

A future for ALMOs – within local communities

A report by the National Federation of ALMOs

The National Federation of ALMOs

The National Federation of ALMOs (NFA) is the representative trade body for Arms Length Management Organisations (ALMOs). Its primary objective is to promote the ALMO option and assist existing and prospective ALMOs to operate effectively. The NFA aims to establish a vibrant and innovative independent ALMO sector that will provide decent homes, raise standards across the public rented housing sector, achieve excellence in service provision, promote tenant empowerment and best practice in the ALMO sector, and help to deliver broader national and local policy priorities.

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The report provides advice and suggestions for ALMOs and councils; however, circumstances for each ALMO and council will be different and they are recommended to seek their own tax, financial and legal advice in taking forward any of the report's proposals.

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Contents

Foreword	4
Introduction	5
1 Summary and recommendations	7
2 What can be done within current ALMO structures?	12
3 How can an ALMO find new financial resources?	21
4 What alternatives are there for new ALMO structures?	35
5 How community ownership could refresh ALMOs	49

Foreword

I have said many times how pleased I am with the job ALMOs have done. But I also feel we have really only done half the job. Yes – through the ALMO Decent Homes Programme our homes are much improved. And yes – the Audit Commission inspection results have confirmed what we as tenants already knew that in an ALMO the quality of housing management is better. And yes – we also know that tenants are more involved and that they are also more satisfied than in many other types of housing.

But tenants of ALMOs right across the country are consistently asking these questions:

'When can we improve our estates and neighbourhoods to the same standard as our homes?' and

'Can we afford to keep looking after our improved homes in the long run?'

We already knew that stock transfer could provide long-term financial stability but this would be at the expense of losing our council tenancies, something that remains at the heart of the ALMO model. This report seeks to find answers to the questions above. It looks at some of the opportunities and some of the difficulties that will prevent us achieving the full potential of the ALMO model – which has already delivered so well for council tenants in many parts of the country.

The report makes a number of recommendations for the government. But perhaps the most important and the most urgent is that it reaches an outcome from the review of council housing finance that will give us the resources and the freedoms we need for a stable and well-funded future.

But whatever strategy an ALMO plans for its future, it will be a local solution decided locally by tenants and the councils that we work with.

Dennis Rees OBE

Chair of the National Federation of ALMOs

Introduction

ALMOs have been a great success. Since the first ALMOs began operations just over six years ago, they have grown in number to 69 organisations now managing over one million council homes, or more than half the remaining council stock. In total, they have invested over £4 billion, using this investment to bring over 250,000 council homes up to the Decent Homes Standard in this short period. Almost without exception, these programmes have completed their work on time, within budget and to high levels of customer satisfaction.

ALMOs have improved services as well. At the end of March 2009 there were 20 ALMOs with three stars from the Audit Commission, which compares with four among housing associations (over the same period from 2004, and with a much larger number of HA inspections). No less than 30 ALMOs have a two-star rating.

One of the reasons for this has been the commitment from all ALMOs to involve tenants much more closely in their work than was the case before ALMOs were established. This starts at board level, but extends down to many aspects of service delivery. And this is reflected too in higher proportions of tenants who say they are 'satisfied' or 'very satisfied' with ALMO services than is the case for either conventional council housing or for housing associations.

ALMOs are locally rooted, and are excellent partners with their councils and with wider agencies in their Local Strategic Partnerships, normally being based on the same geographical area. One of the strengths of the ALMO model is the close working between each ALMO and its local authority. There are also numerous examples of ALMOs improving the wider quality of life of communities they serve by joint working with others, such as the police, children's services and health care.

Yet at the same time, ALMOs are now at a crossroads. Those who have completed the Decent Homes Programme are ambitious to build on this success and are asking... what next? So far, there has been no clear offer from government which would provide an attractive, sustainable future for ALMOs and the community services they provide and wish to extend.

What would ALMOs now do, if they were given such an opportunity?

ALMOs are aware that, however beneficial the Decent Homes Programme, in many cases it didn't go far enough. For example, it didn't include measures to make the common areas of tower blocks secure and attractive. Nor did it sufficiently address the poor energy efficiency of many homes. But current sources of funding will neither address these needs, nor enable the standards achieved through the Decent Homes Programme to be sustained into the future.

Many ALMOs also see the need to address serious problems in the wider communities they serve, such as making whole estates (not just the houses) into attractive places to live, and supporting the further development of those communities – including empowering them to be more involved in service provision.

Several ALMOs already own property and are bidding for funding from the Homes and Communities Agency (HCA) to build new homes to meet housing need. Others are looking to become key partners in regeneration schemes on their estates and in private sector areas. Many are providing additional services for partners and other landlords. However, whilst very welcome, these developments only add marginally to each ALMO's capacity and do not in themselves create a sustainable, long-term future for the ALMO sector.

For this reason, some ALMOs are looking together with their local authorities at the future of council housing in their areas, and have started new stock option appraisals. As a result, a limited number of ALMO authorities are already considering large scale voluntary transfer as the only option currently available that will meet their funding needs for the future.

However, most authorities and their tenants would almost certainly prefer to keep their ALMOs, and to build on their success to date. Some councils, and more importantly many tenants groups, will not contemplate transferring their stock to a housing association, except perhaps as a very last resort. As Dennis Rees, the tenant Chair of the NFA, has put it:

'ALMOs have "put tenants in charge", and have been for tenants "the best thing since sliced bread".'

The National Federation of ALMOs has produced this paper to contribute to the debate on the future of council housing and ALMOs. It looks in some detail at options which would enable ALMOs to continue to build on what they have achieved so far, working jointly with their local authorities. In part it anticipates the outcome of the government's own review of the Housing Revenue Account system, but in part it considers options that could be pursued regardless of that outcome.

As ALMOs and councils consider their options for the future, with new sources of funding and developing new ways of working, they find that there are challenges in stretching the ALMO model so that it is fit for these new purposes. This paper brings together the experience of several ALMOs and the thinking of expert advisers, and considers some of the legal, financial and community involvement considerations faced by any ALMO as they consider new ways of working – whether within the current policy environment or in the changed context expected as the outcome of the review of the HRA system.

1 Summary and recommendations

1 Context

Some local authorities with ALMOs are already contemplating large scale voluntary transfer to enable their housing service and housing stock to be financially viable into the future. However, many ALMO authorities would prefer to retain their ALMOs, because of the service improvements they have delivered and their proven commitment to engaging tenants. This report considers options that might be pursued, which retain and build on the successful ALMO model.

The report has been prepared against the background of the government's HRA review, due to report this year. In part, the options suggested anticipate this review, but others could be implemented within the existing finance system for council housing. The NFA wants to stress that the relationship between each ALMO and its council is an individual one, so the report is aimed at facilitating local discussions about the future of ALMOs, in the best interests of tenants and of the local authority area as a whole.

2 What can be done within current ALMO structures?

With the completion of the Decent Homes Programme, many ALMOs are considering a number of different new activities, using their existing organisational structures. The potential activities and the legal issues that arise are these (see chapter 2 for details).

Delivering new services for the council

What new services are possible will depend on the ALMO's objects (set out in its Memorandum of Association) and its Management Agreement with the council. Normally, there is considerable scope to provide new services. In some cases, a new consent may be needed from the Secretary of State.

Providing services for other organisations

This raises similar considerations to the provision of new services to the council, but if this element becomes significant the ALMO might need to consider setting up a subsidiary (to minimise the risk of any need to retender the Management Agreement).

Property ownership and new build

An ALMO can acquire a legal interest in properties, and this possibility is covered by the Model Memorandum. Any tenancies awarded by the ALMO will be assured or assured shorthold tenancies. There are a number of tax issues which the ALMO needs to consider.

Participating in wider regeneration activities

The key issue is deciding what these activities are. When identified as (for example) providing services, owning property or creating new structures, guidance on each can be found in different parts of this report.

Legal constraints within existing structures

Whatever the change contemplated, the main constraints affecting the ALMO are to do with:

- its constitution;
- the Management Agreement with the council; and
- European procurement rules.

Chapter 2 summarises how ALMOs can change the services they offer while staying within these restrictions. ALMOs will also of course have to examine the financial implications of new activities, including tax. The chapter points out some of these, but also advises where it is important to get detailed advice, especially on tax.

3 How can an ALMO find new financial resources?

New areas of activity for ALMOs

The likely issues that ALMOs will want to tackle, and the possible ways of financing them, are these. Detailed issues are considered in chapter 3.

- *New build and acquiring stock.* There are advantages to the ALMO (rather than the council) being the owner of rented housing stock, because it is then outside the HRA and not subject to right to buy. However, some kind of subsidy will be required, such as Social Housing Grant, free land or borrowing from the council at the low rates which it can offer. Alternatively, the ALMO might want to partner with a housing association which develops and owns the property, with the ALMO managing it. Advantages and disadvantages to either approach are considered.
- *Regeneration activities.* Regeneration in the form of remodelling estates and replacing unsuitable stock might be possible if land can be provided and houses built for sale, to subsidise the regeneration. There are potential sources of EU finance; at the same time, the ALMO needs to be careful about taking on too much development risk.
- *Further investment in existing stock.* This area of activity is almost impossible on any scale, given the lack of subsidy for work beyond the Decent Homes Standard. Limited work may be feasible using spare approvals of supported capital expenditure, through section 106 finance or by prudential borrowing. However, significant investment must await potential changes through the government's current review of council housing finance.
- *Assistance for owners in the private sector.* There are various ways in which a local authority might want to assist private owners, especially (in the present market conditions) through mortgage lending or mortgage rescue schemes. ALMOs might have a role to play in these, but most likely as an agent of or partner with the council (rather than as a lender in their own right). Another potential role is in working with the council to bring poorly managed or empty property, sold under the right to buy, back into rented stock.

ALMO borrowing and government rules

The earlier report, *ALMOs – A new future for council housing*, made the case for radical reform of local authority and ALMO finances, which now depends on the outcome of the ongoing review of council housing finance. Chapter 3 of the report updates this assessment by saying how a changed borrowing regime and self-financing arrangements for council housing might work.

It then looks at how ALMO borrowing might take place outside government controls, if the ALMO could show that it were not majority-owned or controlled by the public sector. The most likely option would be for control to be in the hands of tenants, as with a TMO. Although there are issues about the application of EU procurement rules to the management contract, there is also a clear advantage to the council in having the ALMO outside the public sector, in the event of the council housing becoming self-financing, as the ALMO's borrowing (financed from the retained rental income) would not count as public sector borrowing.

The possibility of borrowing by the ALMO has considerable implications both for the council and for potential lenders, which chapter 3 describes.

Other options that might be considered

Chapter 3 considers three other options for raising finance without undertaking a freehold stock transfer:

- a leasehold transfer;
- a direct role for the ALMO in PFI; and
- acquisition of former RTB or of relet stock.

4 What alternatives are there for new ALMO structures?

ALMOs are considering new structures that would enable them to widen their activities. Chapter 4 considers the alternatives and the legal issues to be taken into account.

Types of new structure

These include:

- *Structures where there is an organisation with a separate legal personality* – such as a company limited by shares, limited liability partnership, company limited by guarantee or an industrial and provident society.
- *Structures where a separate organisation is created, but with no legal personality* – such as partnerships, limited partnerships, trusts and unincorporated associations.
- *Joint venture agreements* – a contract between individual organisations involved in a project.

Chapter 4 sets out the advantages and disadvantages, enabling an ALMO to identify the most appropriate form of new structure for different new activities.

Is charitable status appropriate?

There are advantages to charitable status in terms of funding, tax, etc. At the same time, restrictions apply. Chapter 4 sets out the considerations and will enable an ALMO to decide whether (for example) a charitable subsidiary would be a useful structure to adopt.

EU procurement rules

ALMOs have to be aware of the implications of EU rules on procurement and of developing case law on the issue, such as the Teckal case. This is unlikely to be a constraint on conventional ALMO activities, but may be a significant consideration if the ALMO's role undergoes a major change.

Particular structures

Certain structures are likely to be particularly attractive options for ALMOs. They can take different legal forms. Chapter 4 considers in more detail four types of structure, their potential relevance and the implications (including financial implications). They are:

- subsidiaries;
- joint ventures;
- local housing companies; and
- local asset-backed vehicles.

5 How community ownership could refresh ALMOs

Greater tenant and community involvement in the management and even ownership of ALMOs is a change that might be considered both in its own right and as a way of adapting the ALMO's status whilst preserving its current style of working. Empowering tenants and communities is also government policy, and is likely to be an aim which is rigorously pursued by the Tenant Services Authority.

Chapter 5 builds on the legal considerations in chapter 4 by looking at the possibilities for and implications of greater tenant and community involvement through six alternative models or approaches:

- *Tenant Management Organisations* – which provided an established structural form for tenant ownership, already found in one ALMO.
- *Housing co-operatives* – which can take different forms and might provide an option for part of a council's stock.
- *The Community Gateway Model* – which can be applied to an ALMO as well as to stock transfer, and where there are already a number of practical examples.

- *Community Land Trusts* – which provide a community-based, non-profit structure for owning land and buildings in perpetuity.
- *Development trusts* – which would have to be independent of the local authority, but may not offer advantages to councils compared with other models.
- *Community associations* – which are a form of joint venture involving tenants and the community (but which are more likely to be attractive as a potential recipient of ALMO services than as a structure for the ALMO itself).

The first four of these are considered in more detail as they offer the more likely possibilities. Chapter 5 also looks at the policy opportunities for taking forward community ownership.

6 Recommendations

As a result of the work carried out for this report, the NFA wants to address the following recommendations to the government, to the HCA and to local authorities and the LGA.

Recommendations to government (CLG and Treasury)

1. That the current review of council housing finance be concluded and published as quickly as possible.
2. That the review be based on the recognition that the current HRA system is no longer viable at national level because (a) it provides insufficient finance locally and this position will get worse not better, on current trends, (b) it is unacceptable to tenants, local authorities and ALMOs that rents are generating surpluses for the Exchequer and (c) any outcome must therefore lead to sufficient finance being available to councils and ALMOs to maintain the Decent Homes Standard and to provide an attractive housing stock and environment.
3. That consideration of the review focus on moving forward towards self-financed HRAs, with a timetable and steps for implementation.
4. That the government consider changing the classification of borrowing for council housing investment, recognising that council housing is a trading activity and that under European accounting conventions its borrowing need no longer count towards the main measure of general government debt.
5. That, in the interests of a fair market in housing management services and of rational housing management at neighbourhood level, the government reconsiders the way in which VAT is applied, and removes fiscal barriers to ALMOs taking on contracts to manage housing stock owned by housing associations.
6. That the tax rules which apply to ALMOs developing new housing on behalf of councils also be changed, so that an ALMO is at no fiscal disadvantage compared with the development being carried out by the local authority itself or by a housing association. This should include reviewing the rules relating to stamp duty land tax, corporation tax and VAT.
7. That government recognises the remarkable achievements of ALMOs since 2002, including the ways in which ALMO tenants have developed such a strong role in ALMO governance, and the strength of ALMOs in having good relationships with the local authorities that own them; that it therefore sets a target of *no later than the end of 2009* for providing viable financial options to local authorities to enable them to retain their ALMOs in the long term, without further recourse to stock transfer.

Recommendations to the HCA

8. That the HCA recognise that, among local authorities, those with ALMOs are in a particularly strong position to undertake new build and regeneration, as one third of ALMOs have already pre-qualified for the NAHP.
9. That the HCA reviews the arrangements for ALMOs and their local authorities to access Social Housing Grant, realigning the criteria to reflect ALMOs' status as part of the public sector and enabling ALMOs to access grant more quickly.

Recommendations to the LGA and to local authorities

10. That LGA and local authorities with ALMOs also recognise the achievements of ALMOs since 2002 and urge government to provide viable financial options to retain the ALMO model in the longer term, without stock transfer.
11. That local authorities consider how they can best work with their ALMOs to take advantage of opportunities currently available to build new housing through the NAHP.
12. That local authorities, ALMOs and tenants consider the different organisational options set out in this report, including opportunities for greater community control of ALMOs, so that ALMOs and local authorities continue to empower tenants and that ALMOs adapt to become long-term models for building and managing council housing.

2 What can be done within current ALMO structures?

1 Introduction

With the completion of the Decent Homes Programme for many ALMOs, and the potential implications of stock loss, ALMOs are considering a number of different activities to diversify their operations. These activities could include:

- delivering new services for the council;
- providing services (which could include housing management and maintenance) or consultancy and professional services for other organisations, either within or outside the council's area;
- property ownership and new build; and/or
- participating in wider regeneration activities.

This chapter looks at the legal scope which ALMOs have for extending their activities in these different ways within their existing structures. (Chapter 4 looks in the same way at potential new structures.)

As well as taking tax and VAT advice on the implications of any new activities, there are also constraints on an ALMO which it (and its local authority) must consider before extending its remit. The final section of the chapter outlines these constraints and how to address them.

Inevitably the chapter, and especially the final section, concentrates on the limitations rather than the opportunities. This is because, while this report encourages innovation, it is also important to bear in mind the pitfalls to be avoided.

2 Carrying out new activities for the council

There are numerous activities which ALMOs already carry out for councils, or might consider carrying out, that go beyond housing management. These can range from further activities relating to council housing (eg managing the HRA), to wider activities such as action to prevent homelessness or private sector renewal.

It was always envisaged that ALMO services to the council might extend beyond housing management: optional clause 3(7) of the Model Memorandum of Association¹ specifically provides for this, and is likely to have been incorporated in some form into each ALMO's constitution.

Procedure

If the ALMO wishes to provide these new services:

- It will need to ensure that the planned activities are within its objects, ie that the ALMO has included clause 3(7) from the Model Memorandum of Association (or something similar) in its constitution.
- If those activities include new housing management activities, where the ALMO will take decisions as the agent of the council, the Secretary of State's consent may need to be obtained under section 27 of the Housing Act 1985 (see below).
- An amendment or supplement will be needed to the Management Agreement to delegate the additional functions.

¹ References to the model documentation for ALMOs are to those in the 'documentation' section of the NFA website. These are: the Model Constitution, consisting of both a Model Memorandum of Association and Model Articles of Association; and the Model Agreement (between a council and an ALMO). References to the Model Agreement are to the current (revised) version. (The documentation is on the part of the website restricted to NFA members, and was prepared by Trowers and Hamblins.)

Section 27 consent

Consent is required for the delegation of housing management functions, which are defined widely in section 27 of the Housing Act 1985 as being:

'...functions conferred by any statutory provision and the powers and duties of the authority as holder of an estate or interest in the houses or land in question'.

Section 27 is often misunderstood. Specific consent is required only where the provision of the services that are delegated involves taking decisions as the agent of the council. If this is not the case, for example where the ALMO is simply delivering a service to the council (such as repairs), then there is no delegation of the function and specific consent is not required.

Section 27 consent could be obtained either via the original section 27 consent, if the additional services are within its scope, or by an additional consent (eg for new services that were not covered by the original one).

Implications

These activities will not breach the Management Agreement restriction on carrying out services for others (if clause 23.3 of the Model Management Agreement has been included) since this does not apply to carrying out other services for the council.

Similarly, there is no concern in relation to the Teckal argument (see later in this chapter), since the activities will be carried out for the council. This strengthens the second part of the 'Teckal test' that the majority of the activities *'...must be carried out in conjunction with the controlling council'*.

Finance

If the council is asking the ALMO to undertake other activities, the council will need to check whether those activities can be financed from the Housing Revenue Account (HRA) or whether the finance needs to come either from the General Fund or from another budget. This is an issue for the council rather than the ALMO.

If activities are to be financed from a budget other than the HRA, the council will need to consider whether there should be an apportionment of the budget for overheads between the HRA and the General Fund or other budget expenditure.

Since the ALMO is a separate organisation from the council and the HRA is a council account rather than an ALMO account, there is no difficulty (in legal terms) with using surpluses from either HRA or non-HRA activities as the ALMO wishes. Effectively the council is paying a price for the particular services to be delivered. Although that price is not calculated on the basis that it includes any element of surplus, if a surplus is made it will belong to the ALMO and not to the council.

In this context, it is helpful to explain clause 53 in the Model Management Agreement, which could easily be misunderstood. This clause applies where the ALMO carries out its activities so that the council receives an unbudgeted surplus on the HRA, for example through the voids rent loss being lower than anticipated or rent collection being higher than anticipated. In these circumstances the council must make that surplus available to the ALMO (through the management fee) unless the council requires those surpluses to meet its own commitments. The clause does not relate to surpluses made by the ALMO itself, and it is up to the ALMO (within its rules) as to how these are spent.

3 Providing services to others

The kinds of services an ALMO could provide to others range from consultancy and professional services to acting as a managing agent to manage another organisation's properties. The kinds of organisations to which the ALMO could provide services could be other social landlords or private landlords, or other parts of the public sector such as regeneration agencies. These could be within or outside the ALMO's area.

Procedure

As with all new activities, the ALMO will need to check that what is proposed furthers its objects and is within its powers. If not, then the objects or powers will need to be changed in order to allow the new activities. This is done using the procedure set out later in this chapter.

Where clause 23.3 of the Model Management Agreement has been included in the ALMO's Management Agreement, the ALMO will need to obtain the council's written consent to provide new services for other bodies.

The ALMO should consider all the things a prudent service provider should take into account before entering into any contract. These include:

- checking the legal powers of the service recipient and ensuring they have obtained all consents necessary for them to enter into the contract for service provision;
- carrying out financial checks on the service recipient;
- entering into a properly drafted legal contract, on which they have taken appropriate legal advice;
- ensuring they have all necessary permissions and regulatory approvals (including, for example, ensuring their and the service recipient's data protection notification covers all personal data to be provided by either of them to the other); and
- considering appropriate insurance protection and liability caps in the services agreement.

Implications

Provided it has been properly authorised in the ways set out above, a modest extension of service provision to other organisations is unlikely to cause problems for the ALMO or the council. The council will want to ensure that the services provided by its ALMO to council tenants do not suffer as a result of the focus on winning business elsewhere, but the ability to share overheads is likely to be seen by all parties as beneficial.

If the amount of work carried out for other landlords becomes substantial then there are likely to be concerns over whether the ALMO continues to '*...carry out the essential part of its activities with the controlling local authority*' (see below). In order to minimise the risk of this leading to a need to retender the Management Agreement, ALMOs would be well advised to consider whether a subsidiary should be set up through which services for third parties are provided (see chapter 4).

Finance and tax

In practical terms, funding the activity is unlikely to be a problem. The cost of providing the services should be more than met by the fee paid by the service recipient. Bear in mind that profits derived from providing services to others will generally be subject to corporation tax.

The ALMO will also need to consider whether it has to include VAT in the amount it charges to the other organisation for providing the new services. This will depend on the VAT treatment of the services provided (whether standard-rated, subject to a special rate, zero-rated or exempt) and the VAT treatment of the ALMO. Where a requirement to charge VAT arises in (for example) an ALMO providing services to a housing association, and VAT would not be paid if the association carried out the services itself, the NFA is pressing for government to equalise the tax treatment so that tax is not an artificial barrier to more effective local housing management arrangements.

If the services provided are exempt from VAT, the ALMO should consider partial exemption issues (explained below). For this reason it is essential that the ALMO takes specialist advice on the VAT implications beforehand.

Any surpluses created from this activity will, subject to taxation, belong to the ALMO, and will not be a part of the HRA.

Practical example: Expanding the remit of Blyth Valley Housing

Blyth Valley is an ALMO managing stock in a district council which will be merged into the new unitary Northumberland Council from 1st April. Only one other district still has council housing stock, Alnwick. Following consultations with tenants in both areas on the proposal, in April the ALMO will become county-wide, be renamed Homes for Northumberland, and will manage all the remaining council housing in the area.

The ALMO's owner will be the new council, and it will have a new governance structure: two area boards in the areas where it manages stock (Blyth Valley and Alnwick), and a Northumberland Housing Board whose tenant and council nominees will come from the two area boards.

4 Owning property and undertaking new build projects

One of the most likely new activities for an ALMO is becoming the owner of properties either by buying properties or by undertaking new build. Again, this section discusses the legal issues.

Distinction from housing management

An ALMO can acquire a legal interest in properties. This could be ownership of the freehold, such as in some of the new build schemes that are being considered, the taking of a long lease from the authority, or the acquisition of a short-term lease, for example for use in accommodating homeless people.

The difference between a management agreement and a lease is that with a lease the ALMO will obtain a legal interest in the properties. Any tenancies will therefore be granted by the ALMO in its own right rather than as agent for another organisation for whom the ALMO is managing. The implications of this are fundamentally different from where the ALMO is providing management services.

Procedure

Optional clause 3(5) of the Model Memorandum allows an ALMO to *'provide housing which is to be kept available for letting.'* This includes 'providing' housing either by owning the properties or by taking a lease of them. There is a similar provision in clause 3(6) in relation to temporary accommodation. However, this is unnecessary if clause 3(5) has already been included, since all the activities envisaged by that clause are covered by clause 3(5).

If the local authority and ALMO have adopted this clause from the Model Memorandum then the acquisition of properties for renting will be within the ALMO's legal powers. If the ALMO does not have these provisions in its constitution then it will need to amend it using the procedure set out later in the chapter.

There is nothing in the Model Management Agreement which would prevent the ALMO from taking an interest in properties.

Implications

In terms of EU procurement rules, the implications of an ALMO owning or leasing its own property are similar to the implications of providing services for others (see above). However, if those properties are used to provide accommodation for people from the council's waiting list then it can be argued that this is providing a service for the local authority. This therefore should not undermine the principle that the ALMO is still *'carrying out the essential part of its activities with the controlling local authority'*.

Any tenancies granted by the ALMO will not be secure tenancies since only a local authority can grant secure tenancies. They will be assured tenancies (or assured shorthold tenancies). As such, they will not be subject to the right to buy, although the right to acquire will apply if they are funded with Social Housing Grant from the HCA.

Finance

The financial implications of an ALMO owning its own properties are significantly different from where the ALMO is managing property on behalf of the council or other landlords. Renting out properties as a business is subject to corporation tax. At the moment there is a concession giving ALMOs an exemption from corporation tax in relation to the activities they carry out for the council. However, if an ALMO makes a profit from renting out properties that it owns, this profit will be subject to corporation tax.

At the moment, all of the ALMO's activities are subject to VAT. This means that if the ALMO is registered for VAT it must add VAT to any charges it makes for those activities. However, the council is entitled to reclaim all VAT that it pays in carrying out its statutory functions, including that payable to the ALMO. In practice some ALMOs therefore do not charge their local authorities VAT, and many ALMOs have a 'non-trading' status for VAT.

If a proportion of the ALMO's activities become exempt from tax then the ALMO will be unable to reclaim input tax (ie VAT the ALMO pays out) which is 'attributable to those activities'. This means that if the ALMO has to pay VAT on a contract to maintain those properties, the ALMO will have to pay that VAT and will not be able to recover it. If the amount of exempt activity becomes significant then the ALMO will also need to apportion part of the VAT paid on external fees (such as audit and legal fees) associated with central functions to the exempt activities. This means that the ALMO will not be able to reclaim a proportion of the VAT it has had to pay on those costs.

Renting out of properties is exempt from VAT. It is possible to 'waive the exemption' (known as 'opting to tax') which makes renting subject to VAT, but this should only be done on the basis of expert professional advice.

The ALMO will pay stamp duty land tax (SDLT) on the acquisition of the properties or the land on which they are to be built. This contrasts with the position for housing associations, where there is a statutory exemption from SDLT. There is also a (more limited) exemption for charities that are not housing associations. SDLT is payable as a percentage of the purchase price of the land, so this should not be a problem if the land is being provided for free.

This highlights the importance of getting tax and VAT advice if the ALMO is planning to own its own properties.

5 Wider regeneration activities

Regeneration activities can range from assisting with a community consultation on a masterplanning exercise to comprehensive estate regeneration involving changed land ownerships and usages. However, most of the activities that could be carried out that are regarded as 'regeneration' could be categorised as either the provision of services for third parties, land ownership or the setting up of new structures. For this reason, regeneration activities are covered either by the sections above in this chapter, or in chapter 4.

6 Main legal considerations and constraints

The ALMO's Memorandum and Articles of Association

All the proposed activities must be within the legal powers of the ALMO, set out in its constitution.

An ALMO's Constitution

The constitution of an ALMO (or any company) has two parts, the Memorandum of Association and the Articles of Association.

The **Memorandum of Association** sets out the purposes of the ALMO, and the powers it has to further those purposes.

The **Articles of Association** is the internal 'rule book' of the ALMO dealing with issues such as decision-making and proceedings at meetings.

The only basis on which an ALMO can undertake any activity is to further the objects set out in the Memorandum of Association. That activity must also be within the powers of the ALMO.

It is not now necessary for the objects of a company to be set out in its Memorandum of Association.² A company is also treated as having unlimited objects unless specific objects are set out in its Articles of Association.³ However, for companies incorporated before the Companies Act 2006 came into force, any objects in the Memorandum of Association are treated as though they had been included in the Articles of Association instead.⁴

It is fairly straightforward to change the objects and powers of the ALMO as long as the council agrees to this. All that is required is:

- A board meeting of the ALMO to approve the change being put to the council as the sole member of the ALMO.
- The council giving authority to make the change through its usual procedures (which could be a decision of the portfolio holder, a decision delegated to the appropriate director, or a decision of cabinet or council).
- The appropriate officer of the council signing a written resolution to make the change, a copy of which is filed at Companies House together with a revised Memorandum of Association within 15 days of the change.⁵

Avoiding the danger of acting 'ultra vires'

If an ALMO engages in an activity which does not further its objects or is not within its powers, then it will be acting 'ultra vires'. The consequence of an activity by an ALMO, as a company, being ultra vires, is different from that of a local authority. For a local authority, ultra vires acts can generally be set aside and contracts related to them cancelled. With an ALMO, a third party can treat any act decided on or authorised by the board of a company as valid.⁶ This applies unless that third party knew that the act was outside the powers of the company. This means that any contracts entered into with third parties for activities that are ultra vires will still be valid.

It is a breach of duty by board members to authorise an ultra vires act or to allow a senior officer to do so under delegated powers. If that act results in loss to the ALMO, then the council, as the sole member of the company, can bring an action against the board members to recover that loss from their personal resources. Whilst this may seem unlikely to happen to ALMO board members, the council could be put in a position where it would be very difficult for them not to do so. The council owes a fiduciary duty to council taxpayers, and by extension, to rent payers in its housing stock.⁷ This duty is to act prudently in financial terms. It includes a duty to bring any claims or legal activities which the council properly ought to bring to recover damages for losses caused. This duty will primarily be enforced by the council's auditor. An authority may find itself under pressure from the auditor to bring such a claim where the board has authorised an ultra vires act by the ALMO and the ALMO has suffered a financial loss.

For this reason ALMO board members should ensure that all activities carried out by the ALMO further the objects of the ALMO and are within its powers.

The Management Agreement

Clause 23.3 of the Model Management Agreement requires the ALMO to have the council's written consent before carrying out any activities for third parties. Failing to get consent would be a breach of contract – the Management Agreement being a contract between the council and the ALMO – so it is vital that this is done in a formal way.

The steps the council could take if there was a breach of contract are set out below. Obviously, prior agreement between the council and the ALMO, followed by written consent, will avoid these being taken.

² Section 8 Companies Act 2006

³ Section 31 Companies Act 2006

⁴ Section 28 Companies Act 2006

⁵ Section 30 of the Companies Act 2006

⁶ Section 35(A) of the Companies Act 1985 (which, when it is brought into force on 1st October 2009 will be replaced by Section 40 of the Companies Act 2006)

⁷ This was set out in the Roberts v Hopwood case in 1925

Remedies the council has for breach of contract

Where the ALMO breaches the Management Agreement, the council has a number of possible remedies under contract law. These include:

- the ability to claim damages from the ALMO for any financial losses the council suffers as a result of the breach;
- the ability to apply to court for an injunction to prevent the ALMO from carrying out the prohibited activities; or
- to the extent that the breach ‘goes to the root of the contract’, the ability to terminate the contract for material breach.

Clause 65 of the Model Management Agreement states that if the ALMO breaches the Management Agreement, the council can terminate it. There is also the option to withdraw the relevant part of the services from the ALMO, either temporarily or permanently.

The drafting of the termination provisions in the Model Management Agreement refers to ‘any breach’. However, this does not take account of the relevant case law.⁸ This states that a contract may only be terminated for a fundamental breach which ‘goes to the root of the contract’.

These remedies under contract law are in addition to the ‘constitutional’ remedies that the council has under the Memorandum and Articles of Association of the ALMO and under company law. These rights enable the council to remove any (or all) board member(s) at any time and to fill the board with their own appointees. Those appointees would then be likely to put right the breach.

European procurement rules

Contracts for housing management services with a value of over £139,893 generally have to be tendered under EU procurement rules.⁹ However contracts between certain ‘related’ organisations can be exempted from tendering where they can be brought within the exception to those rules in the ‘Teckal’ case.¹⁰ Subsequent cases have developed the test of what is required to rely on this ‘Teckal exception’.

What is the ‘Teckal’ case?

The ability of the ALMO to provide housing management services to the council without first winning the right to do so following a tender under the EU procurement rules relies on the Teckal case. In the case, the court indicated that the EU procurement rules would not apply to a contract between two public bodies (a council and another public body) where the other public body is legally distinct from the council but:

‘...the council exercises over the person concerned (the other public body) a control which is similar to that which it exercises over its own departments and, at the same time, that person carries out the essential part of its activities with the controlling council’.

What are the issues about control of the ALMO by the council?

The Stadt Halle case¹¹ established that Teckal cannot apply to a contract awarded to a company which is majority-owned by the public authority but in which a private third party holds a minority shareholding. The European Court ruled that:

‘...the participation, even as a minority, of a private undertaking in the capital of a company in which the contracting authority in question is also a participant excludes in any event the possibility of that contracting authority exercising over that company a control similar to that which it exercises over its own departments’.

The European Court’s justification for this approach was that any private capital investment would mean that the company would be driven by private sector concerns to maximise profit and not solely by the public interest. It is

8 Rice v Great Yarmouth Borough Council, 2000

9 This figure is benchmarked to the euro every 2 years. The figure quoted applies until 1st January 2010

10 Teckal Srl-v-Commune di Viano and Azienda Gas-Acqua Consorziale (AGAC) di ReggioEmilia – Case C107/98

11 Stadt Halle, RPL Recycling park Lochav GmbH-v-TREA Leuna – Case C-26/03

unclear whether the court would consider that this argument should apply where the ‘private third parties’ are tenants, who derive no financial benefit personally from their involvement in the company. In such a case the argument that the company is motivated by private sector concerns to minimise profit will not apply. The consequence of an ALMO being found to have insufficient control to meet the Teckal requirements is the risk of the council having to tender the management agreement.

It is also relevant to the proposals for the future of ALMOs to mention the Mödling case.¹² In this case a separate company was set up by Mödling municipal council. The contract with was let whilst the company was 100% owned and controlled by the council. A proportion of its shares were then sold to the private sector. The European Court decided that the contract needed to be re-tendered at the point at which the company ceased to be 100% owned by the council.

In the Parking Brixen case¹³ the European Court gave further guidance as to how the Teckal test should be assessed. Their starting point was that the test should be interpreted strictly. It was up to the council to prove that the arrangement meets the Teckal test. The European Court said that the assessment should take account of:

‘...all the legislative provisions and relevant circumstances...’

The influence the council exercises:

‘...must be a case of a power of decisive influence over both strategic objectives and significant decisions.’

In Parking Brixen, the factors that were considered to undermine Brixen relying on the Teckal test were:

- the external organisation being a company limited by shares (the corporate form generally used for private sector companies);
- the company having wide objects allowing it to work in significant new fields (such as transport and information technology) beyond those originally delegated to it (managing car parks);
- the likely extension of the company’s activities to the whole of Italy and abroad; and
- the broad powers of the board of directors to make all administrative decisions including the purchase of assets, shares and businesses with a value of up to €5 million with no management control over those decisions being exercised by the local authority.

The European Court decided that the control exercised by the council over the company was not sufficient to meet the ‘Teckal’ test. They contrasted this situation with that which applied before recent changes that had been made to the Parking Brixen company. Before these changes the authority:

- laid down its operational guidelines;
- provided start-up capital;
- subsidised the costs of it providing public services;
- monitored its performance; and
- exercised strategic supervision.

There are clear warnings in this case for an ALMO that is looking to diversify, dealt with earlier in this chapter.

Since these cases there has been the RMP v Brent case,¹⁴ this time in the UK, explaining the level of control required. The court said that it was not sufficient for the public sector just to own the whole share capital of the subsidiary. For Teckal to apply, they needed also to exercise ‘management control’. In the case, the board of the subsidiary was largely independent of the participating local authorities. The local authorities had also appointed private sector managers to manage the company. These factors suggested that the level of control was not sufficient to satisfy the Teckal test.

¹² Commission-v-Austria – Case C29/04

¹³ Parking Brixen GMBH-v-Municipality of Brixen/Bressanone – Case C-458/03

¹⁴ Risk Management Partners-v-Brent LBC, 2008 EWCH 1094 (admin)

Rather worryingly, the court suggested that the inclusion of dispute resolution provisions in the contract between the local authorities and the subsidiary indicated that the level of independence was too great; if a dispute could arise between the authority and company requiring a formal dispute resolution process this suggested that the authority did not have sufficient control to resolve the dispute how it wishes.

ALMOs need to consider this case in relation to any dispute resolution procedures in their Management Agreements. Simply relying on the 'expert decision' provisions in clause 67 of the Model Management Agreement could be dangerous unless this can only be used with the agreement of the council. Management Agreements should now include a dispute resolution process where the final decision is given to the council, unless the council voluntarily opts to have the issue decided by an external person and to abide by their decision.

'Essential part of its activities'

In relation to the second part of the Teckal test, there is not yet any case law as to what is meant by '*...carries out the essential part of its activities with the controlling authority.*'

Different approaches to this test have been suggested by different commentators including:

- analysing the proportion of the turnover of the subsidiary derived from work with the contracting local authority, with it being suggested that 'essential part' could mean 'over 50%', 'over 80%' or 'almost all'; or
- assessing the 'significance' (in other than purely financial terms) of the activities the subsidiary carried out for the contracting authority, to both the authority and the subsidiary.

We will not know how strict this test is until there is further case law on it. However, the court is more likely to require 'over 80%' or 'almost exclusively', than 'over 50%'.

Optional clause 23.3 of the Model Management Agreement prevents an ALMO from providing services to third parties without the council's consent. Where this clause has been included, it should enable the council to monitor whether the essential part of the ALMO's activities are carried out with the council.

Summary

In summary, the ALMO arrangements have to satisfy two tests for exemption from the council having to tender the Management Agreement under EU procurement rules (either when the ALMO is set up or when its Management Agreement is renewed):

- The council must be able to demonstrate that it exercises a control over the ALMO '*similar to that it exercises over its own departments*'. This must amount to the ability '*to exercise a decisive control over both the ALMO's strategic objectives and significant decisions*'. The level of control required needs to be demonstrated both by the controls the council has over the ALMO in its Memorandum and Articles of Association and Management Agreement, and by the way this control is exercised in practice, eg through approving the delivery plan and setting the management fee.
- The ALMO must carry out the 'essential part of its activities' with the council.

3 How can an ALMO find new financial resources?

1 Introduction

ALMOs would like to tackle a number of local issues that would require additional resources. These might include:

- new build, where the ALMO owns the new properties;
- regeneration schemes to achieve replacement of poor council housing managed by the ALMO;
- further investment in existing stock owned by the local authority; and
- loans to homeowners, including to council leaseholders for works to their home, loans for private sector renewal, loans for market renewal, and investment in private sector housing as part of a mortgage rescue scheme.

In 2005, the National Federation of ALMOs (NFA), together with the Chartered Institute of Housing (CIH) and HouseMark, produced the report *ALMOs – A new future for council housing*. Research for that publication established how ALMO borrowing could be treated as private finance and so be outside government controls.

This chapter explores what might be achieved by ALMO borrowing and other sources of finance. It is in three parts. Part one looks first at the four main potential areas of new activity just mentioned, largely in terms of what might be done within the existing system (or with only marginal changes to it). Part two then revisits the discussion of the private finance option in the light of government policy developments and recent market conditions, and argues that it will be more important once local authorities are allowed to negotiate a self-financing HRA independent of the HRA subsidy regime. It also re-examines public borrowing rules as they affect ALMOs. Finally, part three briefly considers the advantages and disadvantages of a leasehold transfer, as an alternative means of raising finance for the ALMO.

PART ONE: NEW AREAS OF ACTIVITY

2 New build housing

Local authorities have lost properties through the right to buy and currently have no means of replacing them. This has put pressure on unit costs. In most areas, there is a critical shortage of social housing for rent. It is therefore important to the authority and their ALMO to have new build schemes.

Until recently proposed changes, the status of new build social housing owned by the local authority itself would have been within the HRA and subject to the HRA subsidy regime, whereas social housing owned by the ALMO, or a subsidiary of the ALMO (or a local housing company), would be outside the HRA. This would have been the case even if the ALMO (or the company) were 100% owned by the authority. Rental income from an ALMO scheme would be available to service debt.

In January, CLG consulted on a proposal to allow councils to apply for new build schemes (and for new acquisitions) to be exempt from two important rules – that they have to be included in the authority's HRA subsidy determination, and that if they are sold through the right to buy, 75 per cent of the capital receipts have to be pooled (ie. paid back to the government).

If the proposals go ahead, and a council makes a successful application, new build or newly acquired properties could be exempt in the ways just described (although the properties would still be in the HRA, and therefore subject to rent restructuring, and still subject to right to buy). However, the extra income available from a typical council of rent of £65 will (according to the CLG) be about 28 per cent, or £18. So there will still be a very considerable gap between the income available to repay debt and the capital cost of a new unit, even if new build rents were somewhat higher.

The government plans to allow local authorities to bid directly for Social Housing Grant (SHG), but so far the details of how this will apply are not known. In any event, SHG covers only a proportion of the cost and is subject to competitive bidding. Nevertheless, the proposals will make it easier for councils to do small new build schemes if they can finance the majority of the cost through other means.

However, compared to a local authority new build scheme going ahead within the HRA, there are advantages for the ALMO of owning the housing itself:

- The properties would not be subject to the right to buy.
- Rent restructuring rules would not apply (if there was no SHG), and rental income could be set at a higher level to cover more of the costs of debt.
- The ALMO's balance sheet would be strengthened by ownership of the assets.
- If it was decided to apply for SHG, there are established procedures and precedents for ALMOs applying (see below).

Where the housing has been constructed on land acquired from the local authority at nil cost or below market cost, consent under Section 133 of the Housing Act 1988 would be required for any sale of the ALMO-owned properties.

ALMOs are also subject to VAT if they undertake development on behalf of their parent council but if new social housing development is undertaken by the council then VAT is not a cost. ALMOs want to help local authorities make the best use of their assets. However, their tax treatment does not help encourage this activity and in some cases may prevent local authorities going ahead with schemes that would have improved a neighbourhood. The government is recommended to consider applying the same VAT rules that apply to local authorities, to their wholly controlled ALMOs as well. (There are a number of technical points for ALMOs arising from new build schemes, relating to VAT and stamp duty land tax – see chapter 2.)

All social housing requires some kind of subsidy to enable rents to be affordable. This subsidy can be in the form of SHG, free or low-cost land, or cross-subsidy through sales of commercial elements of a scheme, or a combination of these. The Housing Corporation has already made SHG available for 2* and 3* ALMOs to build, own and manage new build housing. Indeed, the Housing Corporation named 22 ALMOs as pre-qualified sole status partners for SHG, and one scheme has started (see box below). However, the terms on which SHG is being made available are very onerous.

On 1st December 2008, the Homes and Communities Agency (HCA) took over responsibility from the Housing Corporation for allocating SHG. The HCA is continuing the Housing Corporation's requirement for a rentcharge, to ensure that properties built with the benefit of SHG will be used and managed in accordance with its current (specified) or future (unspecified) requirements.

Local authorities are able to borrow prudentially to on-lend to an ALMO (or to a local housing company) for their new housing (as already noted, there is only limited scope to borrow for new build schemes within the HRA because of the HRA subsidy regime). Such borrowing for an ALMO scheme would be in the General Fund rather than the HRA. The conditions attached to the loan would be for the local authority to decide.

The local authority would have to be convinced that the rental income from the ALMO scheme would be sufficient to service its debt plus an on-lending margin. Most local authorities, as prudent lenders, would expect the ALMO to give a charge over the rental income to the authority as well as seeking a first charge on the property. But, the HCA is currently requiring their rentcharge to rank in priority to these in their SHG agreements with ALMOs – see below.

Although the terms of the loan from the local authority to the ALMO may be similar to those from a bank or building society, the interest rate would in many cases be substantially lower. This is particularly so at the current time (April 2009) as local authorities can raise money more cheaply than commercial lenders. The on-lending margin, to cover risk and administration would probably be similar to the margin on a commercial loan that was guaranteed by the local authority.

For on-lending to the ALMO, some authorities will want to lend on a variable rate of interest, with the rate altering each year (or less frequently) linked to the local authority's consolidated loans fund rate. Others are prepared to lend on a 30-year, or even 50-year, fixed rate basis, at a margin over their recent borrowing from the Public Works Loan Board. Either rate is likely to be significantly cheaper than could be obtained at the present time by the ALMO from a commercial lender, who might be seeking a local authority guarantee as the ALMO has little in the way of reserves.

The important considerations for an ALMO borrowing for a new build development are:

- The subsidy needs to be at a level where the net rental from the new development will service sufficient new borrowing to finance the development.
- The HCA's SHG agreement should allow for the ALMO to be able to refinance the loan in the future with a loan from a commercial lender, as terms of loans may change significantly over 30-50 years. However, this will require a significant change to the HCA's current form of SHG agreement and rentcharge, which they have inherited from the Housing Corporation. In recent SHG negotiations, the Housing Corporation was asked to make such a change, but they would not do so.
- A first charge on the development will be required as security by a commercial lender, and will be expected by most local authorities if on-lending to the ALMO (particularly where there is external grant funding). The lender may also require a charge on rental income. However, the current form of SHG agreement and rentcharge makes this difficult. This is because the SHG agreement can require forfeiture of the freehold in certain circumstances, and this would override any legal charges over that freehold and leave the funder without any guarantee of being able to preserve their security. On a forfeiture the lender would be entitled to apply to the court for relief from forfeiture but it is up to the discretion of the court whether or not to grant this. The HCA is currently considering proposals to address this.
- Treasury management advice will be necessary, particularly if affordable fixed rate funding is not available.
- To minimise the development risks, most ALMOs will want the expertise of an experienced housing association developer to be available until the ALMO has become an experienced developer itself.
- The properties will be let on assured tenancies.

There is an alternative approach for achieving new build that avoids borrowing by the ALMO. ALMOs rated as 2* and 3* can also apply to the HCA for investment partner status in consortia. This has been achieved by five ALMOs and is less risky for the ALMO than being a sole status partner. It is anticipated that these ALMOs will work closely with housing association developers, who will do the borrowing and retain ownership of the properties that will be managed by the ALMO. However, since housing management is a service that has to be tendered under EU rules, those associations will be in breach of the rules if they let a management agreement to an ALMO without the ALMO having won that contract in an OJEU tendering exercise.

Now that the Homes and Communities Agency has taken over the allocation of SHG from the Housing Corporation, the NFA, supported by the LGA, could usefully have discussions with the HCA on:

- Security requirements for SHG for ALMOs, so that the security is more fairly assigned between the lender to the ALMO and the grant provider (HCA) in future SHG agreements.
- Allowing the ALMO to repay the grant if it can be refinanced in a cost-effective way.
- Allowing the local authority to make leasehold transfers of land for housing development supported with SHG. (Currently, the SHG agreement requires the land to be transferred freehold. This is because of the legal difficulties with a rentcharge, rather than a mortgage. The SHG agreement relies on the rentcharge to protect the repayment of SHG, where there is a breach of grant conditions and to ensure that the properties continue to be used for social housing at all times.)

Chapter 4 considers partnership and joint venture models and organisational structures such as local housing companies for new build. A key issue for ALMO borrowing is whether there is pressure to get the borrowing out of the public sector, as in their current form most ALMOs are public sector organisations. If they were to change their shareholding and become (technically) private sector, as described below, most of the private sector models would not expect the ALMO to be the borrower: this is because a traditional housing association with substantial assets would be able to borrow the money more cheaply. There are several reasons for this:

- the ALMO would not be able to borrow from the local authority, as this would then count as public sector borrowing, even though the ALMO might be in the private sector;
- the ALMO would not have any spare assets to offer as security, whilst most traditional housing associations would have; and
- the ALMO would not have significant reserves.

Some ALMOs have become accredited by the Housing Corporation to manage social housing stock. Since 1st December 2008, this accreditation process has become the responsibility of the Tenant Services Authority (TSA). The accreditation gives ALMOs the opportunity to manage social housing owned by landlords other than their parent councils. Management of private sector housing, such as buy-to-let properties, does not require this accreditation, does not require borrowing by the ALMO, and is an important area for growth for ALMOs. It helps to address the issue of increasing unit costs, as overheads can be spread over more properties. ALMOs must be careful not to let this activity become too large without moving it into a subsidiary (see chapters 2 and 4), in order to ensure that it continues to retain the benefit of the 'Teckal' exemption due to it '*...carrying out the substantial majority of its activities for the council*'.

Practical examples of new build: Islington, Stockport and Derby

Islington LB has recently started a new build scheme of 14 units, subsidised through capital receipts from sale of commercial properties within the HRA, using council land, and without using Social Housing Grant. Its ALMO will be the housing manager.

Stockport Homes is the first ALMO to receive SHG – £1.02m to help build 17 new homes, also subsidised by the council through free land and prudential borrowing. The ALMO-owned units will not be in the HRA or subject to the RTB.

Derby Homes has prequalified for NAHP and successfully bid for £380,000 grant to build ten large family homes that will be owned by the ALMO, on council-owned sites. The council is transferring ownership of the sites at nil value. The council provided £200,000 of prudential borrowing, and will guarantee the performance of Derby Homes with the HCA. The developer will build the ten houses plus a further 30 units for sale, and use their income to cross-subsidise the cost of building the rented properties.

Adding to the stock by acquisition

As a further opportunity apart from new build, some ALMOs may have private developments near their housing, where house building has ceased prematurely or completed houses cannot be sold. If the properties are suitable for renting, the ALMO could apply to HCA for a grant to purchase the properties, under the recently announced grant scheme to help social landlords and ALMOs buy properties, which were originally intended for private sale, from developers. Depending on the purchase cost, the size of grant and the borrowing cost of the loan from the council, these properties could be let by the ALMO as social rented housing, or as intermediate housing on a rented, or rent-to-purchase basis.

Practical example: acquisition in Derby

In 2008 Derby Homes acquired a block of flats from the local New Deal in the Communities (NDC) based in the Derwent ward of the city. The NDC wished to invest capital at the end of their project in the property to provide legacy funding. The NDC bought and funded the modernisation of the flats using unemployed young people as a training initiative. In return for the transfer, Derby Homes have undertaken to manage and maintain the properties and provide a finance stream from the rents to fund community schemes after the NDC ends. The flats are finished to a modern specification, and let at intermediate rent levels.

3 Regeneration

Some council housing managed by ALMOs needs to be replaced. The decent homes regime favours refurbishment but that would not be good value for money in some cases. Yet without subsidy, demolition and replacement new build will not stack up financially.

There will be situations where there is surplus land within the estate that can be added to the demolition site to enable a mixed development to fund the replacement housing needed. With the benefit of free land, housing for sale on the site can in many cases provide cross subsidy for low cost home ownership and social rented housing. The local authority, a local housing company, the ALMO, or a developing housing association or developer partner could act as developer. However, because of its lack of capital, the ALMO needs to be very careful not to accept too much development risk. If the new housing is to be outside the HRA, the local authority would need to sell the land to a partner; currently leasehold transfers are not possible if SHG is to be achieved on the development – see above. This partner is most likely to be a local housing company, or an ALMO. The ALMO would then borrow from the local authority for the development. As a local housing company is likely to be 50% owned and the ALMO is 100% owned by the authority, this may be more attractive than selling the land to a housing association partner or commercial developer. Borrowing by the ALMO for such a scheme would be similar to the borrowing for the new build projects described above.

English Partnerships, now integrated into the HCA, believed that there were 60,000 potential local authority development sites, where the HCA can assist in the development of new social housing and low cost home ownership. However, this does not necessarily reflect the practicalities of developing some of these sites. In many cases the sites will be subject to the interests of leaseholders, and others with rights of way over them, which will need to be extinguished before the development can take place.

Often, regeneration schemes will be on a larger scale than the ALMO could borrow for. Housing associations will be a likely willing partner with the authority and bring some of their own financial resources to the table. In such schemes, described in chapter 4, the ALMO will want to be involved as a partner itself from the outset so that the properties that the ALMO is later contracted to manage are appropriate ones.

The European Investment Bank (EIB) has indicated that it is likely to make funding available for developments built by local authorities' asset-backed funding vehicles – see chapter 4. There are two advantages of EIB funding:

- its loans being at lower interest rates than would be available from other banks and building societies; and
- its funding can also be available as equity shares or guarantees.

CLG has recommended that regional development agencies consider accessing such EIB funding for developments in their region.

4 Further investment in existing stock

Many local authorities and ALMOs would like to invest in their homes beyond the Decent Homes Standard. In particular, environmental work and energy efficiency measures are needed. Some of these works will save money in the medium term, but not sufficient to fund the borrowing cost. ALMOs are powerless to borrow in such situations because they have no reserves to support loans on marginally viable projects.

Local authorities currently have no source of funding for such works, except occasionally from a supported capital expenditure approval, or a section 106 agreement on another site where this is a proper planning purpose for the use of those monies. The HRA subsidy system stifles 'spend to save' initiatives and other efficiencies. This real need for additional expenditure on council estates is making local authorities and ALMOs desperate for a self-financing HRA, outside the HRA subsidy regime.

The reason that supported capital expenditure approvals are in such short supply is because they lead to new public sector borrowing by the local authority and require subsidy from the Exchequer. Unsupported borrowing, which is possible as long as it meets the Prudential Borrowing Code, is (as mentioned above) limited in potential because of the workings of the HRA system; one side effect of this is of course that the government does not have to worry about the growth of prudential borrowing that would add to total public sector debt.

5 ALMO lending to homeowners

Local authorities currently make loans to homeowners for private sector renewal and to council leaseholders for decent homes works. In some parts of the country, this also includes lending for market renewal, where the authority or the market renewal pathfinder makes loans to help existing homeowners afford to move to a new property in the area when theirs is to be demolished. The authority and the ALMO might see benefits of the ALMO managing this borrowing function by contract, or the ALMO might consider being the lender itself. The latter would normally require the consent of the local authority.

If ALMOs consider making such loans themselves, they would need to look to their local authority for on-lending. In current market conditions, the ALMO would find it very difficult, if not impossible, to raise the money from a bank or building society without a local authority guarantee. Rather than having to charge the homeowner an on-lending margin, it would be better for the authority to be the lender even if they delegate all administration to the ALMO.

Another reason why it would not be appropriate for ALMOs to offer mortgage loans themselves is that they would not be covered by the ODPM guidance on the mortgage sales process for local authorities and registered social landlords (November 2005). These organisations are exempt from regulation by the Financial Services Authority (FSA) but ALMOs are not exempt and would have to be fully regulated. This would be time-consuming to achieve and is expensive in annual fees to the FSA. Depending on the terms of the loans, a consumer credit licence may also be needed as the ALMO would have to comply with the requirements of the Consumer Credit Act. Discussion would be needed with the FSA to ensure that an ALMO could manage the sales process part of the mortgage function on behalf of the authority, without being regulated by the FSA.

The New Local Government Network (NLGN) has been proposing that local authorities should offer mortgages to homeowners who are having difficulty getting a commercial mortgage in their area. NLGN is arguing that the risk of such lending would be low for the authority because such action would help to save the local housing market and there would be a good return on the authority's cost of borrowing. This is being investigated by a number of authorities but is unlikely to be implemented on any scale. Where a local authority does decide to offer mortgages, the ALMO could have a contract for mortgage administration as mentioned above in relation to private sector renewal.

The government has been discussing its embryonic mortgage rescue scheme with local authorities. Local authorities will be encouraged to invest in homeownership properties where shared equity, shared ownership or mortgage-to-rent would enable a household in financial difficulties to remain in their own home. The ALMO could be a partner in the local mortgage rescue scheme, providing expertise to help homeowners assess their options. The ALMO could manage all the properties which were invested in by the local authority.

PART TWO: ALMO BORROWING AND GOVERNMENT RULES

6 The current position

To achieve decent homes, local authorities with 2* or 3* ALMOs have been given borrowing approvals by government for the agreed level of investment required. The authorities have borrowed in the usual way and the debt charges have been met through HRA subsidy. For a number of authorities, this additional borrowing is now complete, and additional supported capital expenditure backed by HRA subsidy is unavailable or (at best) hard to find.

Unfortunately, although the prudential borrowing regime for local authorities provides some scope for new HRA borrowing, this is limited. This is because:

- all rental income is trapped within HRA subsidy calculations and is not available to service a loan;
- the major repairs allowance (MRA) cannot be used to support borrowing; and
- capital receipts are not freely available to lever in borrowing.

The model ALMO constitution allows for an ALMO to borrow but, in a number of cases, this is subject to the council's consent. ALMOs are not formally subject to the prudential borrowing regime introduced for local authorities in 2004, but ALMO boards might choose to follow the principles of that regime. This would require the board to be confident that the income stream from the project being funded was sufficient to meet the interest and principal repayments as specified in the loan agreement.

Under current government rules, if an ALMO that is 100% owned by a local authority were to borrow, the loan would count as public sector borrowing. However, this is unlikely to be a constraint on the ALMO while amounts borrowed are relatively small.

Any ALMO that is majority or 100% owned by the council has no advantage in borrowing from the commercial sector rather than from the local authority. Indeed, under the Prudential Borrowing Code the borrowing by the ALMO would have to be consolidated with the authority's own borrowing for calculating the council's prudential borrowing limit. Any guarantee that a commercial lender might require from the council, if it were to lend to the ALMO, would also need to be taken into account.

7 The government's control of public sector borrowing

Pressures on public expenditure and on public sector borrowing are set to continue as the level of government borrowing this year, and projected for future years, will exceed recent borrowing levels, and so will be tightly controlled.

One way to ease the situation for funding council housing investment would be for government to adopt the European Union's narrower definition of public sector debt. The rest of Europe uses the General Government Financial Deficit (GGFD) to measure levels of public borrowing. Since 1995, CIH has been urging the UK government to change to this measure. CIH pointed out in a press release on 28th October 2008 that a switch to the use of GGFD as the primary fiscal measure for government debt would also unfetter public sector 'trading activities', which would include council housing. Local authorities could then borrow freely against their trading income (for example rents), rather than be constrained (as now) in the same way as with debt for government services. This would provide a significant boost to social housing production at a time when pressing housing needs are unlikely to be met by the private market.

CIH is currently trying to engage government on this. A potential difficulty is that there is the legal obstacle in the UK that local authority borrowing is secured on all the revenues of the authority, so a legislative change would be necessary to have borrowing secured on a local authority's rental income or on housing assets.

8 Self-financing and the HRA Review

The 2005 NFA/CIH/HouseMark report argued that for ALMOs to borrow private finance, their local authorities would have to negotiate their way out of the HRA subsidy system so that each authority's HRA would be self-financing. Influenced by this publication and a slightly earlier report by the Audit Commission, *Financing council housing*, the government initiated a project in autumn 2006 to examine the costs, benefits and practicalities of allowing local authorities to leave the HRA subsidy system. In March 2008, CLG published the results of this project, which involved six local authorities, three with ALMOs, in the report *Self-financing of council housing services: summary of findings of a modelling exercise*.

This modelling project was important for local authorities and ALMOs in highlighting the potential efficiencies and benefits that locally based self-financing business plans could deliver. The project also highlighted the gap between what the current subsidy system is delivering and what will be required if the stock is to be adequately maintained into the long term. Further investment in the housing stock is a key reason why local authorities and ALMOs would like to be able to borrow more freely for housing.

The preliminary results of this modeling exercise were sufficiently positive for government to announce a fundamental review of the HRA subsidy system in December 2007. This joint Treasury and CLG review was formally launched in March 2008 and is still underway. It is hoped that the review will recommend a sustainable, long-term system for financing council housing, with self-financing playing a significant part in achieving this.

It is unlikely that government would want to change HRA borrowing rules in advance of making a decision about local authorities negotiating their way out of the HRA subsidy system. The HRA review report is not expected before April 2009 at the earliest. However, this report recommends the government to consider changing the classification of borrowing for council housing investment, recognising that council housing is a trading activity and that under European accounting conventions its borrowing need no longer count towards the main measure of general government debt. (It is worth pointing out that the advantages would extend to other council trading activities, such as the remaining local authority bus companies, airports and markets, and possibly to leisure facilities if most of their income comes from fees and charges.)

9 The scope for additional borrowing

It is understood that one of the main concerns of government, in their review of the HRA subsidy system, is the scope for very significant prudential borrowing by local authorities if their HRAs were to be remodelled for self-financing. This is because local authorities are confident of being able to generate income for prudential borrowing for what they see as necessary works to support a sustainable community.

A likely result is that agreement by government to self-financing of the HRA will involve Treasury, if it does not agree to changes in borrowing rules, introducing some kind of control mechanism on prudential borrowing for housing. It is generally agreed that this would still be better than the current HRA subsidy regime.

Another way of potentially increasing the level of investment in council housing would be if ALMOs could borrow private finance, as this would be outside all government controls, although of course there would be regulatory controls related to financial prudence. Such a change would have to involve a change in ownership of the ALMO, if it had to satisfy current government definitions. This is dealt with in the next section.

10 How ALMO borrowing could be outside government controls

In 2005, it was established that to make the case for classification of ALMO borrowing as private finance under present rules, the ALMO would have to be able to demonstrate that it was not majority-owned or controlled by the public sector. This would require tests at three levels. First, the governance arrangements would have to ensure that the day-to-day operations of the ALMO were not capable of being controlled by the local authority (or by any other public sector organisation). Second, the local authority as owner of the ALMO would not be able to take control of the ALMO, beyond the arrangements in the management agreement. Third, if anything were to go wrong, responsibility for sorting it out could not be in the hands of the local authority (or any other public sector organisation).

Although the ALMO would no longer be 100% local authority owned, legal ownership of the housing stock would remain with the local authority and the tenants would be secure tenants of the local authority. The ALMO could be either a 100% privately owned company, as currently with Kensington & Chelsea TMO, which is 100% owned by tenants, or have a maximum 50% local authority ownership, probably with equal community or tenant ownership. It is anticipated that in most cases the ALMO would continue to have a board membership of one-third tenants, one-third local authority nominees and one-third independents. In changing the ALMO's ownership to take it outside the public sector, the local authority could not award the management services contract to the ALMO without competition.¹⁵ If the management contract had to be tendered, this would be potentially risky for the authority and the ALMO, as housing associations and private sector housing management organisations might compete and win. In such a situation, most and possibly all of the ALMO's staff would TUPE to the new contractor.

¹⁵ The exemption from the council having to tender the management agreement rests on the Teckal case (see chapter 2). This would apply only if the local authority exercises control over the ALMO equivalent to that which it exercises over its own departments. It will also cease to apply if the ALMO ceases to be 100% owned by the local authority although in this case it is not clear how tenant membership would be classified.

11 Using ALMO private finance to get out of the HRA subsidy regime

Private sector borrowing by the ALMO could be significant for their local authority when the authority is in a position to negotiate its way out of the HRA subsidy regime. If private finance were to be available from the date of HRA remodelling, the government could be more flexible in agreeing the underlying assumptions in the HRA business plan (than with options relying on public sector borrowing). This is because the ALMO borrowing will be off the government's balance sheet (without any change in the rules) and, as with transfer, there would no longer be any local authority (public sector) HRA debt.

However, the interest costs on the ALMO's private finance would be significantly higher than on local authority debt. This is because to qualify as private sector debt, there can be no recourse to the public sector. This is far more risky for the lender than lending to the local authority with all its revenues as security.

This difference in cost would be reduced as the ALMO develops a successful track record. As with LSVT, it is likely that the ALMO would refinance its loans to take advantage of lower borrowing costs when they become available. The ALMO could be asked to share the benefits achieved from refinancing with the local authority, as with PFI. However, there will be a limit to the reduction in borrowing costs that can be achieved since the borrowing will continue to be secured against the right to collect the rental income (as with PFI), rather than on the housing stock, which is the case with an LSVT.

An options appraisal would be necessary to test the financial viability of the different approaches. This would require the co-operation of CLG to find out the importance of getting future borrowing into the private sector. The circumstance where ALMO private finance is likely to be most worthwhile in the remodelling exercise, is where additional expenditure can bring with it efficiencies not available with the lower level of expenditure in a publicly funded business plan. Value for money can then be demonstrated.

In remodelling situations where government agrees that a high level of expenditure is required, but efficiencies are not easily demonstrable, the government would have to write-off more HRA debt if ALMO private finance was the source of funding, or accept a smaller increase in debt for this option. However, as with LSVT, the government might see this as a price worth paying to get all the HRA debt off the public sector balance sheet.

12 Implications for the local authority and ALMO of ALMO private finance

It is acknowledged that if ALMOs are to take on more responsibility and risk, as they would with private finance, an appropriate regulatory framework needs to be in place to protect tenants and the public purse. This would be particularly important should service delivery deteriorate significantly.

For the ALMO to raise private finance:

- The local authority would have to delegate all day-to-day decision-making for the remodelled HRA. This would be achieved by agreeing a framework with the ALMO that would be documented in the HRA service contract. An annual delivery plan would still be agreed each year.
- A key difference from current arrangements is that the ALMO's management agreement with the local authority would have to be superseded by a long-term management and investment service contract. This would be similar to a PFI contract and would not be cheap to put in place. CLG would need to support the proposals, as the cost of the contractual arrangements would need to be taken into account in the remodelling negotiation and section 27 consent¹⁶ would be needed for the contract. The local authority would manage the HRA through this service contract with the ALMO, of at least 35 years duration. Any ALMO borrowing would have to be at least five years shorter than the period of the service contract. (Borrowing for less than 30 years is unlikely to be good value for money for the ALMO, as principal payments would need to be made earlier than on longer loans.) The service contract would include investment in the housing, so that the local authority would not need to borrow itself to finance capital expenditure on the housing stock.
- The remodelling negotiation with government would have to enable the authority to commit to a specified level of contract fee in relation to all of its stock without the backing of PFI credits from the government.

¹⁶ Section 27 of the Housing Act 1985

The ALMO would raise private finance on the strength of the service contract fee, which would be performance-related as with PFI. In order to give commercial lenders sufficient security to raise the private finance, the authority would need to guarantee the level of contract fee throughout the life of the contract. This would be similar to a PFI contract, where the payment stream typically consists of two elements: an 'availability payment' for keeping the properties available to the authority for letting (and up to specified minimum standards) and a performance-related element. The contract fee would have to be sufficient to cover the ALMO's projected cash flow, including the servicing of its debt.

The service contract fee payments would be agreed at a level which could be afforded by the 30-year HRA business plan, out of the local authority's rental income, without any HRA subsidy. The ALMO's track record of managing the stock and the service contract fee payment arrangements would determine what the ALMO could borrow. The ALMO's loans would be secured on the ALMO's income and receivables.

A tri-partite agreement would need to be in place between funders, the ALMO and the local authority owner of the properties, to address what would happen if the ALMO were to come close to default on its loan agreement. The main ingredients of this tri-partite agreement would include:

- The local authority would delegate to the ALMO all decisions on demolitions or sales of vacant properties where there was a commitment to replace them with more appropriate properties or to achieve remodelling of an estate. This would need to be covered by the section 27 consent from CLG – the practicalities of this would need to be worked through as the properties would continue to belong to the local authority and CLG consent would need to be obtained for any disposals.
- Step-in rights would be given to funders in the event of default on the loan. This would allow step-in for a short period (usually up to six months) after which a new section 27 consent would be needed from CLG – exactly the same as in HRA PFI.
- Ultimately, if the ALMO defaulted and the funder could not remedy the default by stepping in, the funder could sell the right to manage the properties and receive the income for the rest of the management agreement period. As with PFI, these new long-term arrangements would require section 27 consent, but CLG would be unlikely to stand in the way of a private sector manager if this is what was necessary to ensure the funder was paid. Any refusal to approve the appointment of a manager by a funder would be likely to damage market confidence, which would be a concern for CLG in relation to HRA PFI.

If the ALMO were to borrow, it would be responsible for treasury management with no housing subsidy payments to protect against rising interest rates. The ALMO would need to have access to hedging instruments to protect against this risk.

The major risk likely to remain with the local authority is any significant cost arising from unexpected environmental contamination. The other risks for the authority would be:

- If the HRA remodelling exercise was, with the benefit of hindsight, too tight. The ALMO might then fail, the staff would TUPE to another contractor and that contractor may also be unable to deliver satisfactorily.
- Some of the demand risk would be taken by the local authority. This would provide a mechanism to enable the output specification in the contract, specifying the number of properties of various sizes to be provided by the ALMO, to be adjusted as local circumstances change. This is common in HRA PFI contracts.

Some local authorities use the HRA to support the strategic housing function. This would be more difficult to achieve if the local authority were to delegate to the ALMO all day-to-day decision-making for the remodelled HRA.

The ALMO would have to act in a business-like way to deliver the performance-related management and investment service contract. There would be incentives for the ALMO to focus on the requirements and needs of tenants, improve performance, proactively manage the assets and respond quickly to changes in demand.

No legislative change would be required to put the remodelled HRA at arms length to the authority. This would mean that the local authority retains the duty to balance the HRA. It would therefore be necessary for the local authority to ensure that the terms of the HRA service contract are robust and provide sufficient comfort to the local authority's chief financial officer (appointed under section 151 of the Local Government Act 1972) and monitoring officer that the

council can satisfy its statutory duties. At the same time, the Model Management Agreement would need to be replaced with an agreement drafted more along the lines of the standard HRA PFI contract. The Memorandum and Articles of Association would also need to be changed to loosen some of the local authority controls around decision-making, given that financial responsibility for the remodelled HRA would principally fall to the ALMO. In particular, the local authority would have to give up all control, which is currently available where it has sole membership.

There would be a significant cost for the local authority in administering the long-term contract with the ALMO. This is because of the greater level of administration that would be required than with the current ALMO arrangements.

13 What lenders would require for ALMO borrowing

In the work for the 2005 report, it was established that for the ALMO to borrow for the HRA remodelling exercise and/or for subsequent investment in the HRA, non-local authority lenders would require:

- The ALMO to have a 35-year HRA management and investment service contract with the local authority landlord if the ALMO's borrowing was to be repaid over 30 years. The ALMO would have to have won this contract through an OJEU tender process.
- The HRA service contract would include an output specification for the service, as with PFI, based on keeping the properties in a good and tenable condition, but allowing replacement of properties as necessary to respond to changing demands. Since the properties will belong to the local authority and cannot be disposed of without consent, the practicalities of this will need to be thought through. The contract fee would be performance-related. The ALMO's loan agreement would require step-in rights to be given to funders in the event of default on the loan. This is common in PFI deals. Ultimately, in a default situation, the effect of step-in could be to take management of the properties away from the ALMO.
- Agreement of the ALMO's business plan each year and receiving regular monitoring reports.
- Clarity about responsibilities for improving performance, if the ALMO were to fall below 2* in an Audit Commission inspection or suffer performance-related penalties under the HRA service contract.

For the ALMO's borrowing to be classified as private finance:

- The ALMO must not be majority owned by the public sector, so the ownership and control would have to change in those ALMOs with 100% local authority ownership. A 50% community ownership would be possible, as long as the local authority with 50% ownership retained no controlling interest and no casting vote. Kensington & Chelsea TMO is 100% owned by tenants and so would not need a change of constitution to raise private finance. It could therefore be a pioneer for others, although the legal basis on which a management agreement is entered into with a TMO under the statutory right to manage route is different from that applying to an ALMO, and is available only if the statutory right to manage route is followed.
- The service contract would have to include sufficient risk transfer to the ALMO that an accountant could demonstrate under FRS5 and new international accounting standards that, for the period of the contract, the properties were in effect an asset of the ALMO. That is, the ALMO would be exposed to the associated risks of the properties and would have access to the benefits it achieved through active management, such that in accounting terms the assets would be on the ALMO's balance sheet and not on the local authority's. Legal ownership would remain with the local authority and properties could not be sold other than as agreed in the HRA service contract; and sales would need Secretary of State's consent under s32 of the Housing Act 1985.
- All the financing risk would be with the ALMO and lenders would have no recourse to the local authority, or its assets. This is what happens with HRA PFI if the local authority is to qualify for PFI credits.
- If the ALMO were to get into financial difficulties, or otherwise fail under the HRA service contract, the lenders would ultimately take responsibility for sorting things out. If the ALMO's business plan could not demonstrate repayment of their loans, lenders would discuss the situation with the local authority. They would together consider the possibility of bringing in a new contractor (which could be a housing association) to take over the contract and the financial responsibilities of the ALMO. The local authority would have no controlling say in sorting out the financial affairs of the ALMO, although they would of course take responsibility for any contract negotiations.

Preliminary discussions with lenders in 2005 suggested that:

- They would lend to ALMOs that were not 100% owned or controlled by the public sector, so long as there were adequate governance arrangements in place.
- They would require regular inspections from an independent body such as the Audit Commission and an annual report on the financial viability of the ALMO to meet its business plan. If a default on the ALMO's borrowing were imminent, lenders would require to take effective control of the ALMO's income.
- They would have a light-touch control, focussed on monitoring the ALMO's business plan. If the ALMO's performance were to deteriorate, lenders would act quickly and ask the board for a remedial action plan which they would monitor closely. If this did not bring about the required outcome in the time agreed, lenders might suggest asking the Audit Commission to assist the ALMO's board to develop a further remedial action plan, or they might bring in an external adviser to work with the management team on producing one.

Further preliminary discussions have been held with lenders in autumn 2008, to see whether the credit crunch has changed their attitude to such lending. There is clearly more caution today, but the principles described here still hold good. So, although it would be complicated and not without risk for the ALMO, private finance could be raised by ALMOs with a minority public sector shareholding, subject to an appropriate HRA service contract and business plan being in place and subject to the ALMO tendering for and winning a long-term management agreement through an OJEU process. Details of the new regulatory regime for local authorities and ALMOs, from 1 April 2010, will be important in determining what additional monitoring, if any, funders would require.

14 Conclusion on ALMO private finance

NFA could explore with its members whether any local authority would like to volunteer to be a pilot for self-financing, with its ALMO raising private finance along the lines described above. If in spring 2009, the government is reluctant to agree to self-financing because of the public sector borrowing implications, pilots with ALMO private finance could be proposed. This could make it easier for government, with continuing pressures on public sector borrowing, to move the self-financing agenda forward. The ALMO would want to be confident of winning the tender for a long-term management contract through an OJEU process before agreeing to do this.

PART THREE: WHAT OTHER OPTIONS MIGHT BE CONSIDERED?

15 A leasehold transfer?

The opportunities described above, where ALMOs can raise money themselves or work in partnership with their authority as borrower, will not bring in as much finance to the HRA as a stock transfer could generate. This has led some local authorities to consider, with their ALMO and tenants, whether there is a transfer option that can get properties back into local authority ownership in the future, while achieving the required level of investment in the properties and estates over the next 30 years.

Bolton at Home, working closely with Bolton Metropolitan Borough Council, has made significant progress with its tenants' federation on a leasehold transfer model, where the ALMO would become a community ownership organisation. It would lease the HRA housing from the council for 30-40 years as well as being a major player in a borough-wide new build programme and in regeneration initiatives. This would involve a new special purpose vehicle (SPV – potentially with HCA providing a representative on the new SPV board), to deliver the new homes. The council, the newly constituted ALMO and Bolton Community Homes (the local strategic housing partnership encompassing key housing associations) would be stakeholders. The views of CLG on this leasehold transfer structure are awaited.

If CLG are supportive of the leasehold transfer model, it will involve similar legal arrangements and consents to a traditional LSVT. A tenant ballot and CLG consent will of course be required. Bolton at Home would need to become a Registered Provider with the TSA and it would raise private finance, using the income stream and leasehold interest

in properties as security. With this model the ALMO's entitlement to manage the properties would be by virtue of its lease, not a management agreement under which management services are provided to the council.

Bolton at Home, together with Bolton Council and tenants, have devised their transfer plans to be integral with their approach to achieving sustainable communities, by transforming estates in a holistic way. This will involve:

- maximising the delivery of affordable homes, with the SPV selling new affordable housing units to Bolton at Home and to the housing associations with 100% nomination rights;
- creating sustainable environments to complement decent homes, with the leasehold transfer facilitating more finance for this than can be achieved without transfer; and
- developing proposals to deliver social and economic change within communities – to narrow the gap of deprivation that currently exists.

They see the benefits of this approach as being:

- the creation of more mixed or balanced communities incorporating home ownership, shared ownership, social and intermediate renting;
- partners maximising their input and playing to their strengths;
- spreading the risk with partners whilst minimising risk to Bolton Council and government;
- the maximisation of customer involvement and potential ownership;
- the creation of sustainable communities;
- meeting Bolton's growing housing needs and aspirations;
- Bolton Council not losing long-term ownership of its housing; and
- all of the above to be achieved with minimal impact on the Public Sector Borrowing Requirement – being effectively off the council's balance sheet.

Although (as with other options discussed) leasehold transfer is not therefore yet at the stage where the model is 'available' for implementation, it may be one which ALMOs and their local authorities will want to consider, alongside other opportunities discussed in this chapter and elsewhere in the report.

16 A direct role in PFI?

As we pointed out in the report *ALMOs – A new future for council housing?*, if the stock needs a large amount of investment, PFI can be a source of additional finance. ALMOs are restricted by their constitution from being a PFI contractor, whereas it would benefit all parties for an ALMO to manage the local authority's housing that is subject to a PFI contract.

The main obstacle to an ALMO managing housing provided by or subject to a PFI contract relates to risk transfer. Obtaining PFI credits from the government requires, among other things, a balanced transfer of risk to the party best able to manage that risk so that ultimately the asset is not on the council's balance sheet. If the ALMO were to become the managing agent of the properties in the PFI contract, the local authority would effectively retain the housing management risk. There is unlikely to be much appetite from the private sector to be involved in a PFI project where the housing management is outside the private sector partner's control.

While the ALMO remains publicly owned, therefore, its potential role in PFI is therefore likely to be limited to the client side – administering a housing management contract that has been awarded to an outside contractor.

If the ALMO were to become technically outside the public sector in the ways described earlier in this chapter, there would be scope for it to be part of a PFI consortium as (say) the housing management contractor. However, if an ALMO took this step it might be more advantageous to explore the private finance options mentioned earlier.

17 Acquisition of former RTB or of relet stock?

Some local authorities are finding that properties sold under the right to buy are lying empty. Such properties would be popular with tenants if modernised to the Decent Homes Standard. They would be efficient for the ALMO to manage and maintain, once essential repairs have been carried out. The ALMO could usefully agree a strategy with the authority for buying these properties at a reasonable price. If the ALMO were to buy them with a loan from the council, the ALMO could charge an intermediate rent to recover its costs and the property would not be subject to the right to buy again. Local publicity for such a scheme could also be helpful in encouraging owners of right to buy property to get in touch with the council or the ALMO if they are experiencing financial difficulties, which might save them from repossession.

A further option which a council and its ALMO might consider is the sale or leasing of empty houses or relets to the ALMO, at a favourable cost or at zero cost. This might be particularly appropriate with a distinct type of stock, such as street properties, that would not necessarily be seen by potential tenants as 'council housing'. This stock could then be let by the ALMO on assured tenancies and at rents designed to recoup the cost of any repairs. Borrowing could either be from the council (given that the council's terms are likely to be the most favourable) or – if the ALMO has ceased to be technically in the public sector – the borrowing could be private. In the latter case, the council may be able to provide some grant funding (using its private sector renewal powers).

One non-ALMO authority which does this through a separate company is Leicester (see box).

Practical example: Leicester HomeCome

In 2004, Leicester City Council set up a private, non-profit company (HomeCome), to which it sells vacant street properties in need of repair. The council has a 49% share in the company. HomeCome has no staff or premises and undertakes its work through contractors. The council provides housing management services.

Currently HomeCome has over 140 properties, let on assured tenancies. Originally HomeCome received improvement grants but lack of resources now prevents this. Instead, HomeCome has acquired property in the private sector on five-year leases. Allocations are from the council's register. Rents are kept within LHA levels through a grant paid from the council, in return for which it makes an index-linked equity charge on the property.

4 What alternatives are there for new ALMO structures?

1 Introduction

In order to carry out some of the wider activities they wish to engage in, ALMOs are looking at establishing new structures. Before considering how those structures may be used to further the ALMO's activities, it is necessary to consider what structures may be available.

A number of structures are currently being considered. These include:

- subsidiaries (charitable, not for profit or commercial);
- joint ventures;
- local housing companies; and
- local asset-backed vehicles.

A number of these are simply a rebadging of structures that have always been available. In addition, there are also some more ambitious alternative structures that are community-led, and their special characteristics will be considered in chapter 5.

This chapter is in four parts. First, it gives an overview of different types of structure. Second, it considers what charitable status means and whether it is appropriate. Third, it looks at how the EU procurement rules would apply to new structures. Finally, it provides more detail on the appropriateness of the specific new structures listed above.

PART ONE: TYPES OF STRUCTURE

2 Three categories of new structures

The types of structure which can be used fall into three categories:

- structures where an organisation with a separate legal personality is created;
- structures where a separate organisation is created, but this does not have a separate legal personality; and
- structures where there is no new organisation, but the relationships between the parties involved in the project are governed by a contractual agreement: a joint venture.

These are dealt with in turn.

3 Structures where there is an organisation with a legal personality

There are four main structures for organisations with a legal personality, set out below.

All these structures have a degree of formality because of their separate legal status.

Company limited by shares

This is appropriate to a project where profit is the main motive. Profits are distributed to shareholders through dividends.

It is unusual for companies limited by shares to be created to further 'public' projects. A company limited by shares cannot generally be a charity.

This is the 'usual' form of a joint venture company since it maximizes the ability to create separate categories of shareholder and director and so 'entrench' the rights of the different participants in the joint venture. There are now specific provisions in the Companies Act 2006 which allow rights to be 'entrenched' in the Articles.¹⁷

A company limited by shares pays corporation tax on its activities in the usual way, subject to the extent that its tax bill is reduced because of any gift aid payments it makes to a charitable organisation.

Limited liability partnership (LLP)

This is a fairly new form of corporate body which is appropriate only to profit-making enterprises as the participants in an LLP have to be '*...carrying on a lawful business together with a view to a profit*'.¹⁸ It has been used for a maintenance joint venture and for a number of property development projects.

The main advantage is that it is tax transparent. The activities an LLP undertakes are treated, for corporation tax purposes, as those of the constituent members. For a local authority, which does not pay corporation tax on activities (such as development for sale) which are normally taxable, this can be a significant advantage. However, this exemption does not extend to the ALMO.

A charitable body that participates in an LLP will pay tax on the taxable activities of the LLP, even though it could not undertake those activities itself. Careful tax planning is needed to minimize the impact of this corporation tax loss.

Company limited by guarantee

This is a 'not for profit' company, which is appropriate to projects where profit is not the primary motive and where there are no special reasons for preferring an industrial and provident society. All ALMOs are companies limited by guarantee.

Where companies are charitable, they are usually companies limited by guarantee. Companies limited by guarantee are also common for projects which have motives other than maximising profit.

Industrial and provident society

This may be charitable or non-charitable. An industrial and provident society is not appropriate for a profit-making project, since there are restrictions on the profits that can be taken out.

Industrial and provident societies are a common form for housing associations, where there used to be special rules which made them advantageous when borrowing from an organisation which is not a bank or building society. These rules no longer apply.

Industrial and provident societies are generally more complicated to register than companies and more expensive to administer (the annual fee alone is roughly four to 12 times that of companies, depending on the size of the society).

It is very rare for a joint venture to be an industrial and provident society.

4 Structures where a separate organisation is created, but it has no legal personality

The structures that are possible here are partnerships, limited partnerships, trusts and unincorporated associations (detailed below).

The disadvantage of all these types of structure is the risk of personal liability for the partners, trustees or committee members. Where potential partners, trustees or committee members are told of the risk, they are often reluctant to take up those positions. This usually leads to a search to find an alternative structure.

¹⁷ Section 22 Companies Act 2006

¹⁸ Section 2(1)(a) Limited Liability Partnerships Act 2006

Partnerships

In legal terms, a partnership exists where persons carry on business in common with a view to profit.¹⁹

Each partner has the authority to enter into obligations on behalf of the partnership as a whole. Each partner is liable for all of the debts of the partnership (subject to a right of reimbursement from the other partners of their share).

A partnership is usually regulated by a partnership agreement, although it can exist without a written agreement being in place.

Limited Partnerships

This is like an 'ordinary' partnership, but has 'limited partners' who limit their liability for the debts of the partnership. There must be at least one 'general partner' who has unlimited liability for the debts of the partnership.²⁰

The partnership is registered at Companies House but has no corporate legal existence independently of the constituent partners.

Trusts

Whilst organisations often use the word 'trust' as part of their name, a true trust involves individuals holding property for particular purposes (usually charitable purposes) or on behalf of particular individuals (in the case of private trusts, used mainly for tax planning). Apart from trusts for individuals, a trust cannot be used other than for charitable or similar purposes.

With a trust, the trustees are personally liable in their capacity as individuals for the liabilities of the trust. Trusts are therefore appropriate to large grant making charities, but not usually for organisations which are engaged in operational activities.

Unincorporated associations

This is similar to a joint venture (see below), in that there is an agreement (usually known as a 'constitution' or 'rules') which regulates the relationship of the participants in the project.

The members of the unincorporated association usually elect a management committee to manage it. The difference from a joint venture is that the management committee is given authority to enter into contracts and other relationships on behalf of the members of the unincorporated association.

The members of the management committee generally have unlimited personal liability for the debts of the association. Whilst they are entitled to be reimbursed by the members if the rules provide for this, the committee takes the risk that the members may not have the funds to be able to reimburse them.

5 Joint venture agreements

The other possible structure is a contractual joint venture. Here the relationship between the participants in the project is regulated by an agreement ('contract'). This may be given many different kinds of title including 'joint venture agreement', 'accord', 'memorandum of understanding', 'project agreement', 'development agreement' and even (although technically incorrect) 'partnership agreement'.

A joint venture agreement is basically a contract between the individual organisations involved in a project. This contract sets out what each organisation is required to do to move the project forward.

There is usually a 'steering board' (which may be called something different) which is set up to provide overall direction to the project. The board itself is given no authority to make decisions outside the contract. It cannot take on employees or sign contracts in its own name. In the joint venture agreement, each party agrees that it will be bound by and will implement the decisions of the board to the extent of the remit they have given to the board.

¹⁹ Section 1(1) Partnerships Act 1890

²⁰ Section 4(2) Limited Partnerships Act 1907

Actions agreed under the joint venture agreement, or by the board within the area of remit given to it, are then implemented by each of the participating organisations.

Since the board itself does not take any action or enter into any contracts, the issue of personal liability for the board members does not arise. Instead the liability for actions taken by each organisation involved in the project falls on that organisation itself.

For this reason, it is important for the joint venture agreement to set out the terms of reference and extent of the authority of the steering board to take decisions which bind the individual organisations involved in the project. This requires careful drafting so as to ensure that the members of the steering board are fully protected from the risk of personal liability.

PART TWO: CHARITABLE STATUS – IS IT APPROPRIATE?

6 Availability of charitable status

An organisation can be charitable if it is established for exclusively charitable purposes and provides 'public benefit'. There is now a list of charitable purposes in the Charities Act 2006.²¹ These include:

- the prevention or relief of poverty;
- the advancement of health or the saving of lives;
- the advancement of citizenship or community development (including regeneration and promotion of the voluntary sector);
- the advancement of environmental protection or improvement;
- the relief of those in need by reason of youth, age, ill-health, disability, financial hardship or other disadvantage; and
- any other purposes previously recognised as charitable.

The provision of housing is not, of itself, charitable. It is charitable only where it is provided in order to achieve one or more of the following:

- to relieve the needs of persons who are in necessitous circumstances ie who have:
'insufficient means to afford (from all available resources including the possibility of obtaining a mortgage) the purchase price or market rental of accommodation which is appropriate to enable him or her to house himself or herself and any dependants in order to maintain a modest and decent standard of living';
- to relieve the needs of those who are elderly;
- to relieve the needs of those who have disabilities or are suffering from long-term sickness;
- in some cases, to meet the needs of those who are engaged in charitable work.

The distinction between charitable and non-charitable activities is not always logical, since the case law has grown incrementally.

If an application is made to register a subsidiary as a charity it will be important to draft its objects and to describe its activities in appropriate language, so as to seek to ensure as smooth a path as possible with the Charity Commission.

7 Registration as a charity

A charity which is a company limited by guarantee is required to register with the Charity Commission if it has an annual income over £5,000.

At the moment, a charitable industrial and provident society is not required to register with the Charity Commission. Instead the Financial Services Authority currently acts as the regulator in terms of charity law. It is expected that, with

effect from October 2009, charitable industrial and provident societies with an income over £100,000 will need to register with the Charity Commission. There will be a number of exceptions to this, notably housing associations, where the Tenant Services Authority will continue to regulate charity issues.

Registration with the Charity Commission provides clear evidence of charitable status. It guarantees the availability of charity tax reliefs from HM Revenue and Customs (HMRC).

Industrial and provident societies currently need to persuade HMRC of their charitable status. In practice HMRC works closely with the Charity Commission to seek to apply similar standards.

8 Charitability of activities

If an organisation with charitable objects engages in activities which are not exclusively charitable then, unless those activities are insignificant or within the limits on 'taxable trading' set out below, it will be acting outside its powers ('ultra vires'). If this is done innocently, the Charity Commission is likely to give advice and guidance to the directors of the charity to ensure it does not happen again. If it is done deliberately, the Charity Commission may bring an action against the directors personally to recover any of the charity's assets that have been used for this ultra vires purpose.

The law is not clear on whether the *extent* to which the activities actually carried out by an organisation are relevant to whether or not it is charitable, but the Charity Commission certainly takes the view that they are relevant.

9 Independence

The Charity Commission requires an organisation that wishes to register as a charity to demonstrate its independence from governmental bodies. These requirements are set out in Charity Commission booklet RR7 *The Independence of Charities from the State*.²² These requirements include:

- The charity being free to decide how it will provide its services and to whom, rather than simply carrying out the wishes and policies of government or a local authority.
- Conflict of interest provisions being included in the Articles of Association which enable trustees to fulfil their duty to act in the charity's best interests and prevent people appointed by a governmental authority to the governing body of the charity from participating in decisions concerning that governmental body.
- The charity not carrying out statutory duties of a governmental or local authority (although a charity can supplement services provided by government or provide services where government has discretion whether or not to provide them).
- A charity receiving separate legal advice (ie not from the governmental authority) on the terms on which it accepts any funding from that governmental body.
- The only conditions imposed on any funding being those which are proper and appropriate to protect the funder's legitimate interests over how the funding is used.

Since an ALMO is currently wholly-owned by the local authority, the Charity Commission will require a charitable subsidiary to be similarly independent of the ALMO.

In practice a majority of the directors of the charity will need to be independent of the ALMO and will not be able to be appointed by the ALMO.

If the charity is to hold property, it will not be possible to protect the ALMO's rights to manage or use that property. The charity will have to be given the right to allocate tenants to those properties. Although this can be from the authority's waiting list, this will be up to the directors of the charity. The charity must have the absolute right to reject any nomination of a person they do not consider it is within the charity's objects to help.

If a charitable subsidiary is set up solely to receive payments under the gift aid scheme, the directors or trustees of the charity must be given full discretion how they use those sums to further the objects of the charity (although the ALMO will, of course, have some input into what those objects are).

²² This and other Charity Commission publications are available at www.charity-commission.gov.uk

10 Restrictions on activities

There are restrictions on the activities of charitable organisations. Activities can be undertaken only if they further the objects.

As well as the requirement to ensure that the activities which it carries out are exclusively charitable, there are particular rules for trading activities. Trading activities are those involving some payment being made for goods or services provided. They include providing services to another organisation.

Any trading activities undertaken to further charitable objects will be acceptable as an exclusively charitable activity. This is referred to as 'primary purpose trading'. It would include, for example, providing housing for people in need of it because they do not have the resources to afford to buy or rent housing in the housing market.

Apart from this, there are only very limited trading activities which a charity can carry out, as follows:

Ancillary trading

Trading is ancillary where it is carried out in the course of carrying out a primary purpose of the charity and is ancillary or incidental to it. Ancillary trading is treated as being primary purpose trading. It would include, for example, a college (whose primary purpose is education) providing accommodation to its students (but not to third parties).

Mixed trading

A 'mixed trade' is where either:

- some goods or services are provided in carrying out a primary purpose of the charity and some are not; or
- some goods or services are provided to charitable beneficiaries and some to persons who are not.

A mixed trade is exempt from corporation tax and acceptable under charity law where the turnover from the non-primary purpose part of the trade is:

- no more than £50,000 in a particular tax year; and
- less than 10% of the turnover of the whole trade in that tax year.

An example of mixed trading given by HMRC is a college providing student accommodation to students during term time and letting it to tourists during holidays.

Statutory tax exemption

By a statutory tax exemption, trading activities are exempt from corporation tax and acceptable under charity law where the total turnover from those non-primary purpose or ancillary trading activities is either:

- below £5,000; or
- between £5,000 and £50,000 and comprises less than 25% of the charity's total incoming resources (ie grants, donations and other income).

The exemption also applies if the actual turnover from the trading activities is over the limit but the charity had a reasonable expectation that it would not be.

It is not clear whether the mixed trading and the statutory tax exemptions are intended to be alternatives but it is unlikely that both of them would be allowed by HMRC for the same trade.

Any trading activities which a charity has undertaken which do not fall within any of the above-mentioned exceptions are likely to be subject to corporation tax on the profits generated by those activities.

11 Additional rules for investments

There are also special rules for charities to follow if they are making investments. These would require the board of the charity to consider:

- the suitability of the type of investment proposed;
- the suitability of the specific investment proposed; and
- the general need for diversification of investments.

Professional advice should be obtained before taking a decision to make an investment.

12 Restrictions on benefits to board members

It is a general principle of charity law that a director may not obtain a personal benefit from a charity of which he/she is a director. There are a limited number of exceptions to this which can be provided for in the charity's Memorandum and Articles of Association (if it is a charitable company). These can include:

- the reimbursement of out-of-pocket expenses;
- the provision of indemnity insurance;
- payments for services provided by directors who are professionals;
- the continued provision of housing for tenants who are tenant directors; and
- the receipt of benefits as a service user of the charity, as long as the benefits are no different from those available to other service users.

In order to reduce the risk of a director influencing the board to grant a benefit in his/her favour, any director with a conflict of interest (either personal or arising out of a duty to another body of which the director is also a board member) must be excluded from the decision to grant the benefit.

13 Additional administration and regulation

As well as having to make returns to Companies House, a charitable company would also have to make returns to the Charity Commission. This involves:

- providing the Charity Commission with a copy of the charity's annual accounts (including the directors' annual report); and
- completing an annual return.

There are also specific requirements to be followed by a charity in its fund-raising activities. These include requirements for public collections (which are unlikely to be relevant) and requirements for commercial sponsorship arrangements (which may be). Advice should be taken on these requirements before a charity enters into any arrangements with a commercial organisation.

The Charity Commission also has powers to make a formal inquiry into the affairs of a registered charity and to require the charity to reply to requests for information. The Charity Commission exercises these powers only when it considers it has reasons to do so, although it is increasingly undertaking random monitoring exercises of a number of charities.

14 Grant funding opportunities

A registered charity is allocated a charity registration number. As set out above, registration operates as a 'conclusive presumption' of its charitable status for all purposes (other than correction of the register). Official bodies and third parties (including grant-making charities) need not look any further than the existence of a charity registration number for evidence of charitable status.

A registered charity is often in a better position to obtain funding from grant-making bodies. Some grant-making charities have objects which prevent them from passing funds to organisations which are not charities.

Registration with the Charity Commission provides an assurance to other funding bodies of a charity's nature as a not-for-profit organisation and that the charity is subject to a supervisory and regulatory regime. An advantage of being subject to the Charity Commission's monitoring powers is that this can reassure potential funders over the likely use of funds provided.

15 Tax reliefs

A registered charity can more easily take advantage of corporation tax and business rate reliefs. The tax reliefs available to charities are as follows:

Corporation tax

Charities are generally exempt from corporation tax on interest income, rental income and capital gains as long as that income is used for charitable purposes.

Charities are also exempt from corporation tax on trading profits as long as:

- the trade is a primary purpose of the charity;
- the work in connection with the trade is carried out by beneficiaries; or
- the profits fall within the mixed trading concession or the statutory tax exemption set out above.

Any profit arising must, of course, be applied for charitable purposes.

VAT

There is no general exemption from VAT for charities. Charities generally pay VAT in the same way as other businesses. There are some specific reliefs for certain charitable activities, mainly relating to health and welfare provision, but they are unlikely to apply to a charity set up by an ALMO.

Stamp duty land tax (SDLT)

Charities are exempt from SDLT on the acquisition of land that is to be used for its charitable purposes. However, where this exemption is relied on, SDLT can become payable if that land is disposed of or ceases to be held for charitable purposes within three years of its acquisition.

Rate relief

Charities are entitled to 80% mandatory relief from national non-domestic rates on non-domestic buildings which they occupy. The remaining 20% can be given as discretionary relief at the discretion of the relevant council. The charity must be in rateable occupation of the property and must occupy it for its charitable purposes.

16 Process of registration

The process of applying to register as a charity is relatively straightforward. After checking that there is no other registered charity with the same or a similar main name, working name or acronym, an application for registration form is completed and sent to the Charity Commission, with:

- a copy of the Memorandum and Articles of Association and Certificate of Incorporation;
- a trustees' declaration form signed by the directors confirming they will comply with the principles set out in booklets CC21 (*Registering as a Charity*) and CC3 (*Responsibilities of Charity Trustees*) in their running of the charity; and
- evidence of income of at least £5,000.

The Charity Commission may raise queries about the running of the organisation and its proposed activities. They may recommend amendments to the Memorandum and Articles of Association which would then need to be negotiated with them. Depending on the volume of work in the Charity Commission at the time and the extent of queries raised by them, registration usually takes 3-6 months from submission of the application.

PART THREE: EU PROCUREMENT RULES

17 The contracting authority test

Where a separate organisation is set up, it needs to be considered whether that organisation must follow the EU procurement rules when making purchases. This depends on whether or not it is regarded as a 'contracting authority' under the rules. Both the council and the ALMO are 'contracting authorities'.

Under the EU procurement rules, 'bodies governed by public law' are contracting authorities. These include:²³

'any corporation established... for the specific purpose of meeting needs in the general interest, not having an industrial or commercial character and:

- *financed wholly or mainly by another contracting authority;*
- *subject to management supervision by another contracting authority; or*
- *more than half the board of directors or members of which...is appointed by another contracting authority.'*

There are two parts to this test:

- whether the organisation meets needs in the general interest which do not have an industrial or commercial character; and
- whether the organisation is mainly financed by, subject to management supervision by or has a majority of its board or members appointed by a contracting authority (either the council or the ALMO).

The first part of the test can be difficult to apply, but the intention seems to be to exclude those bodies where the need to compete means that they are under commercial pressures to purchase commercially.

'Meeting needs in the general interest' has been defined widely and includes promoting trade fairs, property development to stimulate economic activity and refuse collection. Any organisation undertaking activities for the benefit of the ALMO or the council (rather than on a wholly commercial basis as a profit-making activity) is likely to be regarded as 'meeting needs in the general interest'.

Even if only a small part of an organisation's activities involve meeting needs in the general interest which do not have an industrial or commercial character (with the majority of its activities being 'commercial') it will still satisfy this first part of the test.

It is likely that the second part of the test will be satisfied if the new organisation is a subsidiary of either the ALMO or the council.

18 Implications

The implications of the subsidiary being a contracting authority will be:

- it will have to follow the EU procurement rules in relation to its purchases;
- purchases by the ALMO or council from the organisation can be made outside the EU procurement rules only if the 'Teckal test' (see chapter 2) is satisfied.

The implications of the organisation not being a contracting authority will be:

- it will not have to follow the EU procurement rules in relation to its purchases;

²³ Under Regulation 3(1)(w) of the Public Contracts Regulations 2006

- it will not be possible to argue that the Teckal test is satisfied, so it will not be possible for purchases to be made from the organisation by the ALMO or council without tendering those purchases under the EU procurement rules (unless, of course, the value of those purchases is below the tendering threshold and the contract is unlikely to be of interest to contractors outside the UK).

Essentially the test will be whether the subsidiary continues to be run and operated as a commercial business, competing in the marketplace, or whether it is not run on wholly commercial lines in relation to some or all the business it undertakes for the ALMO or council.

The legal justification for exempting contracts from tendering where Teckal applies has not been set out in case law. However, the rationale seems to be that the contracting authority and subsidiary are in effect the same organisation. If this analysis is correct, this would make the subsidiary itself a contracting authority.

Given this analysis, it is difficult to see how it would be possible to argue at the same time that both the organisation is within Teckal (and so subject to management control by the ALMO or the council) and that it operates in a fully commercial way. Thus, if the Teckal test is satisfied for the organisation, this will mean that it is a contracting authority and will have to comply with the EU procurement rules (in relation to its own purchases).

PART FOUR: MORE DETAILS ON PARTICULAR STRUCTURES

19 Subsidiaries

Overview

An organisation is a subsidiary of another ('the parent') if the parent:²⁴

- holds a majority of the voting rights in it, or;
- is a member of it (ie shareholder or member of a company limited by guarantee) and has the right to appoint or remove a majority of its board of directors, or;
- under a shareholders' agreement or joint venture agreement has sole control of a majority of the voting rights in it.

A subsidiary may be set up with any of the corporate forms set out at the beginning of this chapter. The most common form is a company limited by shares, closely followed by company limited by guarantee. A company limited by shares is used where the subsidiary is 'for profit' and a company limited by guarantee is used where the subsidiary does not require working capital and there is no need to transfer profits to the parent by way of dividend.

The 'parent' here could be any corporate body (including a local authority).

There are three principal reasons why a parent may set up a subsidiary:

- to carry out activities the parent cannot itself undertake;
- to ring-fence risk so that if the business carried out by the subsidiary fails, the losses can be contained within the subsidiary rather than having to be met from the parent's resources; or
- to gain tax exemptions, if the subsidiary is charitable and the parent is not.

Potential ALMO involvement

It is fairly straightforward for an ALMO to set up a subsidiary. All that is required is the appropriate resolutions of the board and (where the Management Agreement requires) obtaining appropriate permission from the council. The company is then formed with a Memorandum and Articles of Association that are registered at Companies House.

The most likely reasons why an ALMO may wish to set up a subsidiary are:

- to protect the exemption from having to tender the Management Agreement under the EU procurement rules where the ALMO is beginning to carry out significant activities in its own right rather than for the local authority;

- to hold new build properties so as to avoid the VAT partial exemption issues that would occur if the new build properties are held within the ALMO itself (see chapter 2); or
- to create a charitable fund to which taxable profits are paid by gift aid and used for community projects decided on by the trustees of the charity.

In the case of the charity, it may be necessary for this to be a parallel organisation rather than a subsidiary because of the independence requirement explained earlier.

Implications

The subsidiary will need both funding and resources to carry out its activities. In practice these will need to come from the ALMO. The resources the ALMO will provide can include both central services (finance, company secretarial, audit) and operational services.

The arrangements for the provision of services to the subsidiary need care. The options are:

- the ALMO could provide the services of its staff to the subsidiary;
- those staff could be seconded full- or part-time to the subsidiary;
- those staff could be employed on joint contracts of employment; or
- those staff could be employed by the subsidiary.

If the subsidiary relies on staff of the ALMO to carry out its activities, care needs to be taken to ensure that this supply of services by the ALMO to the subsidiary does not become so substantial that the ALMO no longer continues to *'carry out the essential part of its activities for the contracting authority'*.

Secondment is unlikely to work as a long-term option. There is case law that a long-term secondment with no plans to terminate the arrangement is likely to be treated as a TUPE transfer.

The subsidiary would generally be expected to pay for the services that it receives from the ALMO. It is good practice to set out the services to be provided and the arrangements for paying for them in a services agreement.

If the level of services provided from the ALMO to the subsidiary becomes significant, the staff providing those services should be transferred either to the subsidiary or onto joint contracts of employment, where they work for both the ALMO and the subsidiary.

Staff working with the subsidiary are likely to prefer the security of being employed by the ALMO. Joint contracts of employment, where there is more than one employer, are used by a number of housing associations. There are potential legal risks with joint employment contracts (including the possibility of any redundancy or unfair dismissal payments being able to be claimed from both employers). There are also practical points to consider, including deciding how disciplinary and grievance issues will be dealt with. Obtaining good quality legal advice on drafting the employment contract is essential to mitigate the legal risks, although some of them cannot be totally eliminated.

Finance

The ALMO will need to provide the subsidiary with working capital from its own resources. This could be provided either by loan, gift or, with a company limited by shares, by subscribing for shares.

Unless it is charitable, the subsidiary will be liable to corporation tax on its activities. The subsidiary will also be liable to pay stamp duty land tax on any real property that is transferred to it (again, unless it is charitable). Tax and VAT advice will also be required, particularly on the arrangements between the ALMO and the subsidiary.

Any profits earned by the subsidiary will, subject to tax, belong to the subsidiary.

20 Joint ventures

Overview

The basic types of joint ventures (JVs) possible were set out earlier. As pointed out, JVs may be purely contractual or may involve setting up a separate organisation. JV organisations are most commonly companies limited by shares, followed by limited liability partnerships (particularly where local authorities are involved, because of their tax-free status) and companies limited by guarantee.

A JV can be set up for many different purposes. It can either be based on a single project or may be the vehicle through which a number of projects are undertaken.

Where a separate organisation is set up, its governing document (Memorandum and Articles of Association or LLP Members Agreement) is usually specially drafted. It is usually accompanied by a contractual document called a Joint Venture Agreement or a Shareholders' or Members' Agreement. These documents together enshrine the principle of joint working in the governing documentation of the organisation.

In an equal JV, they will cover things such as removing the chair's casting vote, restricting activities outside the agreed business plan unless both parties agree to them, and giving both parties equal voting rights at board meetings, irrespective of the number of their directors present. In an unequal JV, these documents protect the rights of the minority party.

Potential ALMO involvement

Because the only assets that can be brought to a JV are owned by the local authority rather than by the ALMO, the only likely role for an ALMO in a JV is as the owner or manager of any social housing properties that are created. The ALMO will be heavily dependent on the local authority to bring it into the JV since there will be no 'essential elements' of the JV it can bring to the table. Essentially, therefore, the ALMO will 'share' in the local authority's participation in the JV.

A further role for the ALMO is as the provider of services to the JV. There is no difference in principle between providing services to a JV and providing them to any other organisation so this is covered in chapter 2.

A further possible form of JV for ALMOs is a partnership between two or more ALMOs to share services or undertake joint activities. For example, Brent Housing Partnership and Kensington and Chelsea TMO set up a JV called Grand Union Homes, which bid to manage stock in part of Westminster.

Practical example of ALMO partnerships – Brent and Kensington & Chelsea

For almost five years Brent Housing Partnership and Kensington and Chelsea TMO have had a collaborative relationship. Conveniently, the neighbouring ALMOs have both been 3* rated organisations.

They have developed shared support services in areas such as human resources, health and safety, standards and procurement and communications. In October 2007, BHP's Managing Director also became K&C's interim chief executive. The shared arrangements have helped keep costs low, but have at the same time maximised the resources available for frontline services and provided many opportunities for learning from each other.

The two ALMOs recently embarked on a joint venture to provide consultancy and management services to ALMOs, HAs and councils. Both organisations already had a history of providing consultancy services and have been successful in their independent endeavours. The idea is that the two organisations can provide advice and assistance to other social landlords and any revenue shared between the ALMOs can be used to enhance service delivery to their residents.

Implications

The purpose of an ALMO participating in a JV is likely to be to provide social housing, either through owning or managing that housing. As such, the activity will be within the ALMO's objects.

The Model Management Agreement does not prevent participation in a JV, but the ALMO's Management Agreement should be checked to ensure no consents are required.

Key things to consider in relation to a JV are:

- What activities will the JV undertake and how will they be controlled?
- What will be the role of each participant in supplying services to the JV, on what basis will they be provided, how will they be paid for and what rights will the other participants in the JV have in relation to them?
- What happens if one party breaches its obligations in relation to the JV?
- What are the arrangements for dispute resolution?
- What are the arrangements for withdrawing from or ending the JV?

Finance

As with a subsidiary, the JV will need funding. In most cases the majority of the funding will be provided by private sector parties, since this, together with expertise, will be the main thing that they bring to the JV. The ALMO may also need to provide a small amount of working capital for the JV.

Tax and VAT are key issues in any JV, as is stamp duty land tax on any land transfers. Expert advice is required on this. The advice will need to consider the tax treatment of profits both in the JV itself and when those profits are taken out of the JV, by the participants in the JV (including the ALMO).

21 Local housing companies

The term 'local housing company' (LHC) has had a number of meanings over recent years. Originally it was used as the term for a stock transfer housing association, where there is a balanced (often equal) representation between tenants, councillors and independents. More recently the term has been used to describe a JV between a public body and a private organisation. This is done so as to create a collaborative vehicle where the public sector brings land to the table and the private sector brings both cash and the ability to borrow outside public sector borrowing rules. This is the type of LHC discussed here.

The expectation is that an LHC will be an equal JV between the public and private sectors. ALMO involvement will be treated as being on the public sector side, because of the council's ownership of the ALMO.

In an LHC the public sector cannot have more than a 50% interest because of the need to ensure that any borrowing by the LHC is off the public sector balance sheet and outside public sector borrowing rules.

Although JVs do exist with the public sector being a minority partner (with their rights being protected by special Articles of Association and a stakeholder or Joint Venture Agreement), the expectation is that with a LHC the public sector will usually want a 50% stake. This is particularly the case where the local authority puts substantial assets (usually land) into the JV.

An LHC is a JV that is focused on housing, but essentially it is no different from any other JV.

22 Local asset-backed vehicles

A local asset-backed vehicle (LABV) is also not a set structure. The basic concept behind an LABV is that a public sector body will select a developer and/or an investor partner with whom they wish to set up a joint venture to pursue long-term regeneration and developmental objectives. The public sector organisation (for example a local

authority) will provide the land and the private sector will provide capital and development knowledge. Other labels, such as 'Asset Investment Vehicle' are used to describe the same structure.

A LABV is usually designed to be a long-term strategic organisation, working on a number of projects within an area, rather than simply carrying out redevelopment on a site-by-site basis. They therefore offer the possibility for a strategic approach to regeneration. LABVs may be structured in many ways, such as through a company limited by guarantee or as a limited liability partnership.

As with local housing companies, LABVs are joint venture organisations with representation from both the private and public sectors. The only practical difference from local housing companies is that their activities are not usually restricted to housing. LABVs have been considered by at least two London boroughs, as vehicles for new build.

The implications of an ALMO participating in LABVs are the same as with any other JV.

5 How community ownership could refresh ALMOs

1 Background

The new investment models set out earlier in this report are designed to generate additional resources which would not be counted as public sector borrowing. They require transference of risk, and new governance and contractual arrangements which lessen local authority control. They would require ALMOs to cease to be 100% local authority owned, although legal ownership of the stock would remain with the local authority and tenants would remain council tenants.

This chapter explores alternative structures which involve tenant and community membership and leadership. Some could enable access to private finance whilst retaining council ownership. There are also wider benefits that could be secured through community membership and leadership which would:

- Build on the success of ALMOs in involving tenants and leaseholders in how their homes and neighbourhoods are managed and the governance of their housing provider.
- Support the drive towards community empowerment as set out in the *Communities in Control* white paper or the planned Local Democracy, Economic Development and Construction Bill.
- Provide opportunities to devolve more power to tenants – where they want it – and create a basis for sustainable community involvement and empowerment.
- Fit with government commitments to provide more opportunities for tenant management and to increase the number of asset and management transfers.

ALMOs know that housing is about much more than everyone having a decent home. They share with their partners an ambition to see sustainable communities developed and be better managed. The scope of new community-focused structures, and generating new finance whilst creating new ways of engaging with and involving communities, are issues explored in this chapter.

The alternative structures to be considered are Tenant Management Organisations, housing co-operatives, Community Land Trusts, Development Trusts and Community Associations. The Community Gateway Model is also described – this involves both a process to set up an alternative structure and governance arrangements within that structure. The chapter concludes by considering the policy opportunities that currently exist which would help in taking forward community ownership approaches.

2 Tenant Management Organisations (TMOs)

Chapter 3 pointed out that the Kensington & Chelsea TMO is a private company 100% owned by tenants and so would not need a change of constitution to raise private finance. It suggested that it could therefore be a pioneer for others. This section explores how a similar model could work.

TMOs are a mechanism for tenants to take over the management of local authority housing stock under section 27AB of the Housing Act 1985. This requires that local authorities (if requested) must pass their responsibilities for housing management to TMOs provided that the appropriate regulations and guidance have been followed. The Local Government White Paper (2006) set out the government's continuing commitment to tenant empowerment including a review of the Right to Manage regulations. The stated aim of that review was to create more opportunities for tenants to get involved in the management of housing, community facilities, recreational areas, and other neighbourhood services, resulting in more responsive services and empowered communities.

The Housing (Right to Manage) Regulations 2008 have now been updated alongside statutory guidance to which local authorities and ALMOs must have regard. The changes:

- simplify the Right to Manage, reducing the time it takes to set up a TMO;
- encourage an easier route into tenant management, beginning with limited responsibilities rather than full management;
- create a voluntary route to establishing TMOs which complements the statutory process;
- provide more opportunities for residents to manage other housing-related services such as caretaking or grounds maintenance in their own area; and
- make it easier for existing successful TMOs to take on additional service responsibilities within their neighbourhood.

There are currently over 250 TMOs managing 85,000 homes nationally. They are reported to be performing better than their host local authorities, being equal to or surpassing the top 25 per cent of authorities in terms of repairs, relets, rent collection and achieving higher tenant satisfaction. Under the Right to Manage regulations an approved assessor decides whether a TMO that is proposing to take over housing management functions is competent to do so. A TMO will be considered competent if it can show evidence that:

- It is a well-run organisation that is open to everyone.
- It is an engaged community organisation.
- It can control its finances responsibly.
- It can organise itself to achieve its strategy.
- It has effective plans to provide the services it wants to manage.

Once the approved assessor has decided that a TMO is competent to take on its management responsibilities, the local authority must prepare an offer to tenants and, for the proposal to proceed, obtain the support of the majority of tenants and leaseholders who vote in a ballot. A request to transfer housing management functions to a TMO can be negotiated on a voluntary basis although at any stage tenants may serve a Right to Manage proposal notice, and switch to the Right to Manage route prescribed in statutory regulations.

For the local authority to enter into a management agreement with a TMO, the TMO must become incorporated, either as a company registered under the Companies Act 2006 or an industrial and provident society under the Industrial and Provident Societies Act 1965 (see chapters 2 and 4). Currently ALMOs, with the exception of the Kensington & Chelsea TMO, are creations of the local authority that could be wound up by it. Tenants have the benefit of a statutory Right to Manage, however, and through a TMO they form a membership body which determines its continued existence or not and appoints the majority of its board of directors whom at all times are elected by the members of the TMO.

If tenants support the proposal, the TMO signs a management agreement with the local authority to take on all or some of its management responsibilities for properties. The Secretary of State's section 27 consent to the delegation of functions is automatically granted where the CLG Modular Management Agreement has been used either through the Right to Manage or voluntary negotiations. The Modular Management Agreement allows for TMOs to decide what range of management duties they wish to take responsibility for, offering modules from which tenants can take as much or as little control as they want. The local authority will allocate an allowance per property for management and maintenance on this basis with the TMO operating its own accounts with this allowance. ALMO or local authority staff may also transfer or be seconded to the TMO.

Typically TMOs have been set up by tenants in an estate or local area to run the properties in their area (often where there is dissatisfaction with the services being provided), rather than covering the entire council's stock. A notable exception is the TMO in Kensington and Chelsea which is the only TMO covering almost the whole of a council's stock. An options appraisal is currently being carried out by the local authority which intends to consult tenants on how each of a range of stock options could work, in 2009.

Practical example: Kensington and Chelsea TMO

The Kensington and Chelsea TMO was established in 1996 following decisions made by the tenants and leaseholders of the borough to pursue their legal Right to Manage their own homes. Since that time it has managed and maintained the entire housing stock (with the exception of one estate which has its own Estate Management Board). In addition the TMO can provide management services to other organisations and has wide ranging powers to promote resident participation, both within the borough and more generally, and to enter into contracts for the benefit of the organisation.

In 2002, Kensington and Chelsea TMO became the first tenant-led ALMO when it took over the responsibility for major capital works from the council, when the authority secured ALMO funding. It is tenant-led because tenants constitute the majority of directors on its board, with eleven elected tenant members – compared to five appointed by the local authority and five independent members.

This model could be adopted in other ALMOs, with tenant membership and leadership enabling private finance to be secured provided that there were adequate governance arrangements. The change would of course require an appropriate service contract and business plan and regular inspection by an independent body such as the Audit Commission.

The route for a statutory TMO to be able to enter into a management agreement without it first being tendered under the EU procurement rules is different from ALMOs. It does not rely on the Teckal case. There is an exemption from tendering where an organisation which is a contracting authority under the EU procurement rules is given an exclusive right to deliver those services by ‘a statutory or administrative provision or guidance’. That provision must also be ‘consistent with European legislation’. The argument here is that only a TMO that has been set up under the Right to Manage Regulations has the right to call for the grant of a management agreement. In that sense its right to do so which is given by statute and the regulations based on that statute, is ‘exclusive’.

Since this agreement relies on a right given by legislation, it is not available where the voluntary TMO route is followed.

In March 2009 the NFA, National Federation of TMOs (NFTMO) and the Councils with ALMOs group (CWAG) jointly launched the report *Local Authority, ALMO and TMO Relationships – A Good Practice Guide* which is intended to assist the development of tenant involvement where ALMOs manage their homes. The Minister, Iain Wright MP, has endorsed the guidance and written the foreword.

3 Housing co-operatives

TMOs are often constituted as co-operatives with all tenants of the properties managed by the co-operative being members of the co-operative. Tenant Management Organisations are management co-operatives responsible for stock which remains in local authority ownership. Other types of co-operative involve outright change in ownership arrangements or leasing arrangements on land or homes. They include:

- *Ownership co-operatives* which collectively own the housing that they manage. These can be financed from public funding, mortgages or loan stock. Ownership co-operatives are traditionally small but give tenants more control.
- *Self-build co-operatives* where the tenants have been involved in the building of the properties. The labour that they put into building the properties gives them a ‘sweat equity’ whereby they own a percentage of the property and pay rent for the rest.
- *Short-life co-operatives* take over properties that are in some way unlettable, for a fixed period of time, which can sometimes extend for many years. The co-operative does not own the properties, but has a lease with the landlord.
- *Mutual shared ownership* in which land is leased to a Mutual Home Ownership Society by a Community Land Trust at a peppercorn rent. Residents buy equity units held in a common trust fund until they move out and sell the equity units they hold.

- *Community-based housing associations* which are tenant controlled, having a majority of tenants on the board of the association alongside other representatives. These can arise from estate-based transfers, and those using the Community Gateway Model (see below).

Ownership co-operatives and mutual housing models offer opportunities for tenants that wish to develop new organisational forms. Management co-operatives, like TMOs, avoid stock transfer, but could offer a basis to secure private finance. Government has stated that it supports the spread of strong, viable, well-managed, financially robust and democratically accountable housing co-operatives. TMOs can be established and expanded using the revised regulations outlined above. Ownership and mutual home models can be taken forward through the work of the Commission on Co-operative and Mutual Housing – an independent body taking evidence on how the role of housing co-operatives and how mutual housing solutions could be successfully expanded.

4 Community Gateway Model

The Community Gateway Model is designed to engage tenants in the decision making process and encourage them to take more power. It has been developed through joint work between the Chartered Institute of Housing, Confederation of Co-operative Housing and the Co-operative Union, funded by the Housing Corporation. The model has been applied in a number of recent transfers where the tenant-led character of the transfer RSL formed a part of the offer to tenants. For example, it was applied first in the whole stock transfer in Preston, and was adopted in a partial form for the King's Lynn and West Norfolk transfer.

The Community Gateway Model could be adapted and applied to the creation of tenant-owned and led ALMOs. The model enables this as it contains two elements:

- the *Community Gateway Process* which is an approach to selection and delivery of housing options that creates opportunities for the devolution of power to tenants; and
- the setting up of a *Community Gateway Association* which can be a not-for-profit organisation formed to manage stock (which could be council stock if the body was or became an ALMO) or to take *ownership* of the stock as a housing association.

The Community Gateway Model is designed to be applicable in any situation regardless of the change of management or ownership being considered. The process is based on notions of a ladder or staircase of involvement and includes:

- Developing and investing in a community empowerment strategy showing how tenants can increase their involvement in decision-making and management both at the landlord and local level, including capacity building for tenants and their organisations.
- Agreeing 'Local Community Areas' that will be the focus for community-based activities and decision making.
- Carrying out a programme of community option studies, where every local area gets the chance to consider how it wants to be involved in the future (and providing for different levels of involvement in different areas, according to tenants' views).
- Consulting other residents and the wider community about decisions that are relevant to the whole community (eg ASB, traffic, open spaces, etc).
- Giving every local community a range of options for involvement, from consultative approaches through to management and ownership.

The Community Gateway Association is an organisation which can be formed to take forward this process and become, if tenants wish it, the vehicle to take over management or ownership from the local authority. Such bodies have achieved partial stock transfers and whole stock transfers.

The Community Gateway Model could also be applied, where tenants wish it, in authorities with an ALMO in place. The ALMO could seek through this route to reconstitute itself as a tenant-owned and led body able to deliver an enhanced offer to tenants and access to private finance.

The main features of a Community Gateway Association are:

- An obligation to secure the widest possible involvement in the organisation, and to promote and provide opportunities for increased tenant control.
- An obligation on the association to respond to requests to devolve power, subject to tests of competence and viability.
- Registration either as a company limited by guarantee or an industrial and provident society, either as a freestanding organisation or as part of a newly formed or existing group.
- Tenants and leaseholders being individual members of the association.
- Tenant board members making up the largest single group on the board if not an absolute majority.
- Tenant board members being selected by all tenants of the organisation or by the tenant membership of the organisation.

The model rules for a Community Gateway Association embody objects that benefit the community by:

- Providing housing, accommodation and assistance to help house people and create associated facilities and amenities.
- Providing tenants and members of the community with the opportunity to choose and exercise options in relation to the ownership, management and control of their homes and communities.
- Providing training and information to encourage community development.
- Pursuing other objects that can be carried out by a registered housing provider. This could be adapted to include other objects relevant to an ALMO.

ALMOs could take a gateway approach forward by either:

- Adapting the Memorandum and Articles of the ALMO to include features of a Community Gateway Association.
- Working with tenants, the local authority and tenant advisers to form a separate body constituted as a Community Gateway Association.
- Forming a group structure which includes the ALMO, with or without adapted objects, alongside a Community Gateway Association.

However constituted, the Community Gateway Association would then be committed to the development and implementation of arrangements to devolve management or ownership through the following steps to:

- Identify the area(s) to be the focus of study – which could include part or all of the local authority or ALMO area.
- Commission community option studies to enable local communities to determine their wishes and aspirations.
- Facilitate local representative tenant and resident groups – work which would be aligned to the local Tenant Empowerment Strategy.
- Develop a programme of capacity building to promote the skills of individual residents and tenants and of their community groups (to enable them to take more power over their housing and environment).
- Consider proposals from tenant and resident groups to vary the current provision of management of its housing, including conversion of the ALMO.

The gateway approach does not constrain the approaches that might be selected. Tenants might therefore seek variations to current management arrangements that do not support the ALMO becoming a tenant-led body managing the whole stock. Other outcomes could include:

- Formation of TMOs to which housing management functions would be delegated either covering the whole or part of an area.
- Establishment of a housing association to which housing stock would be transferred either covering the whole or part of an area.

Should either of these options be proposed by tenants and residents, then a Community Gateway Association under the terms of its objects would pursue the matter and:

- Satisfy itself that the group making the proposal is a representative body, open to all, and that its proposals have been communicated in the local community area.
- Ensure that the majority of tenants and leaseholders in the area are in favour of the proposal.
- Commission a feasibility study of the viability and competence of the proposed organisation.
- If the proposal proves feasible, instigate a ballot of all tenants and leaseholders in the area.
- If the ballot is positive, instigate a development process for the proposed organisation.

The Community Gateway Model presents a potential challenge for an ALMO since it establishes and supports a process with an uncertain outcome. An ALMO taking a gateway approach would be obliged to facilitate and support work towards alternative options – if that is what tenants and residents wished. This is arguably less straightforward than the conversion of an ALMO into a tenant-owned body, or one where tenants owned 51% of the company, that could be legally achieved without a wide ranging gateway process.

There are, however, some strong reasons why the gateway model should be adopted with a view to furthering the potential to establish community membership and tenant-led ALMOs. These are because:

- The trigger for change being considered may well be an options appraisal process initiated by the local authority.
- That process would necessarily look at alternative options such as TMOs and stock transfer.
- There is room for an open and honest consideration of whether the best option could be stock transfer.
- The gateway approach may better engage tenants in the process and lead to greater ownership of the outcome.
- An explicit part of the process is developing the capacity of residents so that they are in a better position to be involved in, or take degrees of control over, the management of their housing.
- The involvement and commitment of tenants will better inform the business plans that are developed.
- The process used, the preferred option and business plan would strengthen the case to government for funding.

There are already Model Rules for a Community Gateway Association and a model Community Empowerment Strategy.²⁵ A Model Memorandum and Articles of Association to adapt an ALMO in order to pursue a community gateway approach could be developed with the HCA, co-operative and mutual housing bodies and other partners. Model rules could also be developed for a Community Gateway ALMO that is an industrial and provident society. This would link to the call from the Commission on Co-operative and Mutual Housing for government to review progress of the Community Gateway Model, explore lessons that can be learnt and how the model could be used more widely. This dialogue could provide opportunities to gain support for a staged approach enabling ALMOs to move at a pace supported by tenants, with community option studies, feasibility studies and development costs being built into the ALMO business plan.

ALMO resources devoted to a gateway approach could be complemented by resources that the local authority would provide as landlord and as the strategic housing authority – such as option appraisals, capacity building and consultation. Tenant bodies would also be able to attract external resources to fund feasibility studies, capacity building and independent advice from the Tenant Empowerment Programme. ALMOs working with their local authorities and tenants in this way could make a strong case for the freedoms and flexibilities required to deliver an ambitious programme of community investment and renewal, particularly in disadvantaged and low quality neighbourhoods where action beyond decent homes is clearly required.

²⁵ See *Empowering Communities: The Community Gateway Model*; details of this and related publications, including downloadable bulletins, are on the CIH website at www.cih.org/gateway

Questions about the Community Gateway Model

What are the key elements of the model?

These are set out in the report *Empowering Communities*. A landlord body based on CGM principles should have:

- a tenant majority membership – to give a sense of ownership and community guardianship of the gateway’s key values and directions – which can participate in shaping the gateway’s strategies and policies;
- tenant board members elected in some way by the membership;
- defined *local community areas* reflecting community perceptions;
- a structured programme of *community option studies* carried out in local community areas to define community vision and aspirations, to develop the ability of communities to achieve their vision, and to enable communities to engage with service providers;
- a staircase of housing options available to local communities, from informal engagement to tenant management and community ownership; and
- all of this set out in a written *community empowerment strategy* and built into the rules and structure of the organisation.

Of course, some organisations may not want to go as far as including all these elements, but then they would only be applying parts of the model.

Is the Community Gateway Model only suitable for stock transfers?

No. CGM can be used to manage council housing (as an ALMO), to take ownership of homes, or in a number of other situations. A gateway organisation could be a not-for-profit limited company, an industrial and provident society, a stand-alone landlord or part of a bigger group structure.

Can tenants become the majority stakeholders in a community gateway association?

Yes. In the case of a housing association, this is subject to meeting the TSA’s overall registration and regulation requirements. Guidance on this is given in CGM bulletin no.4, available on the CIH website (see below).

Is this model suitable for parts of an organisation’s housing stock, as well as wholesale transfer?

Yes. It can be used for some, or all, homes. Every neighbourhood or community’s needs are different, so it’s important to be flexible.

What are the main duties of a Community Gateway Association?

Tenants are at the heart of a gateway association and shape everything they do. Initially, new associations usually focus on the housing service. But over time, they could develop a wider role.

What are the main steps involved in setting up a Community Gateway Association?

There are six steps crucial to getting started:

1. Build awareness among tenants, leaseholders, staff, councillors, the media and local communities.
2. Decide which areas would be covered by the gateway approach.
3. Agree the size, legal structure and responsibilities of the organisation.
4. Work with tenants and leaseholders to promote the model and recruit members.
5. Set up the shadow board(s) for the new organisation.
6. Develop a community empowerment strategy and business plan with sufficient resources to ensure that it can be carried through.

If stock transfer or a change of manager is likely, it’s important to build community empowerment programmes into the offer to tenants and leaseholders.

Further information: www.cih.org/gateway

5 Community Land Trusts

Community Land Trusts (CLTs) are local community-controlled organisations that can be set up to own and manage land and other assets – including housing – in perpetuity, for the benefit of the community. They can operate in a number of areas using different legal structures. They are most likely to be constituted as industrial and provident societies or as companies limited by guarantee. Other potential legal forms may be community interest companies, companies limited by shares and limited liability partnerships. However, none of them are ‘trusts’ in the legal sense (see chapter 4).

CLTs have been defined in section 79 of the Housing and Regeneration Act 2008 for the express purpose of ensuring that they are eligible for registration by the Tenant Services Authority. A Community Land Trust which qualifies is defined in the 2008 Act as a corporate body which satisfies the conditions below (in those conditions ‘local community’ means the individuals who live or work, or want to live or work, in a specified area):

- *Condition 1* is that the body is established for the express purpose of furthering the social, economic and environmental interests of a local community by acquiring and managing land and other assets in order:
 - to provide a benefit to the local community; and
 - to ensure that the assets are not sold or developed except in a manner which the trust’s members think benefits the local community.
- *Condition 2* is that the body is established under arrangements which are expressly designed to ensure that:
 - any profits from its activities will be used to benefit the local community (otherwise than by being paid directly to members);
 - individuals who live or work in the specified area have the opportunity to become members of the trust (whether or not others can also become members); and
 - the members of the trust control it.

In 2007 the Housing Corporation began working with Community Financial Solutions at the University of Salford to provide technical support and guidance to 14 CLT pilots. The aim of the pilots was to explore what role CLTs have in delivering affordable housing and identify models that are *scalable* (ie can be used regardless of the size of CLT), *deliverable* and can be *replicated*. CLTs were also invited to bid for the National Affordable Housing Programme 2008-11, for funding from the Housing Corporation/HCA.

The recent Community Land Trust consultation paper from CLG commented that NAHP bids from CLTs have generally proved more expensive, using existing Housing Corporation assessment criteria, but also noted that their aim of creating affordable housing in perpetuity and their wider community benefits merited a review of the way in which such bids are assessed. In the consultation paper, government stated it is committed to the development of a well-managed and financially robust CLT sector. CLTs are now being referred to as a useful part of a mixed economy of different affordable housing providers and models (in addition to local housing companies, ALMOs, local authorities and housing associations).

CLTs work on the principle of separating the ownership of land and the homes provided on the land, retaining the value of the land and assets in perpetuity, on behalf of the wider community. However, there is currently no settled legal model of how to do this since under UK law it is not possible to separate the ownership of a building from that of the land on which it is built. Most CLTs therefore rely on some kind of leasehold or shared ownership model. Land is acquired by CLTs either by:

- being gifted through philanthropic gifts, charitable endowments, legacies; or
- through sale by a public body at a heavy discount; or
- by means of planning gain from developers who endow a CLT with a portion of the land for affordable housing development and/or other community purposes.

CLTs are set up in a way that ensures that a share of the increased asset value will be locked in for the benefit of their local community when the land is developed for housing.

CLTs either rent or sell housing to local residents but homeowners only buy a limited interest in the land they occupy, rather than owning the land outright. Typically where a property is sold, the homeowner will be given a long-term,

renewable lease, enabling the resident to raise a mortgage and allowing for succession rights by family members. The CLT retains the right to buy the lease back at a price defined by a resale formula, which aims to provide the homeowner with a share in the equity built up from mortgage payments and improvements. This mechanism ensures that housing built through CLTs remains affordable – subject, that is, to the grant requirements of funding bodies.

CLTs have the potential to create a permanent supply of affordable intermediate market housing with a seamless transition of tenure from rental to ownership. Research into the national CLT pilot projects identified a need to ensure enduring affordability, and simplify the process of delivery and funding by excluding new homes built on CLT land from the enfranchisement provisions of the Leasehold Reform Act 1967. The Commission on Co-operative and Mutual Housing has called for this change to be made in the planned Local Democracy, Economic Development and Construction Bill.

CLTs seek to raise private finance for the long-term funding of schemes, for example to fund the proportion of equity not sold to shared owners or buy back properties that might otherwise be lost to the open market. CLTs require business plans and governance arrangements that give lenders confidence to lend on properties where covenants on resale are restrictive.

A CLT can open membership to organisations as well as individuals which share the aspirations of or support the CLT and can create different membership classes, representing different stakeholder groups, such as landowners or local authorities. A local authority could therefore appoint directors.

An option would be for local authorities to work with tenants, residents and stakeholders to establish a CLT or a number of CLTs into which the local authority vested land. These CLTs could then work with the ALMO, which itself could take on a changed form, in order to secure grant funding and private finance for new affordable housing. If the land in question were built upon, for example with council dwellings, then an alternative to outright transfer would be a long-term lease from the local authority to a Community Land Trust.

An ALMO could negotiate to manage the existing and/or new stock built on land sold or leased to the Community Land Trust. This option could be complementary to other routes such as joint venture companies and local housing companies. ALMOs contracting to manage stock developed by these companies and CLTs would form part of the wider mixed economy of providers that offer long-term housing and regeneration benefits.

6 Development trusts

The term ‘development trust’ is used to describe organisations that operate in a certain way, rather than to describe organisations having a specific governance structure. The Development Trusts Association (DTA) defines them as being:

‘...community owned and led ... they use self-help, trading for social purpose, and ownership of buildings and land, to bring about long-term social, economic and environmental benefits in their community.’

In order to join the DTA an organisation is expected to be:

- Engaged in the economic, environmental and social regeneration of a defined geographical area.
- Independent, self-sufficient or aiming for self-sufficiency, and not for private profit. (Any surpluses generated should be applied to the social objectives of the development trust).
- Community-based, owned and managed.
- Actively involved in partnerships and alliances between the community, voluntary, private and public sectors.

Community ownership could include for example having residents on the board of directors, who are elected by a ballot of the community, or representation from local stakeholders such as community groups, the local authority, local businesses and others.

The DTA believes that development trusts are a successful way of delivering regeneration aims. They say that regeneration only really works if the direction that a community takes can be steered by the people who are most

affected, namely local residents. They believe that a community-led enterprise culture fosters self-help and reduces dependency and therefore is the basis for confident, thriving and active communities.

Becoming a development trust is effectively an add-on to the governance structure that an organisation has – for example a development trust may be a company limited by guarantee, or an industrial and provident society.

Joining the DTA offers opportunities such as access to specialist information and one-to-one advice from the DTA's regional and national team and access to the DTA's Knowledge and Skills Exchange small grants fund.

ALMOs have a number of attributes similar to development trusts, in terms of their engagement of stakeholders. However, the fact that ALMOs are local authority owned means that they may not be regarded as having sufficient 'community ownership' to become development trusts.

In any case, since recognition as a development trust brings with it only support and advice, it is unlikely to be of significant benefit to an ALMO.

Again, the most likely role of an ALMO is as a service provider to a development trust.

7 Community associations

A community association is a joint venture organisation with representation from tenants and residents, the local authority, other stakeholders and independent experts. There were developed in the 1980s and were the forerunners of the large scale voluntary transfer housing associations.

The early community associations were not registered as housing associations. Properties were transferred to them as part of the redevelopment process. This meant that a tenant ballot was not required, since it was empty properties and new build sites that were transferred to them.

A community association is one of the types of the bodies to which a local authority can provide administrative, professional and technical services (and charge for those services).²⁶ This enabled the local authority to provide a high level of support to residents on the board, enabling significant capacity building and community ownership.

Again, the most likely involvement of ALMOs with community associations is as a service provider to them.

No new community associations are currently being set up. From the late 1990s, CLG refused to consent to any transfers of local authority housing land to organisations other than registered housing associations, even where the proposed transfers were of empty properties and vacant land as part of a redevelopment project.

8 Policy Opportunities: Taking community ownership forward

The wider national policy agenda provides opportunities to take forward community ownership of ALMOs, or similar successor bodies, in a way that could enable private finance to be raised in order to invest in sustaining decent homes, wider regeneration and new build.

The *Communities in Control* white paper (2008) states an aim to pass power into the hands of local communities and to give real control over local decisions and services to a wider pool of active citizens. It asserts that citizens and communities are capable of taking difficult decisions, balancing competing demands and solving complex problems themselves, given the right support and resources.

The Sustainable Communities Act 2007 aims to promote the economic, social and environmental wellbeing of local areas, including channels for people to take action to promote sustainable communities. The government has stated it is on the side of tenants in social housing who want to have a direct influence and say over the running of their homes, estates and neighbourhoods.

Government sees Tenant Management Organisations as successful social housing managers who are ideally placed to use their skills, experience and community roots to influence and deliver other neighbourhood services. Government has also been promoting 'Community Contracts' whereby public services and community groups agree priorities for action and, in return, people collectively agree to take responsibility for local facilities.

Government has stated that it wants to increase the number of people engaged in the running and ownership of local services and assets. The Quirk Review *Making Assets Work* (2007) suggested that in every locality a proportion of public assets should be in the ownership or management of sustainable and energetic community organisations. To this end government is establishing an Asset Transfer Unit, working with the Development Trusts Association and its partners, to step up the number of asset transfers (either of ownership or management).

A duty on local authorities to involve people, to ensure that they have greater opportunities to influence decision-making and get involved, will come into effect from April 2009 as a result of the Local Government and Public Involvement in Health Act 2007. Government now proposes to extend this duty to other organisations including the HCA. From April 2009, Comprehensive Area Assessment (CAA) will test and evaluate the level and quality of public engagement and empowerment, including how well vulnerable and marginalised groups have been involved.

Government has said that it now wishes to move the Community Land Trust debate forward and to consider, amongst other issues, what the criteria for financial support for CLTs might be, how to maximise the chances of a viable and well-managed sector being developed, the role that CLTs might play and how perpetuity of community benefit should and may be ensured. The Commission on Co-operative and Mutual Housing has welcomed this debate and called on government to establish a CLT technical assistance fund.

Government has announced that it proposes to commission a study to examine how issues of value for money are considered in order to see if CLTs could compete for grant without being disadvantaged when compared to other providers. The project aims to develop a framework and set of criteria for assessing grant funding of CLT schemes. Usefully, its terms of reference are also to consider issues in relation to other present and potential future delivery vehicles, such as local housing companies.

Local housing companies (see chapter 4) form part of the mixed economy that could deliver affordable homes in the future. They involve local authorities retaining an interest in land, rather than selling it for a one-off profit, and working with the private sector to build new homes, benefiting over the longer term from increases in land values and sales that can be reinvested outside the HRA subsidy system. CLTs are a community-based method which are also about retaining land value over the long term and capturing asset appreciation for wider benefits.

There are current opportunities for dialogue and for the development of models and pilot projects. These include the start of work by the Home and Communities Agency, and of the Tenant Services Authority (with its tenant involvement remit), from December 2008; the government's HRA Review, due to be published in 2009; the work of the Commission on Co-operatives and Mutual Housing due to report in late summer 2009, and the forthcoming Local Democracy, Economic Development and Construction Bill.

It is important that, in seeking new life for ALMOs, options are not narrowly conceived and developed by local authorities and ALMOs before being put out to consultation. Tenants' expectations about their involvement are now much higher, as are those of the regulatory bodies and policy framework within which ALMOs and local authorities operate. The community-based approaches outlined in this chapter should, therefore, be taken further with tenants, government and stakeholders to produce new models that could enable some ALMOs to add to a mixed economy of housing providers whilst at the same time contributing to the empowerment of their communities.