Annex D

STEVENAGE BOROUGH COUNCIL HOUSING OPTIONS APPRAISAL FINANCIAL REPORT

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Housing Quality Network Services
Tel: 01723 350022 Fax: 01723 350888
E-mail: hqn@hfta.co.uk Website: http://www.hqnetwork.org.uk.

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1 Introduction and Background

Housing Quality Network Services was invited to assist Stevenage Council in the financial aspects of its Housing Option Appraisal. We began this project in April 2004 but were required to put all work on hold until a revised stock condition survey was undertaken. The results of the new survey were made available in April 2005.

Following the Government's announcement of the Communities Plan and PSA Plus Review of Decent Homes in 2003, there have been a range of developments in the debate over housing options and an update is provided within this report. In particular, there are a range of proposals and changes affecting the housing finance regime for local authorities, which will have an influence on the financial outlook for the options. The report highlights some potential scenarios.

Our review suggests that two of the whole stock options to be financially feasible – Arms Length Management and Stock Transfer. A local investment and service standard has been developed against which the options have been appraised. The development of the "Stevenage Standard" which is represented in investment terms by the **Base Standard** will be a key measure against which the Government and Community Housing Task Force will judge the robustness of the consultation within the appraisal.

2 Government policy and options update

This section summarises the recent policy framework and sets out the key features, and latest progress, on the options.

2.1 Policy announcements

On 5th February 2003, the Government published "Sustainable Communities: building for the future" – the Communities Plan. On 3rd March, along with the application guidance for future Arms Length Management Organisation (ALMO) and Stock Transfer rounds, the Government published the outcome of its review of Decent Homes delivery: the "PSA Plus Review". Within the Communities Plan, the detailed allocations of housing and regeneration budgets at a national level were announced following the 2002 Spending Review. Both documents represent an attempt to deliver a comprehensive package of measures to enable four key macro objectives to be reached:

- More new homes in areas of high need, particularly in the four growth areas in the south east,
- Tackling low demand and abandonment,
- Meeting the Decent Homes Standard for existing stock,
- Bringing housing and regeneration together into an overall approach to sustainability.

Both documents place an emphasis on "delivery mechanisms", for decent homes in particular, but also in terms of improved services and greater levels of tenant and resident participation and influence. All of the major investment programmes for the alternative housing options were put on hold pending the Communities Plan and the outcome of the PSA Plus Review. The material covered about the "options" is therefore a key area of attention.

Housing Quality Network Services
Tel: 01723 350022 Fax: 01723 350888
E-mail: hqn@hfta.co.uk Website: http://www.hqnetwork.org.uk.

2.2 Option appraisals

Every authority still with stock must complete an option appraisal for "sign off" by the Government Office by July 2005. Guidance on the criteria upon which "sign off" will be based was published on 18th June 2003. Schedules of the key criteria have been widely distributed by the Community Housing Task Force and are listed under the following headings:

1. Tenant and Leaseholder involvement
2. Consultation
3. Financial Appraisal
4. Stock Condition Survey
5. Analysis of Demand
6. Mixed Solutions
7. Tenant Management and tenant led solutions
8. Wider strategy for Neighbourhood Renewal
9. Objective robust evaluation
10. Decision making process
11. Change Management process
12. Management of the process

In essence, the guidance concentrates on the *process* and the need for decisions about preferred options to be based on robust information, with tenants "at the heart", with the key "deal breaking" factors:

- The need to develop proposals to meet the Government's key objectives,
- The need to appraise all options equally, consistently and impartially,
- The need to maximise the meaningful participation of tenants in the decision making process arriving at the "preferred option",
- The need to consider the prospects for service delivery and improvement under the different options,
- The need to consider the varying approaches to tenant involvement and influence in any future housing organisation,
- The need to consider, where appropriate, options "below" the whole stock level.

The Community Housing Task Force has been actively engaged in developing and agreeing appropriate mechanisms to ensure that Councils engage with stakeholders and place tenants at the heart, through the development of a Communications Strategy and Tenant Empowerment Strategy for each appraisal.

2.3 Private Finance Initiative

2.3.1 General description

PFI for council housing is based on a 30 year contract operated by a consortium, usually Housing Association, Construction firm and funder. The consortium usually forms a company specifically for the purpose of operating the contract, borrows money up front on the private markets and recovers the investment and ongoing revenue in the form of annualised contract payments over 30 years paid by the

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E-mail: hqn@hfta.co.uk Website: http://www.hqnetwork.org.uk.

Council. Because the cost of additional investment and refurbishment is included in the contract, the contract payments are greater than the level of expenditure currently within the HRA and the government pays subsidy (or PFI credits) to make the contract affordable.

Because of the financing issues involved, this solution cannot be used for the whole stock and has tended to emerge as a favoured option for areas or stock types, which need significantly higher than average levels of investment to reach a modern standard. In the two active rounds to date, only around 25,000 properties are involved. In the third round of expressions of interest, a similar number is involved.

2.3.2 Progress and update

The first round of 8 pathfinders dating back to 1998/99 has signed, were due to sign, contracts during 2003 and 2004. 12 authorities were included in the second round of pathfinders, which began the application process in early 2001. A third round of bids (or expressions of interest) were approved in May 2004 with another 10 projects approved in April of this year. Government have made it clear in later bidding rounds that they wish to see the overall process substantially speeded up with the whole process expected to take no more than 2 years to complete.

The first round pathfinders have been developing their schemes for a long time. After nearly 4 and half years from first application, Manchester City Council became the first council to sign a HRA PFI contract in February 2003. The London Council of Islington became the second to sign in March 2003. Since then 2 more contracts have been signed. The involvement of so many parties in a negotiation process which will result in a performance contract affecting partners in a consortium over a 30 year period is, necessarily, extremely complex. Interested councils generally need to be convinced of the unavailability of alternative private finance or regeneration funded options before commencing.

What is emerging is a sense of the “optimum” circumstances for PFI schemes. These include very poor condition and / or low demand stock usually in areas requiring wider investment in regeneration and scheme sizes upwards of 1,000 but less than 3,000 properties. Barriers to HRA PFI to date have included the difficulty in avoiding residual cost to the HRA and hence there is usually a significant element of “spend to save” in the proposals.

The announcement of substantial additional resources (£685m) for this option in the Communities Plan of 2003 and the developments highlighted in the PSA Plus Review to address legal and subsidy barriers to the PFI programme clearly indicate that the Government continues to have some confidence in the ability of PFI schemes to deliver high amounts of investment in specific local schemes.

2.3.3 PFI for new build?

Related to these announcements, the Government consulted in the early spring of 2003 on the potential for using PFI schemes to effect new build HRA properties. This proposal has now been confirmed with the appropriate Statutory Instrument and Regulation changes taking effect later in 2003. The key focus of the proposals was around replacement build following considerable demolition or redevelopment, particularly for estates requiring complete overhaul or investment in regeneration. In fact a number of the round 3 bids included such proposals.

Housing Quality Network Services
Tel: 01723 350022 Fax: 01723 350888
E-mail: hqn@hfta.co.uk Website: http://www.hqnetwork.org.uk.

2.4 Arms Length Management Organisation (ALMO)

2.4.1 General Description

From 2000 when the concept of ALMO was introduced in the Housing Green Paper, the Government tended to view this option as appropriate where stock transfer is not proceeding for whatever reason. As the programme has developed, ALMO has tended to emerge as the most favoured alternative to retention across the country.

Under this option, the Council establishes a new Organisation to take over the landlord services for the stock. The ALMO is a not for profit company, limited by guarantee, owned by the Council. In essence, the approach is one whereby the ALMO operates under a Management Agreement with delegated powers from the Council, delivering all landlord services, either utilising directly employed staff, contractors or continued Council services in the short term. Detailed plans are covered in an Annual Delivery Plan agreed with the ALMO.

Some features are common with stock transfer, for example the board of management, its membership and the establishment of a separate legal entity. Staff delivering landlord services would move across to the ALMO under TUPE. In all other respects, the ALMO is distinct from stock transfer:

- The ownership of the assets stays with the Council which remains the landlord,
- Tenancies and rights remain unchanged,
- The Management Agreement is finite and reversible,
- No other option could develop without the express consent of the Council and its tenants.

The Government has provided additional capital resources for councils which wish to establish an ALMO, subject to the achievement of a minimum 2* rating in an Inspection of all landlord services. The qualifying standard applies to the ALMO, once established, and not the Council prior to the establishment of the ALMO. In the first two rounds, the maximum additional resources bid for represented the equivalent of £5,000 per unit although this “ceiling” has since been dropped.

The public sector financial regime stays in place under this option. The HRA continues and a small team of officers carries out the monitoring of the Management Agreement and the ALMO’s performance. As the HRA stays in place, any changes to the local authority housing finance system will affect the ALMO.

As the ALMO programme has developed, several critical issues have tended to emerge. Some of the key points are set out below:

- The need for the ALMO Board to exercise operational freedom from the Council, including the freedom to procure services to deliver the Management Agreement as it deems appropriate in line with the principles of Best Value;
- The need for a robust and well-drafted Management Agreement; there is scope for disagreement and dispute on clauses and finances. These have most often been evident in those councils where the ALMO was initially seen as the Housing Department under a different name.
- The need to gear up to spend the additional resources should not be underestimated with programmes often doubling or even trebling within a few months.

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2.4.2 Availability of additional resources

The additional resources are made available to authorities, which not only have satisfied the appropriate criteria, but also have established an ALMO and can demonstrate that the resources are required and will be put to good use. Given the demand for ALMO nationally, it is likely that the priority criterion affecting the level of allocation will be the extent to which additional resources are required to enable an authority to fully meet the **Decent Homes Standard (that is to deal with all element failures).** Within the PSA Plus Review of March 2003, ODPM recognised the need for wider investment to achieve sustainability of stock, which has been brought up to the **physical Decent Homes Standard**. For the ALMO option, 5% of additional resources have been allocated to deal with such investment and these can be included in applications from Round 3 onwards.

2.4.3 Progress and update

Rounds 1 and 2 were invited during 2001 and 2002 and a total of 21 councils were given pre-allocations of resources to join the programme. The total allocated to the successful bidders was £655m against the national allocation of £460m from the 2000 Spending Review. This element of “over programming” is continuing as some councils will not achieve the necessary standard (thereby releasing the resources). However, following the Spending Review 2002, the growing demand for ALMO resources could have an impact on the availability of resources into future years.

During December 2002, following inspections of the first 8 ALMOs in October and November, ODPM announced the success of all eight first round ALMO’s in achieving the minimum 2* standard. Ashfield Homes, Derby Homes and CityWest Homes became the first ALMOs to receive 3* ratings. As 2003 proceeded, round 2 ALMOs received their inspections and, at the time of writing, all have been successful in achieving the 2* rating with one (Carrick Housing) achieving 3*. Of four second round ALMOs having received a 1* rating for all services, all four have obtained 2* though a second inspection round.

The Communities Plan and PSA Plus Review resulted in:

- The allocation of £700m between 2004 and 2006 for two further ALMO rounds (three and four), with the set aside of 5% of these resources to cover investment beyond the **Decent Homes Standard**. Round 3 applications were invited in May 2003 and Round 4 in December 2003.
- The need, at application stage, to have developed clear thinking on future governance arrangements; this arises from some of the critical reports of the Inspectorate for the first round inspections where the separation of functions was not thought to be rigorous enough.
- The need for applications to be supported by a 30-year maintenance and investment plan (the Building Cost Model) as with applications for stock transfer.

15 authorities expressed interest in round 3 during April 2003 and 14 applied to join the programme. 13 were accepted onto the programme in July. Round 4 Expressions of Interest were received on 26th September 2003 and 19 councils submitted. Of these 14 applied in December 2003. The results of Round 4 applications were announced with all 14 making the list. The total of bids in Rounds 3 and 4 together were over £3 billion. Currently the round three and four ALMOs are

undergoing inspection with one ALMO to date not making the minimum required 2 stars.

A further two bidding rounds were announced in the autumn of 2004. Applications for Round 5 funding closed on 28 January 2005 and there were 11 applications.

Given that resources are likely to be subscribed several times over, it is likely that allocations will be based around liabilities towards the **Decent Homes Standard**. For future bidders, this has implications, which are different to those of the first two rounds, when a rather more comprehensive investment bid was the norm. Nonetheless, work with several of the round 3 bidders does suggest that a bid to cover the essential expenditure required in order to be a good landlord, i.e. that generally accepted to be the "Industry standard" norm for investment and renewal, is forming the basis of most bids. This would generally include expenditure in excess of the "**pure" Minimum Standard (i.e. to deal with all element failures).**

One recent development is the first "no vote" for ALMO in Camden in December 2003. Prior to this, all ALMO votes had been strongly positive. The development of active "no" campaigning against ALMO is something, which all councils considering this option will need to take account of in future rounds.

2.5 Stock Transfer

2.5.1 General Description

The Large Scale Voluntary Transfer (LSVT) programme has now been running for over 15 years. Early LSVT proposals established the main bases for the conduct of the programme, which has now covered over 100 councils and well over 750,000 properties. Despite some reversals particularly in the early part of this decade, LSVT remains the single biggest basis for levering in private finance to sustain additional investment in the housing stock and improved services.

The earliest transfers were to traditional style Housing Associations established under the Industrial and Provident Society model. In 1996, the model of the Local Housing Company was formed which allowed Boards of Management of new landlords to consist of three way membership between the Council, tenants and independent board members. This has remained since the predominant form for whole stock transfers. During 1999, the Government agreed to write off so-called overhanging housing debt thereby opening up the transfer option to many urban councils with low value stock and high debt levels.

Financially, the transfer process works on the basis that current HRA expenditure on debt charges and negative subsidy become available to a new Association to fund loans to purchase the stock and finance investment, without the expenditure counting against the Public Sector Borrowing Requirement. Existing debt is written off and there may be some money left over for investment in other services, especially meeting affordable housing need.

Any transfer of over 500 properties is deemed to be a LSVT subject to specific guidance. For example, there must be a ballot of tenants in which a majority (of those voting support the transfer proposal in order for it to go ahead. Transfers above this stock number must also be to a Registered Social Landlord (RSL) or Housing Association, registered with the Housing Corporation.

The key features, which distinguish a transfer from an ALMO approach, are as follows:

- LSVT is the only option where ownership of the stock changes,
- The Housing Corporation acts as regulator rather than ODPM directly,
- An RSL is not subject to public expenditure restrictions although rent restructuring does apply as for local authorities,
- Tenants have an Assured Tenancy where the main rights affected are the Right to Buy, Manage and Repair. The Right to Buy can be preserved for tenants who were previously council tenants. The Rights to Manage and Repair can be included within commitments of the new organisation at transfer. It should be noted that the Government is due to advance proposals later this year to develop a single social housing tenancy.
- Some RSLs are able to receive grant funding for new build from the Housing Corporation and Regional Housing Boards. However it is unlikely that any transfer organisation will be able to access such funding.

2.5.2 Transfer to whom?

Transfer can be to a range of organisations or types of organisations. These include existing RSLs, newly created stand alone RSLs or newly created RSLs belonging to a group structure with an established RSL.

The key differences between these options relate to:

- The sense of local belonging associated with whether transfer is to an existing or a newly created body,
- The opportunities to secure economies in management by transferring into an existing infrastructure. Skills required as an RSL (and not as council housing provider) will include Treasury Management, Loans and Financing, as well as possibly the expertise involved in development and the building of new homes.

In certain circumstances, if the stock to be transferred is of low value or deemed risky, an existing RSL may also be able to use its existing assets to ensure a transfer could proceed.

With the 2002 transfer guidance, the government introduced the notion of “choice of landlord” into the LSVT process. Following a decision to pursue transfer in principle, this guidance points to the involvement of tenants in the selection, firstly whether to establish a newly created RSL, thereafter whether to be stand alone or into a group (the parent being the subject of a “competition” or selection process) or secondly, which landlord to transfer to.

Councils pursuing transfer are encouraged, therefore, to engage tenants at an early stage to input into the decision of which landlord “receives” the stock.

2.5.3 Tenant led transfer?

Historically, both the government and Housing Corporation have not supported the notion of tenant majorities on boards of management. Recently, the Confederation of Co-operative Housing has been lobbying hard for the “Community Gateway” model of stock transfer which involves transfer to a tenant led RSL and tenant owned and managed service delivery. There are two example schemes in progress (in Lancashire and in East Anglia) although there are at early stages; possible models for such an approach are also being developed in Wales, where Bridgend has become the first Council to establish a form of "Community Mutual" Association to own and manage the stock. Decisions on stock transfer may well need increasingly to account for a Community Gateway approach.

2.5.4 Progress and update

The appetite from the private and funding sector for stock transfers continues to be sufficient to provide funding for all those transfers reaching conclusion. There are however concerns that rent restructuring (and the limiting of RSL rent increases to half a percent above inflation) has limited the ability of some transfers to proceed by depressing valuations and / or providing too much pressure on the future business plan for the RSL. Certainly the government shows every sign of supporting stock transfers at the rate at which Councils wish to pursue them. In contrast to the ALMO programme, the acceptance or otherwise onto the transfer programme is dependent upon financial feasibility and the proposals within the scheme, rather than in competition with other applicants.

High profile rejections of stock transfer during 2001 and early 2002, at Dudley and Birmingham in particular, have, whilst certainly not leading to a general trend of "no" votes, placed the achievement of the government's original Green Paper objective, of 200,000 properties per year to transfer, under pressure. Given that transfers have not, since 2002, been proceeding at this rate, the ODPM has been forced to reconsider its overall approach to the financing of housing capital investment in the context of the overall achievement of the Decent Homes Standard for all stock by December 2010. This led to the PSA Plus Review of Decent Homes Delivery.

The key developments arising from the Communities Plan and PSA Plus Review of 2003 were as follows. These measures, along with the strengthening of the option appraisal process (backed by specific guidance and the need for sign off), can be seen as an attempt to "reinvigorate" the transfer option by removing the "barriers" to transfer which had developed.

- Clearance of redemption premia on (PWLB loans only) as well as overhanging debt on low value transfers.
- Exploration of ways to fund negatively valued transfers, although PSA Plus appeared to rule out central grant funding the ODPM announced that they have a central fund in the region of £140m annually for such negative transfers.
- Partial debt clearance for partial transfer in order to ensure the capital receipt from any subsequent whole stock transfer is as far as possible available for the authority.
- Some criticisms acknowledged of value for money on set up costs and the use of the capital receipt following transfer, with a commitment to find ways to measure value for money at the local as well as national level.
- Relaxation of the upper limit of 12,000 properties for individual RSLs.
- A reaffirmation of the commitment to seeking landlord choice in the transfer process.

Whilst the policy changes on stock transfer are primarily aimed at providing transfer as a real financial alternative in large stock, urban and low value areas (where there would normally be a low or negative transfer valuation).

The message about the need to secure stock transfers in general is clear.

There is also a clear belief running through the PSA Plus Review that stock transfers deliver service improvements, or at least tenants need to understand the “service dimension” when they are consulted on the options. Given the previous emphasis on transfer being primarily about increasing investment and going beyond the Decent Homes Standard, this emphasis is significant. The potential for service development and improvement following a stock transfer therefore requires detailed investigation.

Whilst ballot results early in 2003 continued to be mixed with “no votes” at Stockport and Nuneaton & Bedworth, over 20 councils expressed interest in April 2003 to join the current Disposals Programme covering 123,000 properties. The majority of those, which have balloted, have received positive results although there were two “no votes” at Stroud and Islington late last year. This number is significant given the policy uncertainties which have been prevalent within the last year or two and demonstrates a continued willingness of councils to prefer transfer as the key option bringing additional revenue and capital financial resources.

The Guidance for stock transfer issues in October 2004 highlighted a number of changes to the process. The major changes are as follows:

- Where an authority proposes to transfer its stock to a stand alone organisation then the authority will be required to demonstrate that it has worked with tenants to explore the scope for working with existing RSLs.

- To look at the possible valuation of stock over a 30 to 50-year period with greater consideration given to the discount rates used. (Note in this report a 30 year valuation has been used)

2.6 Housing Finance Reform

The following summarises the key changes being implemented for the future of housing finance. Many of these proposals are contained in the Local Government Act, which was passed in September 2003. Others have been out to consultation and are the subject of very recent guidance and the new Capital Accounting Regulations of December 2003. Together, they add up to a near complete overhaul of the system with no aspect left unaffected beyond April 2004.

1. ***Introduction of Prudential Borrowing System***: from April 2004, HRA capital borrowing will be on the new basis of prudential indicators. Essentially, revenue funding for debt repayment will come from the HRA (within the current subsidy constraints) although it is expected that some form of government support for existing debt charges will still be part of the system, particularly in the short term. The key issue will be whether revenue freedom can be identified which could genuinely increase the amount of capital resources available, especially given the Government’s statement in the PSA Plus Review that “no additional resources will be available to retention-only authorities”.

   It should also be noted that the form of additional resources under an ALMO is affected by these developments. This does not mean that an ALMO can borrow but the Council can borrow on behalf of the ALMO through the HRA.

2. ***Abolition of Minimum Revenue Provision and Resource Accounting***: the Government has abolished the need for councils to set aside amounts to repay HRA debt from April 2004. Whilst this does not affect spending power on a day-

Housing Quality Network Services
Tel: 01723 350022 Fax: 01723 350888
E-mail: hqn@hfta.co.uk Website: http://www.hqnetwork.org.uk.

to-day basis, proposals to extend the use of Major Repairs Allowance to allow the repayment of debt might.

Effectively, there is no longer the need to repay housing debt and this will be reflected in a subsidy system which all but "freezes" the level of government supported debt charges in time from April 2004. Debt repayment will therefore be voluntary, either utilising "spare" revenue resources within the HRA or resources from the MRA. The prospect of flexibility in Treasury Management terms is potentially enhanced as well as possible variations in the way Councils fund their HRA capital programmes in the future. In effect, the current combination of MRA and borrowing approvals could be replaced by the availability of MRA, limited government support, and new borrowing financed from the HRA (if headroom can be created).

3. ***Recalculation of subsidy allowances***: Management and Maintenance Allowances have been re-based with effect from 2004/05 following extensive research into their levels undertaken by the Building Research Establishment. Through consultation and draft determinations, the final determination for 2004/05 and 2005/06 subsidy highlights a generally positive picture for Stevenage with an increase in Maintenance Allowance and a lower, but still above inflation, increase for the Management Allowance. The ongoing sensitivity of forecasts to changes in housing subsidy allowances is set out below.

4. ***Freedoms and flexibilities***: consultation on the development of a debt restructuring solution for 3* ALMOs was due to take place during late 2003 but it is not expected that this could be introduced before April 2006. The potential to borrow against asset values outside of the constraints of the current housing subsidy regime is offered, placing these organisations in a "self financing, quasi RSL" financial position able to retain their own rent income following a one off restructure of their finances.

5. ***Regionalisation***: A key aspect of the investment agenda for new homes is the move towards a Regional Housing Pot distributed by a Regional Housing Board through a Regional Housing Strategy. The first draft Regional Housing Strategies were published in July 2003. Investment resources currently covered by the Housing Corporation's Approved Development Programme and Local Authority HIP allocations are both covered by the regional pots. Although it was intended that existing patterns of allocation would be maintained to 2006 (at a minimum level of 70%), the regional picture differs across the country.

   Resource allocations for capital investment over and above useable Right to Buy receipts and the Major Repairs Allowance are therefore being taken out of direct local authority control. This is consistent with the Prudential System for borrowing. The precise mechanism for Government support for housing capital expenditure in the long term future has yet to be formally determined following consultation in the autumn of 2003 which set out options for direct capital grant funding and revenue support for debt charges. Whatever the form, resources will be allocated by Regional Housing Boards. It is clear that the Government wishes to move towards grant funding only as this is more consistent with the Prudential System; however in the short term, a form of borrowing support has been introduced called "Supported Capital Expenditure" to run from 1st April 2004 at least until March 2006.

Housing Quality Network Services
Tel: 01723 350022 Fax: 01723 350888
E-mail: hqn@hfta.co.uk Website: http://www.hqnetwork.org.uk.

These changes impact upon the future financial prospects for retention, ALMO and PFI. Our analysis below starts with the system as it currently has been put in place although some of the uncertainties are subject to sensitivity analysis.

2.7 Spending Review 2004

The Comprehensive Spending Review was reported in July 2004. The plans announced will run through to 2008 and should provide a degree of predictability in developing forecasts for the options. The last 2 reviews have been generally positive for ODPM, housing and regeneration with national boosts for spending in all of the key areas, including real increases in the amount of housing subsidy available for local authorities with stock.

The main points to come out of the review for housing were as follows:-

- 3.3% growth a year in real terms
- £430m for new social housing units and £300m for market renewal areas
- £835m to be found in efficiency savings across the social housing sector
- £150m extra for targeting low demand in the North and Midlands
- £180m for funding negative transfer values

3 Form of analysis

3.1 General

In appraising the options financially, consideration must be given to basic Government objectives flowing from the Communities Plan. Preferred options must:

- Be financially and technically feasible under current rules,
- Be fundable in the short, medium and long term,
- Be able to meet the M**inimum Standard (to deal with all decent homes failures)** for all stock by 31st December 2010,
- Demonstrate the extent to which a local standard (Baseline Standard) for stock and service investment is achievable and the extent to which tenants have been engaged in providing feedback on objectives and priorities for spending,
- Demonstrate the ways in which the Council's ability to meet wider housing and corporate objectives might be affected.

Where minimum standards can be met, the analysis focuses on the opportunities under each option to further meet the objectives and aspirations of tenants and residents.

3.2 Development of Standards

3.2.1 Stock Condition and Investment

A stock condition survey was undertaken during the winter 2004 / spring of 2005. The outputs represent the need to spend in the following key areas:

- The need to meet the minimum Decent Homes Standard for all stock by 2010

- General planned maintenance and renewal works over 30 years
- The need to carry out specialist works relating to non traditionally built properties and asbestos
- Ongoing recurrent, revenue funded, expenditure on cyclical maintenance and repair.
- Tenant's preferred improvements.
- The survey did not consider investment required in most non-dwelling assets as garages and shops are not held on the HRA.

Three standards have been developed.

The Base Standard:

This standard represents the baseline stock condition survey outputs and includes the aspirations identified by the tenants of Stevenage.

The Reduced Standard:

This standard is the stock condition survey outputs without the tenant aspirations included where they are not a requirement for investment identified by the surveyors. This standard is only used for the stock transfer calculations.

Minimum Standard:

The investment requirement to meet all decent homes criteria and to satisfy landlord and health and safety responsibilities is called the Minimum standard. Essential expenditure is required even though it falls outside of the narrowly defined Decent Homes Standard. This standard represents a sustainable investment strategy. Any investment below this level would not be sustainable in future years for the stock and the HRA.

4 Base financial analysis

4.1 General assumptions

We have prepared financial forecasts based on the continuation of the existing housing finance and subsidy regimes for retention, ALMO and PFI, and assumptions based on the most up to date information announced by the Government and the Council. The detailed assumptions are contained in appendix 2.

Revenue assumptions

In general, we have projected forward from 2005/06 budgets with a price base of 2005/06, excluding general inflation based on stock levels projected at 1st April 2005 (of 8,532 units including LSSO).

For retention and ALMO, rent restructuring results in average rent increases of 1.65% above inflation from April 2005 to April 2011 moving average rents from £63.74 (on a 52 week basis) in 2005/06 to £69.70 (at today's prices) at the end of the rent restructuring period in 2011/12. Right to Buys have been assumed at 114 in 2005/06 reducing by 5% a year, to 84 by 2010/11. From 2006/07 we have assumed 2% real increases in Management & Maintenance allowances to compensate for rent

Housing Quality Network Services
Tel: 01723 350022 Fax: 01723 350888
E-mail: hqn@hfta.co.uk Website: http://www.hqnetwork.org.uk.

restructuring at a national level. This is a critical assumption (see sensitivities below). The rent restructuring proposals in the ODPM consultation document have not been included in this appraisal as the proposals have been delayed for a year to allow further consultation. However, it is assumed that any negative impact of the changes to the formula will be at least compensated for through the proposed increase in management and maintenance allowances.

For stock transfer, rent restructuring would mean that rents would increase at an average 1.19% above inflation each year to 2011/12 giving an average rent of £67.78 (at today's prices) by that year. It should be noted that the formulae for RSLs and local authorities are to be merged and the 2011/12 targets brought together. Assumptions specific to stock transfer include the need to pay VAT on external contractor work and an increase in management costs to reflect the "disaggregation" of the service from the rest of the Council.

Capital Expenditure assumptions

The base "need to spend" is that from the **Stock Condition Survey**. The baseline investment needs include an allowance for fees at 8% and a reduction in raw profiles to reflect Right to Buy sales for the retention and ALMO options. The total adjusted investment profile on units at 1st April 2005 are £101.4m to 2010/11, £133.5m to 2013/14, £219.8m over 20 years and £300.4m over 30 years. The unadjusted profile is shown in Appendix 1.

The **Minimum Standard requirements** are estimated at £74.0m to 2010/11, £100.8m to 2013/14, £178.5m over 20 years and £252.5m over 30 years.

Capital resources

We have assumed that the level of capital resources for the HRA capital programme will be the Major Repairs Allowance, Revenue Contributions from the Supporting people windfall and proposed usage of Right to Buy Sales receipts as shown in the Council's Capital Strategy.

Under retention and ALMO, the Prudential System could affect the level of capital resources able to be raised to finance investment having both a "capital" and "revenue" impact. This is also addressed below. Under stock transfer, capital works are funded from within the valuation, i.e. increased programmes reduce the value of the stock and reduced programmes increase the valuation of the stock.

4.2 Retention

4.2.1 Base forecast

The base retention forecast on these assumptions is summarised in the charts below. Detailed tables setting out the revenue and capital forecasts are included at appendix 3.

Chart 4.1: 10 year revenue forecast from 2005/06

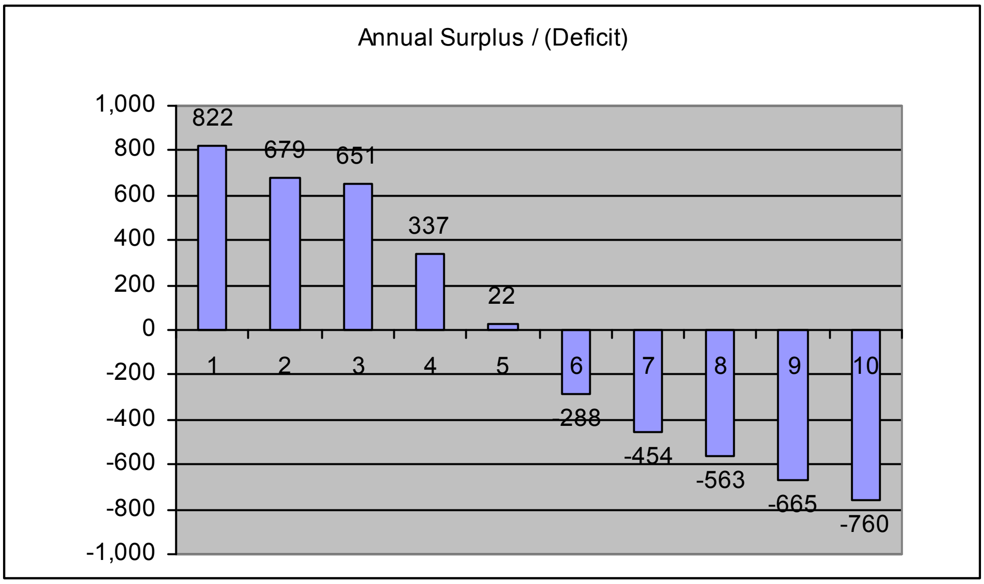
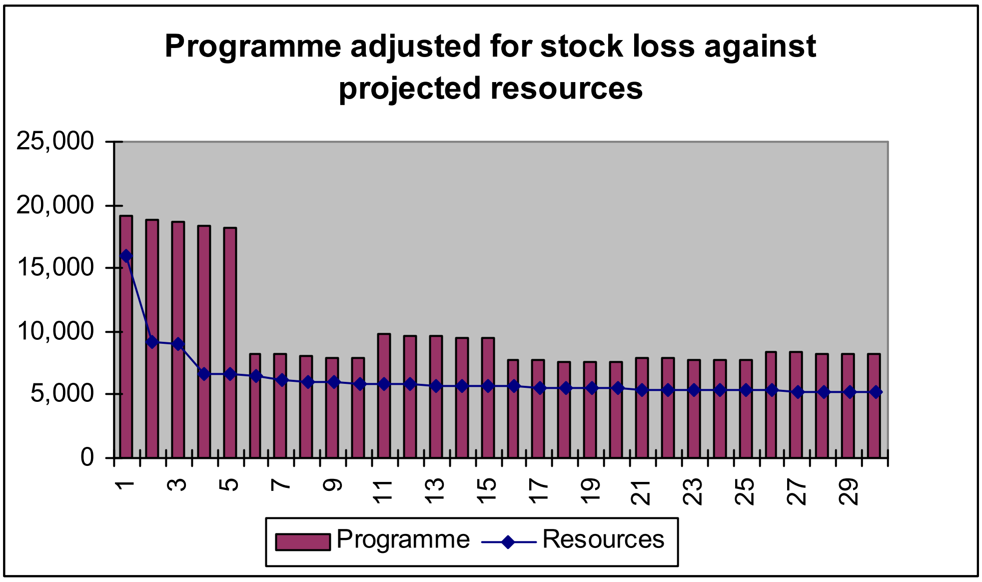


Chart 4.2: Capital profiles and resources 2005-2035



4.2.2 Notes / commentary

- The forecast revenue position generates annual surpluses/deficits before Revenue Contributions to Capital Outlay (RCCO) to illustrate revenue resources available at the current level of service spending.

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E-mail: hqn@hfta.co.uk Website: http://www.hqnetwork.org.uk.

- The in-year position of surpluses decline as the effect of right to buy sales reduces resources.
- The HRA is therefore forecast to make in year surpluses until 2009/10 and working balances would remain in surplus until 2010/11 if the in year surpluses are not utilised.
- Conversely, the stock investment profile is unfundable to 2010/11 with a shortfall estimated at £47.4m. The investment profile is cumulatively more and more unfundable throughout the 30-year period with an overall £112.4m shortfall on capital over 30 years.
- If the available surpluses on the HRA are used as revenue contributions to the capital investment programme the shortfall only reduces to £46.8m at 2010/11 and £111.8m over 30 years.
- The Council does have other capital resources available that could in theory be made available to the HRA. 100% use of such resources would increase resources by £16.8m over 6 years and £43.1m over 30 years. This would not enable the investment gap to be closed to 2010/11 or over the 30-year period. Such use of these resources would leave minimal resources for General Fund capital requirements such as private sector renewal and other corporate priorities.
- If the **Minimum Standard** is compared to the available resources the investment gap stands at £20.1m at 2010/11 and £64.4m over 30 years. The use of all other Council capital resources would enable the investment gap to be reduced to £3.3m by 2010/11 and £21.1m over 30 years. If the Council was to take up the option of using its HRA Supported Capital Expenditure (SCE) then £3.4m resources could be generated enabling the shortfall to 2010/11 to be funded. The use of this HRA SCE would have no effect on General Fund and minimal effect on the HRA.

4.2.3 Sensitivities

The above base forecast has been subjected to sensitivities to illustrate the following scenarios.

A. ***The impact of management and maintenance allowances –a 4% real increase from 2006/07:*** if the Government commits to real increases in management and maintenance allowances through to 2012 at 4% pa rather than 2% pa, the HRA would go further into surplus with a surplus of £1.1m in 2011/12 compared to a deficit of £454k in the base position. The HRA would remain in overall surplus until 2031/32.

B. ***The impact of management and maintenance allowances –no real increases from 2006/07:*** if the Government does not commit to real increases in management and maintenance allowances through to 2012 rather than 2% per annum, the HRA would have an in year deficit of £1.7m in 2011/12 and would go into overall deficit in 2009/10.

C. Right to Buy Sales Increase by 25%: the deficit on the account would become a deficit of £762k in 2011/12 compared to £454k.

D. Right to Buy Sales Decrease by 25%: there would be a deficit on the account of £205k in 2011/12.

The above analysis highlights the extreme sensitivity of the revenue forecast to medium term government subsidy policy. Should successive settlements put pressure on M&M allowances, the prognosis would be for increasing deficits on the HRA. More investment at the national level would create reduced deficits.

4.2.4 Summary

The base forecasts highlight challenges for the Council without additional resources for investment:

- The HRA is currently in surplus and the forecast suggests that the HRA will continue with surpluses until 2010/11.
- There is however a shortfall against the stock condition survey investment profile of £47.4m by 2010/11. Shortfalls rise over the 30-year period.
- The investment shortfall would not be deliverable even with the allocation of all available Council resources.
- The minimum standard has an investment shortfall of £20.1m to 2010/11 and £64.4m over 30 years. The investment gap to 2010/11 could be met through the use of all available Council capital resources and the use of Supported Capital Expenditure. However, the use of all Council resources would leave no funding for other Council capital schemes.

4.3 Prudential borrowing

From April 2004, councils are able to borrow according to their own set of Prudential Indicators. Under the system, government support for such borrowing will not be given and councils will need to ensure that repayments or the coverage of debt are affordable into the longer term. Existing debt (or measures of debt) together with limited continued government supported borrowing (Supported Capital Expenditure) in the short term continues to be covered in the subsidy calculation. It should be noted that there will still be a limit set on borrowing nationally for local government as a whole although the Government has yet to decide the precise mechanism for this.

Apart from the current debt position of the Council, the major constraint on the Council's ability to raise extra borrowing is the inability to raise rents above the target levels under rent restructuring. Raising income to fund new debt is therefore not an option.

The implementation of rent restructuring makes the scope for prudential borrowing in all HRAs across England subject, therefore, to the ability to "free up" existing revenue funds in order to finance repayments. In essence, this means spending less on management and repairs to free up revenue.

As the HRA is generating only a small level of annual surpluses in the short term with these being replaced with in year deficits from 2011/12 there is minimal scope for prudential borrowing. If HRA expenditure is liked to property numbers in the future then limited borrowing could be possible but would require a reduction in all services provided.

4.4 Arms Length Management Organisation (ALMO)

4.4.1 Introduction

Stevenage shares a typical profile with authorities which have adopted an ALMO strategy where:

- The M**inimum Standard** is not able be met from MRA by 2010/11, and
- There is an absolute shortfall of investment resources against the **Baseline Standard** expenditure profiles, both to 2010, over 10 years and rising in the longer term.

Before advancing any bid, any council would need to be satisfied that there were realistic prospects for achieving a 2* rating for all landlord services within two years.

4.4.2 An ALMO bid?

The combination of factors where there is an overall investment shortfall and where the Decent Homes Standard cannot be reached with existing resources has been used as the basis for a credible bid for additional ALMO resources.

The Community Housing Task Force do wish to see the Council develop an approach, which is able to meet the aspirations of tenants through the "Stevenage standard." In these circumstances, it may be possible to develop an ALMO bid in excess of the decent homes minimum but not necessarily up to that indicted by the stock condition survey. On the assumption that an ALMO bid is made at least up to the minimum standard then a minimum bid of at least £20.1m could be made. However, it is unlikely that such a bid would reach the Baseline Standard that has been developed so far.

Under an ALMO, the Council could bid for additional regeneration resources (5%) not linked to a bid based on Decent Homes, for example to remodel its unpopular sheltered bedsits or other comparatively "unsustainable" properties.

4.4.3 Set up costs of ALMO

Setting up costs have varied from less than £200,000 in the smaller ALMO authorities to over £600,000 in one metropolitan area. Costs may typically vary depending upon the level of consultation, whether a ballot is held, the number of sub-boards within the ALMO etc.

A key advantage many ALMOs have reported to date is the ability to renegotiate service agreements with other parts of the Council to achieve efficiencies, thereby enhancing the opportunities to achieve a balanced HRA into the medium term.

4.4.4 Impact on the General Fund of ALMO

Whilst there are some potential impacts resulting from the ALMO, in time, beginning to source services independently from the Council, the short-term implications on the General Fund have generally been found to be marginal. This is primarily as a result of the continuation of the HRA, which allows a longer-term financial strategy for dealing with recharges to be developed. Nonetheless, the creation of an ALMO has tended to increase transparency of the recharges between General Fund and HRA and highlight any anomalies, which exist. A council wishing to pursue ALMO is advised to review such issues at an early stage.

Currently Stevenage is debt free with a negative measure of debt on the HRA of £32m and a positive measure on General Fund debt of £24m giving an overall negative measure of debt of £8m. Currently ALMO capital investment is funded though additional supported capital expenditure. If this remains to be the case then the Council would go back into debt to the amount of £12m plus. The result of this should be neutral on the Council and not create an issue for the General Fund. However, the formula used to calculate the Minimum Revenue Provision (MRP) on the debt figure for the General Fund does not have the desired effect that was intended by Government and results in a cost to General Fund of up to £1m by 2010/11. ODPM have been consulted and have suggested that this should not be the case and if requested will amend the formula to ensure that no such costs fall on to General fund.

4.4.5 VAT - ALMO

The arrangements in place within agreements in operation at the ALMOs already live are VAT efficient and with no VAT consequence at all.

4.5 Private Finance Initiative (PFI)

A PFI scheme typically applies to high cost, high investment need, and/or low demand stock in urban areas. The need for comparability with stock transfer and other forms of financing tends to result in PFI schemes working when other forms of private finance might not, for example in areas of negative value for stock transfer or where there is a high element of "spend to save" in any redevelopment plans.

The main factors for a PFI to be worth considering are:

- Very high cost of investment
- Need for regeneration and wider investment in the area
- Need for some redevelopment
- Schemes sizes of between 1,000 and 3,000 properties
- The potential impact on the remaining HRA of the PFI scheme.

In Stevenage whilst there are some properties falling into the categories generally covered, particularly some of the non-traditionally built PRC stock, the numbers are insufficient to secure affordability for Government, the PFI consortium and the remaining HRA. The up front costs associated with developing a PFI scheme are massive (up to £1m) and would not be affordable to Stevenage Council. Given the overall size of the Council's stock, and the fact that it is reducing on an ongoing basis, we do not believe that a PFI scheme is either feasible or desirable in Stevenage.

4.6 Stock Transfer

4.6.1 Base Valuation

The value of the stock for stock transfer purposes is based on a 30-year cashflow forecast called the "Tenanted Market Value". The value seeks to capture the value to

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Tel: 01723 350022 Fax: 01723 350888
E-mail: hqn@hfta.co.uk Website: http://www.hqnetwork.org.uk.

a landlord of future rents less future costs when sale of the properties on the open market is not possible. Future rents reflect rent restructuring. Future costs reflect current day-to-day management and repairs costs and the Industry Standard capital expenditure profile. It is important to note that the assumptions made affect the valuation: more cost leads to a lower valuation.

An illustrative valuation of the stock (based on 1st April 2005 and at 2005/06 prices) is **£15.63m (£1,832 per unit)** based on the Baseline Standard. Appendix 4 shows the forecast.

4.6.2 Set up costs –LSVT

These are generally significant in a stock transfer reflecting the transfer of a large service from one organisation to another completely new organisation. Estimates are around £2m and Appendix 5 shows some illustrative costs. However these could vary depending on what approach was taken to a transfer. The costs identified relate to a transfer to an existing group structure. Should a ballot fail, pre-ballot costs (estimated at a minimum £480k) would be charged to the General Fund with the exception of statutory consultation costs, which would be charged to the HRA. These latter are generally limited to less than £50,000.

Loan arrangement fees represent a significant set up cost arising from the arrangement of initial financing for the new RSL. On peak borrowing of approximately £50-60 m, we have estimated fees of £1m.

This results in a net receipt after set up costs of £12.6m for the Baseline Standard, and a total net receipt £10.1m, after paying the Government's 20% Levy.

4.6.3 Funding of the Transfer to the Baseline Standard

As the Council is debt free and has an overall negative measure of debt on the HRA there will be no debt clearance costs associated with transfer.

Table 4.3: The total funding requirement

Description	£'000's	£'000's
Gross receipt		15,630
Set up costs	2,000	
Loan arrangement	1,000	3,000
Net after set up		12,630
SCFR 2006/07	0	
Proj. SCFR 2007/08	0	
Ext debt	0	
Premiums	0	
Debt clearance		0
Net after debt		12,630
Non-leviable assets	0	
Levy	20%	2,526
Net Receipt		10,104

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Tel: 01723 350022 Fax: 01723 350888
E-mail: hqn@hfta.co.uk Website: http://www.hqnetwork.org.uk.

4.6.4 Impact on the General Fund of LSVT

The revenue impact on the General Fund is shown in Table 4.4 below:

Table 4.4: The possible impact on General Fund

£000s	**2007/08**	**2008/09**	**2009/10**	**2010/11**
Costs				
Residual Support Costs (Worst Case Scenario)	2,300	1,750	1,200	1,000
Loss of Transitional Negative Subsidy	1,100	730	370	0
Total Costs	**3,400**	**2,480**	**1,570**	**1,000**
Benefits				
Interest Income Retained on General Fund	(1,400)	(1,400)	(1,400)	(1,400)
Interest earned on LSVT Receipt	(500)	(500)	(500)	(500)
Interest on Preserved Right to Buy Receipts	0	(75)	(150)	(225)
HRA Balance	(500)	0	0	0
Total Benefits	**(2,400)**	**(1,975)**	**(2,050)**	**(2,125)**
Net (Benefit) / Cost	**1,000**	**505**	**(480)**	**(1,125)**

- Residual costs if the HRA is closed: total support service recharges are around £2.3m in 2005/06. In practice, some staff in support areas may transfer to the Housing Association. It has usually proved possible to reduce the support service recharges to about a half within 3 years through natural wastage etc. Should redundancy become a factor, one off costs would be payable. Any costs that cannot be lost will fall on the General Fund. The estimates for residual costs are, at this stage, purely indicative. If the Council were to pursue a LSVT detailed negotiations would have to be entered into regarding the form of the Transfer.
- Negative Subsidy Transitional Relief to General Fund would cease at the point of transfer.
- The current transfer of £1.4m of interest receipts to the HRA would remain with the General Fund after transfer.
- If the LSVT receipt and any Right to Buy receipts retained by the Council were invested whilst needed interest income could be generated to assist in off-setting the negative effect of residual costs.

- Balances on the HRA: would revert to the General Fund on transfer. The HRA is required to maintain a minimum revenue balance of £500k, although the position on rent arrears and bad debt provision would have to be considered at the point of transfer. The Major Repairs Reserve (MRR) would be repayable through subsidy, although the Council would seek to ensure that all MRR resources had been utilised at the point of transfer.
- Mortgage interest: would revert to the General Fund though this is small at £32k per annum.
- VAT Partial Exemption: Transfer could put the Council's Partial Exemption limit at risk with a potential cost of up to £160k, although the Council could consider actions to seek to mitigate this impact.

In the worse case scenario that support costs cannot be reduced in year 1 the net receipt and other income is not sufficient to generate enough income to cover the net £3.4m of residual costs. However, after 2 years it is estimated that the net impact on the General Fund would switch to become positive. If prior to transfer and depending on which posts transfer to the new RSL, costs could be reduced, then the net effect on the General Fund could possibly be reduced to a more cost neutral position on transfer.

The Council would lose its supply of useable capital receipts but could receive a share of any preserved right to buy receipts posts transfer. This would have to be negotiated with the RSL at the time of transfer. Until 2010/11 the amounts received could be similar if the receipts are shared equally with the new RSL partner but over 30 years there will be at least 50% less capital resources available through preserved right to buy receipts than though the projected current sales.

4.6.5 Transfer Valuation using the Reduced Standard

If the calculation is undertaken using the Reduced Standard Stock Condition (i.e. with most tenant aspirations removed) then the gross valuation becomes £32.5m with a useable receipt of £23.6m. A receipt of this amount would generate an additional £600k in interest income, reducing any potential General Fund costs on transfer.

4.6.6 Use of Receipt in the longer term

Once the residual support costs have been minimised on General Fund the net receipt and preserved Right to Buy sales are available for the Council to use. Stevenage Council would need to agree with ODPM on how such receipts would be used but it is common for the net receipt to be used to grant fund the building of new affordable homes for rent.

4.6.7 Summary of LSVT

Stock transfer is therefore financially viable. Transfer will enable the Baseline Standard (includes tenant aspirations) to be fully funded and with day-to-day spending at 2005/06 maintained throughout 30 years.

5 Conclusions

1. PFI-There is little or no prospect of a PFI scheme applying to the council housing stock in Stevenage.
2. Retention - The short to medium-term prospects for the HRA are positive throughout the remainder of the rent-restructuring period. This allows some level of flexibility in how resources are deployed, either for investment in the stock or service delivery or both.
3. Retention - Conversely there are significant levels of shortfall against the S**tock Condition Survey by** 2010/11. More capital resources are needed to support a Retention Strategy at this level of investment.
4. Retention – if the Council and tenants adopt the **Minimum Standard**, then the investment profile to 2010/11 is only affordable though the use of MRA, Supported Capital Expenditure and all other Council capital resources beyond those already planned to be used. This would have severe implications for the General Fund capital programme.
5. ALMO - A bid for additional resources under Arms Length Management could be made with a bid of at least £20.1m being possible with the a level of funding above this amount being a possibility. Stevenage will need to ensure that ODPM alters the formula that calculates how the cost of MRP is applied to General Fund.
6. Stock transfer is financially feasible generating a net receipt of £10.1m. However the Council would need to ensure that the residual costs of support services are reduced as soon as is possible to minimise the impact on General Fund.

6 Recommendations

The viable options would appear at this stage to be:

- Retention through the adoption of the Minimum Standard, the use of Supported Capital Expenditure and all other Council Capital Resources.
- ALMO
- Stock Transfer.