policies.
Effect upon staff	Protection of employment rights including pensions under TUPE etc arrangements.	Protection of employment rights including pensions under TUPE etc arrangements.

9.3 We can see that Transfer brings with it very considerable benefits over the ALMO option, with the exception of the possible impact on the General Fund where additional costs would need to be managed. There is also the question of whether Transfer is acceptable to the Council and the tenants.

Consultation on the options to date

9.4 The outcome of tenant consultation on the options as undertaken by the ITA is to indicate a preference to stay with the Council under ALMO in the ratio of 60:40.

9.5 While this is a significant majority in favour of ALMO:

9.5.1 There was only a brief time before the test of opinion for tenants to take in the outcome of the technical and financial analysis;

9.5.2 In the Aspirational Survey tenants expressed a strong desire for a range of improvements to their homes and estates which would not be available under ALMO. There are similar consideration in relation to increasing the availability of affordable housing in the District;

9.5.3 Comparing the outcome of the ITA's telephone survey (when it was not fully appreciated that "as is" was not an option) with the test of opinion, it appears that of the 30% tenants initially preferring "as is", 4% changed to ALMO while 26% preferred Transfer; and

9.5.4 There has been no indication from the Council as to what it believes is in the tenants' and community's' best interest. Tenants will often be swayed towards the Council's view, particularly when there is not significant opposition from any Council Members.

9.6 In our experience the response from tenants to the consultation to date is typical of where Tenants do not relish change, preferring "the devil they know" and being fearful of the reputation of some RSLs operating in the District. At this early stage they will not generally understand the full implications of the options, including the effects of the government's rent policy or the benefits of a new Council-sponsored Rochford Housing Association taking ownership of the stock.

9.7 We are aware of Rochford's early and unsuccessful attempt to transfer its stock in 1988, and that tenants' and the community's memories of this live on. The Council's transfer ballot took place before any transfer had been successfully completed and when the benefits and risks involved in transfer were in practice unknown. Since December 1988 some 100 large scale voluntary transfers have been completed successfully, and research has shown that the benefits promised for tenants and communities/ authorities have very largely been realised.

9.8 While the unsuccessful ballot must be borne in mind, provided that consultation and information on transfer is full, open and delivered at a pace that tenants are comfortable with, we do not see this as a barrier to achieving a successful ballot outcome should that be the Board's and the Council's preferred way forward.

9.9 **In many successful Transfers to date the type of early response to change we have in Rochford has not stood in the way of a successful Transfer ballot where, supported by tenant representatives, the Council has believed that Transfer is the best way forward and has explained its reasoning to tenants during the pre-ballot consultation/ information campaign.**

10 Conclusions

10.1 The main issues to emerge from our analysis are:

10.1.1 Transfer and ALMO are the only viable options for the future of the Council's housing stock in seeking to achieve and maintain the Decent Homes Standard, including the possible mixed solution of general needs stock ALMO and sheltered stock Transfer;

10.1.2 The major improvement in the level of investment available under Transfer compared with ALMO;

10.1.3 Transfer having the potential for generating further capital resources available for the community; and

10.1.4 Transfer benefits being offset by the need to manage positively potential General Fund cost increases, which are likely to arise but have a lesser impact under ALMO.

10.2 While, subject to achieving a 2* inspection within a reasonable time frame, ALMO has the potential to deliver an adequate service for general need tenants, it:

10.2.1 Falls short of delivering all but a minor amount of the aspirations for the Council's homes and estates expressed by tenants and residents through the survey

10.2.2 Does not resolve the "lack of demand" issues identified in respect of the Council's sheltered housing schemes; and

10.2.3 Fails to provide any resources to help meet the need for affordable housing in the District.

10.3 By contrast Transfer:

10.3.1 Can provide the resources to meet most tenants' aspirations and the improvements necessary to bring the sheltered stock into demand.

10.3.2 Has the potential to provide the Council with additional resources through RTB sharing and VAT recovery mechanisms.

10.3.3 Restrains tenants' rents to government policy levels and protects and enhances tenants' rights.

10.4 The reasons for the difference in resources available can be found by examining the extent to which RTB receipts and tenants' rent income is paid to government under the new HRA arrangements introduced this financial year. The chart at Appendix 8 shows the extent of RTB receipts and HRA (revenue) payments to central government are made under the base case HRA projections. By contrast under Transfer these resources are kept available locally, and additional government resources are available to help redeem the HRA debt.

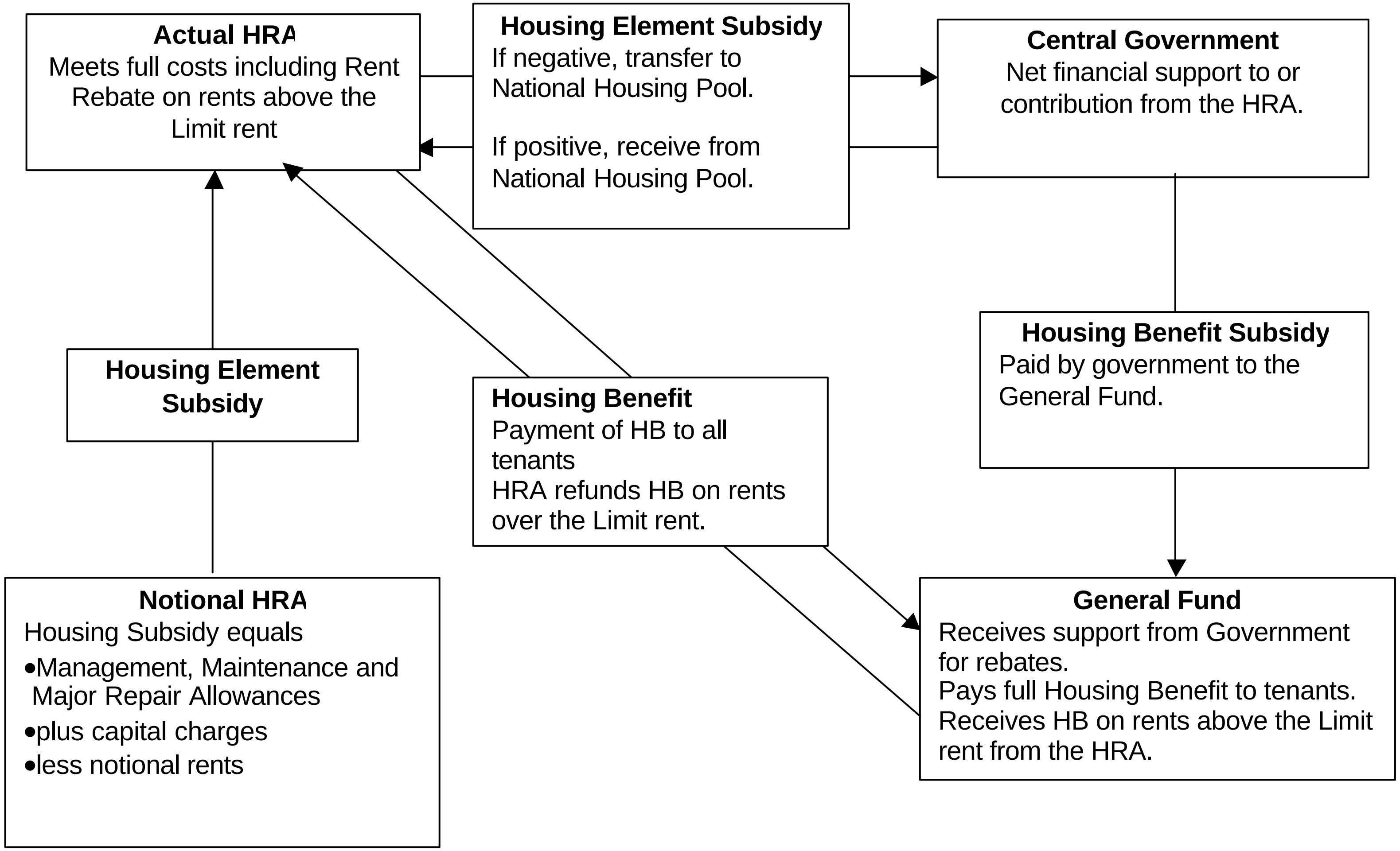
10.5 The outcome of tenant consultation so far is to indicate a higher level of support for ALMO than for Transfer, but as set out in paragraph 9.4 et seq., from our experience elsewhere and at this early stage this is not necessarily an indication of how tenants would vote in a Transfer ballot.

10.6 **Taking all the above matters into account and given a positive approach to the management of General Fund costs, we believe that a whole stock transfer is in the best interests of tenants and the community as a whole.**

10.7 **If, however, the Board or the Council decides to consider an ALMO solution, we would recommend that this is for the general needs stock only, and that in order to secure the improvements needed to secure long-term demand, Transfer is in any event pursued for the Council's sheltered schemes.**

Graham Moody
Graham Moody Associates
March 2005

Appendix 1 The New Housing Subsidy System



Appendix 2 The Aspirational Standards

The various aspirational standards adopted by RHOAB were set out in a Newsletter to tenants and residents, and which is included as this Appendix 2.

Appendix 3 HRA Base Case: Operating and Capital Positions

Appendix 4 HRA Sensitivities and Aspirations

The Table sets out the results of the sensitivities listed in paragraph 4.12 together with the base case for comparison.

Outcome	Base Case	1	2	3	4	5	5a	6
Revenue HRA								
Meet minimum balance requirements?	No	No	No	No	No	No	No	No
If not, year when first in deficit	25	18	20	18	25	14	28	28
Balanced annually throughout?	No	No	No	No	No	No	No	No
If not, year when first in deficit	16	10	12	11	16	13	27	27
Capital								
Sufficient capital?	No	No	No	No	No	No	No	No
If not, what is the deficit to 2010.11? (millions)	£11.9	£11.9	£11.9	£11.6	£9.4	£9.0	£8.4	**£6.0**

Notes:

Revenue robustness

1 The removal of the real "re-basing" subsidy weakens the HRA's revenue position considerably. If an HRA solution for the additional investment is pursued it will be necessary to keep the extent of subsidy receivable under annual revue and set HRA budgets accordingly.

2 The HRA's revenue position is damaged but not irretrievably. Savings in R&M budgets to reflect RTB losses could restore the base case.

3 The increase in RTBs increases revenue pressures on the HRA. However, RTBs accumulate to nearly 250 over the first 10 years so that cuts in R&M and management budgets to restore the position should be possible without damaging service quality unduly. The investment gap reduces slightly as responsibility for investment in the RTB stock is removed.

Reducing the Investment Gap

4 There is no change to the revenue position but the investment gap is closed by £2.2 million. This would leave few if any capital resources for the full range of General Fund investment needs.

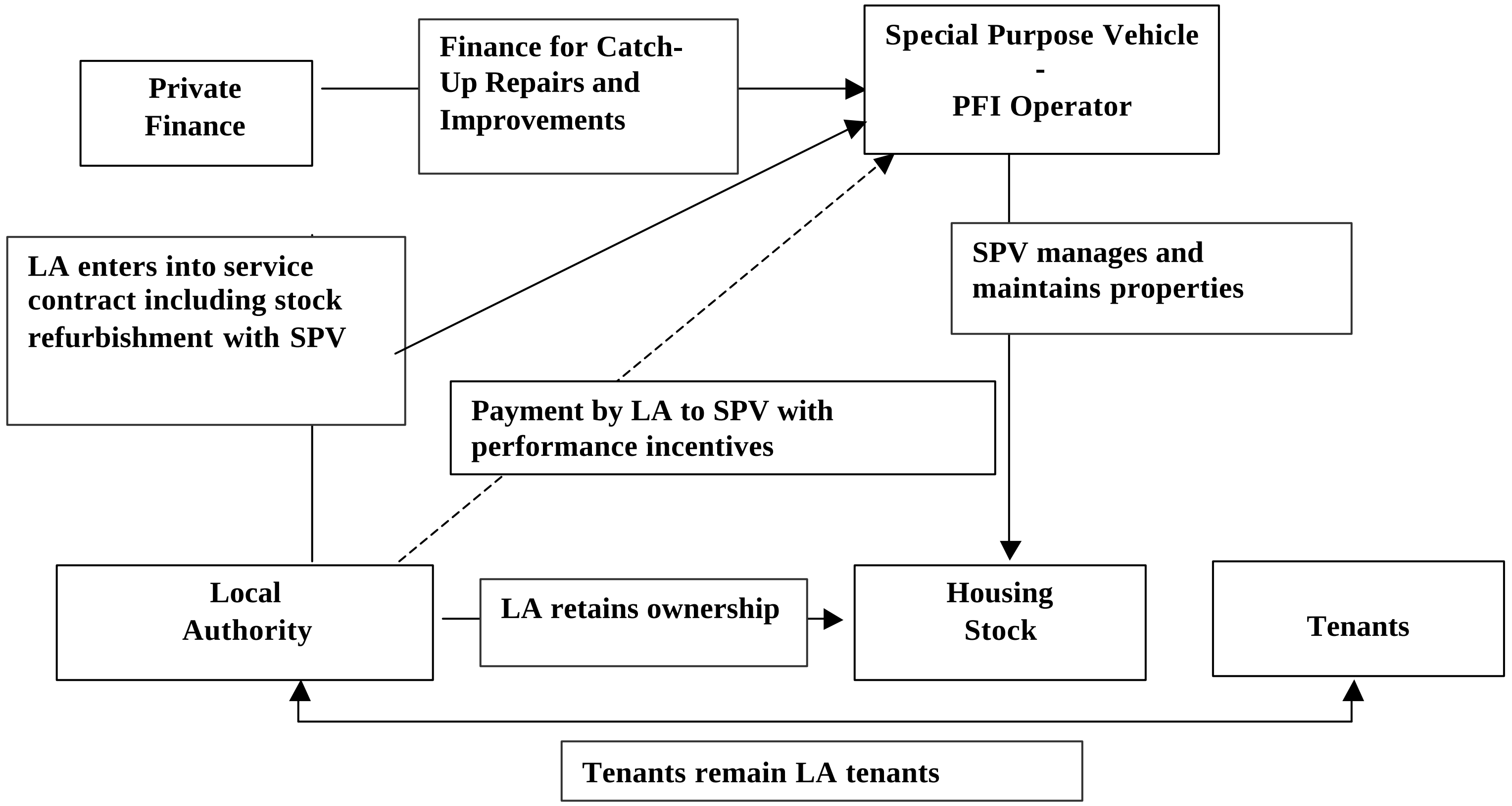
5 The revenue position is weakened considerably, as balances previously earmarked against future HRA losses are used early to close the investment gap. The investment gap itself is closed to £9 million.

5a The possibility of generating RCCOs is an important consideration in examining whether the HRA investment gap may be closed so we have examined the "optimistic" position where repair and maintenance and management budgets are reduced pro rata to RTB losses <u>and</u> have their underlying real growth reduced to 0.5% pa. In this scenario the combination of management and maintenance budget restrictions in 5a improve the revenue position of the HRA (although they would probably also prejudice service standards), and the investment gap is reduced to £8.4 million.

6 The combination of 4 and 5a reduce the investment gap to £6.0 million.

We have also considered the possibility of using prudential borrowing to close the initial investment gap. This would be to borrow in the early (high investment) years against HRA surpluses in later years. In the "best case" investment scenario at 6 above the initial investment gap is reduced to some £6.0 million, and our HRA projections show that the maximum HRA reserve is £3.7 million at the end of year 20. Setting aside considerations as to the feasibility of making the HRA savings needed and whether the borrowing would be "prudent", with interest to pay on the borrowing reducing the value of the future balances involved, it can easily be seen that prudential borrowing would not close the investment gap by the amount needed.

Appendix 5 HRA PFI Arrangements



Appendix 6 Transfer Cash Flows

Appendix 7 Social rented stock under HRA and Transfer

Appendix 8 Base Case HRA Resources paid to government