National Federation of ALMOs

championing better homes and communities

Building on the potential of ALMOs to invest in local communities

A report by the National Federation of ALMOs

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Rachel Terry

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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 its members to operate effectively. The NFA represents organisations that manage about half of all council housing in England. The ethos of the vibrant ALMO movement is to empower tenants to make decisions about the management of their housing and to transform neighbourhoods, enhancing life chances of council tenants. ALMOs have provided tenants with excellent local, customer-focused and cost-effective housing management services. The NFA aims to continue supporting the ALMO sector that provides decent housing, promotes tenant empowerment, and transforms neighbourhoods and local communities. The NFA helps ALMOs to deliver broader national and local policy priorities.

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Tenant Services Authority

Local Government Association
London Councils
Councils with ALMOs Group

Tenant Participation Advisory Service
Tenants and Residents Organisations of England
Confederation of Co-operative Housing
National Federation of Tenant Management Organisations

Council of Mortgage Lenders
Barclays Corporate
Royal Bank of Scotland

CIPFA
Savills

Above all and in particular, a large number of tenants, board members and officers of ALMOs and of ALMO authorities participated in a series of events at which the proposals in the report or draft versions of the report were discussed and debated.

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The report has benefitted considerably from all of these inputs. While the report and its proposals remain the responsibility of the NFA and the authors, the discussions have helped considerably in creating the climate for taking forward the ideas which it contains.

Introduction

Nearly 900,000 council homes, approximately half of all council housing in England, are now managed by ALMOs, in which partnerships between the local authority, tenants and the local community provide the landlord service and secure the improvement of the homes. In only nine years, since their inception in 2002, ALMOs to date have invested approximately £6 billion in bringing homes up to the Decent Homes Standard. Almost without exception, these programmes have been completed on time, within budget and to high levels of customer satisfaction.

At the same time, ALMOs have achieved a marked improvement in landlord services. This has been reflected in high levels of tenant satisfaction. Another reason for such satisfaction has been the commitment from all ALMOs to involve residents much more closely in their work than was usually the case before they were established. This starts at board level, but extends down to many aspects of service delivery. In a typical case, an ALMO often has dozens of tenants involved in some way in its governance, as well as having many broader ways of engaging regularly with tenants.

Yet partly because of their success, ALMOs are now at a crossroads. Those which have completed the decent homes programme are ambitious to tackle the wider issues that decide whether their estates are good places in which to live. They want to be able to offer choices to residents about their services, address the environmental challenges posed by an older housing stock and help communities determine their own futures. As community-run businesses, they have the potential to resource this wider role from the revenue they generate, but to do this they need to be freed from many of the restrictions that currently apply to them – while maintaining and strengthening their accountability to the communities they serve.

Some local authorities, ALMOs and tenants are considering large scale voluntary transfer as the only option that can now meet their future funding needs. However, while this approach enables the ALMO as an organisation to be maintained, it makes it more difficult to keep the local accountability that is such a strong characteristic of ALMOs. This is because stock transfer housing associations based on ALMOs essentially have followed the accepted approach of becoming independent bodies: while they can retain strong tenant involvement in their governance, their links to the local authority are less strong. Neither the authority nor the tenants might want to weaken these links.

In other cases local authorities have decided to take services back in-house, which might reduce overhead costs but raises big questions about whether ALMOs' achievements in improving services, making efficiency savings and involving residents in running the landlord function can be maintained. It can also mean that the interface between the tenant and the landlord simply becomes part of a council's wider customer service function, and tenants can no longer challenge their landlord directly as customers of specific services provided from their rents. Dissolving the ALMO also disregards its potential to raise additional finance in the ways to be explored in this report, and which is likely to become even more important after April 2012.

The coalition government has made it clear that it wants to provide many more opportunities for tenants to run housing services directly and to 'take control over their own homes'. ALMOs can make a strong case that they have been in the vanguard of tenant empowerment, bringing significant numbers of their tenants into their governance structures and involving them in many other ways. This report seeks to develop this experience further by examining models which would give tenants an even bigger say in their ALMOs, by building on the skills and capacities that ALMO tenants have developed over the past nine years.

The National Federation of ALMOs commissioned this report to consider proposals which would build on the current, successful ALMO model, creating a new form of organisation with strengthened accountability to tenants and to the community, and which could raise new resources independently from government finances. The work started while the government's own review of council housing finance was still in progress, and takes into account the detailed proposals published in early 2011.

The work also, of course, recognises the important priority which the government is giving to reducing the public sector deficit and the implications for future spending on housing after the Comprehensive Spending Review. The aim has been to find ways to generate the extra investment needed in council housing, taking account of these financial constraints, and at the same time address the government's agenda of decentralising services and strengthening accountability to customers.

There is clearly an appetite to maintain the distinct advantages of ALMOs – because they have improved services, empowered communities and increased tenant satisfaction. They have created a new model for running council housing which combines operational independence but with the assets of the housing stock still under democratic control. The desire to retain ALMOs comes from tenants and from many of the parent authorities, not only from the ALMOs themselves. It is a major purpose of this report to give concrete form to one or more future alternative models for ALMOs so that – if the government agrees – they can soon be available to local authorities and their tenants, to consider alongside the other options for their housing service.

Of course, decisions on whether to adopt or adapt any of the approaches set out in the report will be made at local level. It will be important that these local decisions reflect a key aim of the report – to provide a sustainable future for council housing.

The role of the NFA in developing new approaches to managing social housing

The National Federation of ALMOs has led the way in considering how to build on the ALMO model and ensure that the successes it has achieved can be built on for the future, in particular using ALMOs' experiences of empowering their tenants:

- In 2005 the NFA, CIH and HouseMark jointly produced the report *ALMOs – a new future for council housing* that helped develop the case for the current proposals for the self-financing of council housing.
- In 2009 the NFA published the report *A Future for ALMOs – within local communities* which looked further at different structures which ALMOs might develop in the future, including ones where the community would own the ALMO.
- In 2010 several ALMOs began to investigate the potential of community ownership or similar models developed from these NFA studies.

The results of this recent and earlier work have provided part of the basis for the current one, which aims to develop proposals to the point where they can now be carried forward by local authorities and their ALMOs in partnership with tenants, and with the support of government.

Executive summary

Aims of the report

The overall objective of the project has been to investigate ways in which local authorities – where they need greater levels of investment than will be provided by the government's council housing finance reforms from April 2012 – can access additional finance outside the public sector borrowing envelope, through private finance.

Three potential models have been developed, all intended to achieve five specific aims:

- First, building on the expected outcome of council housing finance reform, to enable additional, private sector, off-balance-sheet financing where this is needed to meet important investment requirements.
- Second, taking as a starting point the experience of ALMOs in engaging with tenants, to provide opportunities for greater tenant empowerment.
- Third, retaining the strong element of partnership with the local authority.
- Fourth, providing one or more models which will – by meeting the other aims – offer sustainable options to local authorities, and their tenants, for ALMO management of their council housing in the long term.
- Fifth, examining the options in sufficient detail to enable councils, their ALMOs and tenants to make informed local choices and – if appropriate – adopt and adapt one of the options so that it suits their requirements.

What is the context for looking at the future of ALMOs?

Important changes have occurred recently which set the context for the report:

- The policy priorities of the coalition government, especially its wish to give more power to tenants as part of the 'localism' agenda.
- The challenge of tackling the public sector deficit.
- The opportunities arising from council housing finance reform from April 2012.

Council housing finance reform

The coalition government's proposals for council housing reform are due to be implemented in April 2012. Councils are now assessing the implications and want to make the most of the reforms.

The particular challenge for ALMOs is to show how they will operate once self-financing begins. They will want to demonstrate that any new model would have advantages compared with *either* taking services back in-house *or* with traditional stock transfer.

The challenge of the cap on borrowing and the need for private finance

From April 2012 councils will have more financial freedom but the scope for new investment will be very limited. Several may find they have scope for some new investment, but many will not. With little realistic prospect of the cap being raised for some time to come, the only alternative is to seek private finance. This will be more expensive, so it is important that any new investment in council housing is in addition to public sector borrowing, not instead of it.

Private finance means the borrower is not part of the public sector. An ALMO could be the borrower if it is able to demonstrate that it is not majority-owned or controlled by the council. The challenge is to do this while keeping ALMOs as locally owned and community-based. One way is by tenants taking an even bigger role in the ALMO, while retaining a significant link to the local authority. The report aims to show how this can be done.

Why retain ALMOs?

ALMOs offer a whole range of advantages to local authorities and tenants which are lost if the service moves back in-house and are difficult to maintain with conventional stock transfer. ALMOs also continue to offer advantages at a national level, notwithstanding that the decent homes programme is nearing its final stages.

Some authorities have already decided to keep their ALMOs and two new ALMOs have recently been set up without any promise of extra funding. So why can't the ALMO model simply be left as it is? The difficulties in doing this include:

- Limited resources for those who need to complete decent homes programmes.
- The cap on borrowing that will apply after April 2012.
- Insufficient funds for many authorities in future to tackle earlier backlogs or address issues outside the Decent Homes Standard, achieve decent estates, promote ongoing tenant empowerment, tackle challenges such as fire safety and making homes more energy-efficient.

The available resources from each authority's April 2012 settlement will be needed to protect the investment in decent homes so that council housing does not slip back into providing poorly maintained properties that do not meet tenants' expectations.

Three alternative models

Three potential models have been developed to enable additional, off-balance-sheet, financing by ALMOs (private finance) by securing their reclassification as private, non-profit corporations, while further empowering tenants and retaining the strong element of partnership with the local authority:

- **Model 1 – long-term management contract** – based on the ALMO having a much longer contract and on the local authority having a one-third (rather than sole) interest in the ALMO's ownership.
- **Model 2 – long-term management contract and transfer of some vacant properties or land** – similar to Model 1 but with some limited transfer.
- **Model 3 – transfer to a Community- and Council-owned Organisation (CoCo)** – a more fundamental change both in the ALMO's constitution and in its becoming the owner of the stock, but on a different basis to current stock transfers.

In Model 3, the CoCo would not be a conventional stock transfer organisation because it would retain a financial relationship with the council. It would do this through a covenant to service the council's housing debt, which would remain with the council after transfer.

The ability to borrow to carry out further investment

Two case studies have been developed to analyse key financial factors associated with the models – both are based on an 'average' ALMO authority with 18,000 properties, an HRA debt settlement of £180m and only a small amount of borrowing headroom after April 2012. Both however have different needs, which would be constrained by the borrowing cap:

- Case study 1: the authority has met the Decent Homes Standard, can maintain it for 30 years and has a sustainable plan for the stock – but with no scope for additional investment to improve stock further, to regenerate or redevelop estates or build any new homes. Model 1 is tested in this case study.
- Case study 2: the authority is part way through the decent homes programme but as a result of reductions in backlog funding and challenges with its stock, it cannot meet the standard and risks properties running into disrepair as backlogs develop. The CoCo (Model 3) is tested in this case study.

Both case studies aim to show how the business plan can sustain additional borrowing above the cap; of course (because of the cap) this would have to be private finance.

Case study 1 – Using Model 1 to deliver more investment

The authority's HRA self-financing plan stacks up. The £180m debt is able to be repaid well with 30 years. But opportunities to invest more in communities would be delayed. The case study shows that using Model 1:

- Investment over ten years of £197m can be increased by additional private finance of £47m – a 25% increase in short-term investment.
- The cost of interest for the private finance is higher than for the HRA by 2%, but the plan is still able to repay that finance in 18 years leaving plenty of time to bring the HRA debt to zero within 30 years (if required).
- There are no taxation or other additional longer-term costs to take into account although some set up funding has been factored in.
- There is no requirement for extra support from government or otherwise.

The main factor affecting the amount of deliverable investment is the ability of the plan to service the borrowing at a relatively high interest rate. However, as in this and many other HRA plans around the country, there is significant untapped potential – which could be released through private finance above the cap in Model 1.

The financial features for Model 2 would be 'between' the analysis for Model 1 and the CoCo model.

Case Study 2: Using the CoCo (Model 3) to turn an unviable plan into a viable one

The HRA business plan does not stack up – this is not an issue with the settlement but the combination of unmet backlogs and the borrowing cap. Having previously bid for £170m ALMO resources to meet decent homes, the latest allocation for the 'average' authority in this case study is only £100m. The need to lever in finance above the cap is pressing so as to avoid deteriorating conditions.

There are financial challenges which the CoCo must be prepared to meet head on, including a need for additional financial support to make the model work, but the case study shows that:

- Private finance up to £80m can be raised above the cap to increase investment to meet the Decent Homes Standard.
- The cost of interest for the private finance is higher than for the HRA by 1.3%, but the plan is still able to repay that finance in 23 years leaving plenty of time to bring the HRA debt to zero within 30 years (if required).
- As the stock has transferred, the CoCo would be liable for irrecoverable VAT (in line with other registered providers). The opening self-financing debt would therefore need to be reduced to reflect this liability – a reduction of £47m (£180m to £133m) achieved by adding an element for VAT to the allowances utilised in the self-financing settlement, setting the cap at the lower level.
- A VAT shelter which would be negotiated with HMRC has been applied and added back into the business plan (running over 15 years in line with recent traditional stock transfers).
- Some set-up funding has been factored in.

Two main factors affect the amount of extra investment that is deliverable in this case study – the private finance is at a relatively high interest rate compared to HRA debt (albeit not as high as Model 1) and the need to provide for irrecoverable VAT on an element of service costs throughout all years of the plan and on capital costs in the second half of the plan.

In order for the plan to work, support from government (or other sources) to assist in dealing with VAT is required amounting to £47m on the transfer date. However, the equivalent support for a standard stock transfer would be much higher, at £68m. VAT flows into government would also exceed the support needed by the CoCo over time.

Conclusions from the financial modelling

The three models developed in this report may be particularly effective where the debt cap will be a significant constraint on future investment; there is potential for additional investment to be achieved, which is affordable and sustainable. There is also a case for considering the ownership and management benefits of the models in their own right.

Model 1 offers a way of levering in additional investment paid from future revenue streams for authorities and ALMOs where some additional investment is needed, and where the HRA self-financing plan provides sufficient income to meet the borrowing costs. As for case study 1 this model might be most suitable where additional needs are relatively modest, where decent homes backlogs remain relatively low, where investment could be linked to 'spend to save' initiatives, or where there is potential to build new homes. The key *financial* consideration would be financing additional borrowing at a relatively high cost.

Model 2 provides opportunities for estate regeneration and new build.

For authorities and ALMOs where needs are pressing and the achievement of decent homes might be decades away without further up-front investment, the CoCo model might offer a means of levering in the finance needed with a lower level of public support than would be required within a traditional stock transfer. The CoCo model could also deliver additional investment for regeneration, redevelopment or new build.

The government is expected to confirm a role for stock transfers after the implementation of self-financing with the assumptions around income and spending for future transfers being similar to those made for self-financing; the key focus for access to additional support being made via a robust business and value-for-money case. The development of the government's approach to transfer after self-financing therefore has implications for the CoCo model.

Views of lenders

Lenders like stable sources and flows of new business. Those currently funding new LSVTs are likely to be interested in lending to CoCos. Their starting point will be the current LSVT model, so there will need to be clarity about the differences.

There was less enthusiasm by lenders for Models 1 and 2. Lenders do not like the complexities of PFI for housing and with Model 1 they are concerned at the absence of private sector involvement.

Lenders would like to see a standard funding solution for each model that is pursued.

Tenant empowerment

In the alternative models, the new organisations would be committed to tenant empowerment. They would adopt the devolution provisions to be found in many stock transfer constitutions and would continue with any Tenant Management Organisations and support the creation of new ones. In the CoCo model, the Right to Manage would no longer apply statutorily, but the commitment to devolution would embody its principles.

A special section of the report, by Nic Bliss, considers tenant empowerment issues in detail.

Legal and regulatory issues about the models

If the local authority no longer owns a majority interest in the ALMO, some of the key legal implications are:

- If the ALMO primarily still *manages the houses*, but is not majority-owned by the council, then the authority could no longer award the management contract without a tendering process that complies with EU procurement rules.
- If the ALMO *takes ownership of the stock*, there is no requirement for a tendering process. Tenants would no longer have secure council tenancies but steps can be taken which effectively give all tenants the same security.

There are other detailed implications considered in the report.

Overall conclusions

Of the models, the CoCo model (Model 3) is the one most likely to provide a solution to authorities which require borrowing significantly above the ‘cap’ that will apply after April 2012. It can offer a bigger role to tenants while also being attractive to private lenders. It requires a government policy decision on stock transfer after self-financing, in particular to enable a solution to the VAT costs.

Models 1 and 2, which do not require transfer of tenanted stock, provide more limited options which may nevertheless be attractive to authorities where investment needs are more modest and/or are restricted to particular estates or neighbourhoods.

Recommendations

To local authorities, ALMOs and tenants

1. All local authorities, when considering the implications of council housing finance reform for the HRA, should consider the three models and discuss them with tenants.
2. Local authorities with ALMOs who are reviewing the ALMO management agreement and the ALMO’s future should include these three models in the options to be reviewed and should discuss them with their tenants and with the ALMO.
3. Authorities and ALMOs should pay particular attention to the needs of TMOs in any discussions about these options.

To central government

4. The government is recommended to consider the options set out in the report, with a view to all three models being available as options to all stock-retaining local authorities after self-financing, from April 2012.
5. The models should be included within the framework of government advice that will be issued to local authorities to assist them, their ALMOs and their tenants in local decision-making on the future of ALMOs once council housing finance reform has been implemented.

To TSA and HCA

6. The TSA and HCA are recommended to consider the implications of the report as an additional vehicle for investment in the council housing stock and, in particular, as a means of furthering the regulatory standards on tenant empowerment, quality of accommodation and value for money.

PART ONE: Background and context

1 Current context and the future of ALMOs

The factors influencing the debate over the future of ALMOs are radically different from those which applied at the time of the earlier NFA reports, not least because of the change of government. This section briefly summarises the new context, covering:

- the policy priorities of the coalition government that are relevant to the future of ALMOs
- the challenge of tackling the public sector deficit
- council housing finance reform.

It then considers how local authorities and ALMOs are responding to the various changes so far.

1.1 Coalition government – new priorities

In addition to the reduction of the public sector deficit and the planned reform of council housing finance (both dealt with below), the new government has established a number of priorities for public services and communities, which are highly relevant to the debate on the future of ALMOs. The most significant of these are:

- **Empowering communities** – the 'localism' agenda. 'We are committed to a radical devolution of power and financial autonomy to local government and community groups.' (DCLG Under-Secretary Bob Neil, 17 June 2010). Communities will be given new rights to own assets and run services themselves as the 'big society' approach develops.

- **Empowering tenants** – a key part of the localism agenda is greater tenant empowerment. 'There are inspiring examples across the country of where tenants have taken control. But at the moment, only two per cent of council properties are managed by their tenants – I want to see that figure increase substantially.' (Housing minister Grant Shapps, 15 February 2011).

- **Encouraging more diverse models of provision** – such as social enterprises, co-operatives and mutuals, and through the Community Right to Build, to get 'more innovation, diversity and responsiveness to public need' (Prime Minister, 19 July 2010). Public service workers will have new rights to take over and run services as co-operatives or mutuals.

- **Decentralising government** – reducing the regulatory, guidance and policy-making roles of central government and its agencies, and passing responsibility to local level. There will be no 'one size fits all' approach, and local authorities will be expected to build stronger relationships with communities.

- **Providing greater accountability to the public, rather than to Whitehall** – which should favour models in which tenants, as customers, have a greater role.

- **Make the transparency agenda a core part of all government business** – putting in place financial arrangements which are easily understood and which facilitate reporting to the public.

- **Delegation of financial control and the withdrawal of 'ring-fencing' from central government funding for local services** – now part of the Localism Bill.

- **New approaches to providing finance** – 'We believe in paying public service providers by results' (Prime Minister, 19 July 2010).

The proposals in this report have been framed with these priorities and policy directions very much in mind and would – in the NFA's view – represent a significant step towards meeting many of these goals, in the many and varied communities where council housing is managed by ALMOs.

The report will argue that the ALMO model has not only demonstrated its worth, but also that it is inherently flexible and is better able than, say, large scale voluntary transfer (LSVT), to take on board and pioneer many of the new approaches which the government is seeking.

1.2 Challenge of the Spending Review and proposals to cut the budget deficit

The coalition government set a target in its 2010 Budget to make substantial reductions in the public sector fiscal deficit, principally by a further £40bn of spending cuts and tax changes, over and above the previous government's plans. The details of how this affects housing were set out in the Comprehensive Spending Review (CSR) in October 2010. It is not necessary here to summarise the CSR or subsequent announcements on spending issues, but the main ones which affect the debate about the future of ALMOs (apart from the commitment to HRA reform) are:

- **Decent homes funding** – to continue at a level of £2.1bn for the CSR period 2011/15 (of which £1.6bn is for local authorities). The target of 150,000 further units to be brought up to standard by 2014/15 from this budget makes it essential to continue to deliver the programme as cost-effectively as possible. The phasing of the budget also means intense competition for funds in the early part of the four-year period.
- **Decent homes backlog funding to be open to all councils** – with no preference given to authorities with ALMOs, as was previously the case, and with no requirement to have a two-star housing service. This has clear implications for the ability of current ALMO authorities to finish their programmes: many that were expecting to do so now have reduced funding and are uncertain as to when they will be able to achieve full compliance with the Decent Homes Standard.
- **Overall investment in affordable housing** – of £4.5bn over the CSR period; once current commitments have been met, the majority of the remaining funds will be allocated to 'affordable rented' housing, that is housing at intermediate rents with fixed tenancy terms.
- **Reductions in local authority finance** – central government revenue support for local authorities' General Funds will fall by over 7% per year over the four years. Ring-fencing has been removed from all General Fund spending from 2011/12.
- **Public Works Loan Board (PWLB) interest rates increased** – on 20 October 2010 the PWLB increased the interest rate on new loans to an average of 1% above the government's costs of borrowing.
- **Self-financed capital spending by local authorities** – is expected to fall by 17% over the next four years.
- **Energy efficiency** – from 2013 the Green Deal and the Energy Company Obligation (ECO) will provide new funding for retrofit work, to which social landlords will have access. Government is encouraging social landlords to package remaining decent homes work with retrofit funding so as to use the available finance as efficiently as possible.

Clearly the priority which the coalition government is giving to cutting the public sector deficit places tight limits on future public funding for housing and neighbourhoods. Inevitably it also puts a premium on creating models which either reduce the call on public resources or – at the very least – do not add to it (including not adding to public sector debt). These constraints have very much been taken into account in the proposals which follow.

1.3 Council housing finance reform

The coalition government's proposals for council housing reform are now available in detail, and provide the financial and policy context for this report.[1] Relevant aspects are summarised in the box.

The 160 or so authorities which have housing stocks are now engaged in assessing the detailed implications of these proposals for their council housing finances and for the authority as a whole. All authorities will naturally be keen on making the most of the reforms, including various possibilities for changing their debt arrangements so that, within the borrowing cap that applies in each case, they have the most efficient arrangements possible so as to free up resources to invest in the stock and in services.

The particular challenge of council housing finance reform for ALMOs now is to show how the ALMO model – or a new model which can be developed from the current one – will operate once the self-financing regime begins. They will also want – if at all possible – to demonstrate that a new ALMO model, if available, would have strong advantages for those authorities with ALMOs when compared with *either* taking landlord services back in-house *or* with traditional stock transfer.

1 DCLG (2011) *Implementing Self-Financing for Council Housing*. London: DCLG.

Key features of the government's housing finance reform plans

- The current HRA subsidy system will be abolished and replaced with a system in which rents will be retained by local authorities following a one-off and mandatory settlement of the current system.
- A national debt figure of £28.4bn will be allocated across the approximately 160 authorities which will have stock at April 2012, based on assumptions of future rents and costs over 30 years.
- When compared to the current level of HRA subsidised debt, this gives a cash receipt to the government of about £6.5bn – which represents a share of future net rental receipts 'up front', with the remainder being retained by local authorities in their 30-year business plans.
- Continuation of the current arrangement in which 75% of right to buy receipts are pooled nationally – which now appears likely to apply across all 30 years.
- Confirmation that there will be a cap on debt at the starting level of the settlement – arrangements for setting the cap will take into account borrowing by authorities before and during the transition to self-financing.
- The following key national assumptions are being made:
  - Rents to converge with targets/formulae in 2016 with some provision for the £2 limit on annual increases built in – there is therefore no assumption of any move towards greater rental flexibility built into the settlement.
  - Uplifts in expenditure allowances totalling about 14% including a new allocation for aids and adaptations.
  - Movement on a range of technical areas lobbied for by the sector including taking account of PFI, property changes and the increased costs of managing debt.
- A parallel consultation paper from CIPFA proposes new accounting and technical arrangements in the new system, relating to debt management and depreciation – a key feature of which is a proposal to split the current debt pool and 'ring-fence' debt to the HRA.
- The timetable is dependent on the successful passage of the Localism Bill, now going through its parliamentary stages.

1.4 How are local authorities and ALMOs responding to current challenges?

At the present time, many ALMOs have still not reached the end of their decent homes investment programmes, so although choices about their future are looming they are still either within the initial management agreement periods set by their local authorities or their contracts have been extended for relatively short periods. Where decent homes programmes have been finished, a number of authorities have already decided to extend their ALMOs' management contracts to take on additional functions while others have brought their ALMOs back in-house or gone down the stock transfer route.

Two new ALMOs have been created so far, outside the decent homes regime. These are Welwyn Hatfield Community Housing Trust, which went live in April 2010 with a focus on community regeneration, and East Kent Housing – an innovative example of an ALMO managing the housing stock of four separate local authorities. These developments demonstrate the flexibility of the ALMO structure in being able to adapt to local priorities, as well as its intrinsic value in delivering more efficient, high-performing landlord services.

However, with the introduction of self-financing, many more authorities – both with and without ALMOs – are expected to carry out stock options reviews as they assess their long-term funding and investment requirements. For local authorities with ALMOs, government guidance[2] states that ALMOs should be retained unless there is a demonstrable benefit to tenants, and that a council contemplating a major change such as bringing the service back in-house should undertake the same level of tenant consultation and engagement as it undertook when establishing the ALMO, including carrying out a test of opinion. In many cases this requires a ballot of all tenants, as applies in the case of stock transfer.

2 DCLG (2006) *Review of Arms Length Housing Management Organisations.* London: DCLG.

At the same time, as noted earlier, a number of authorities and their ALMOs have also been investigating options which would build on and develop the ALMO model itself, without replacing it with a housing association (albeit one based on the previous ALMO). Here are two recent developments.

Kensington and Chelsea TMO

The K&C TMO is unique in that it is not wholly owned by its council. Instead it is 'owned' by its resident members under the Right to Manage legislation. Because of this any borrowing it undertakes would not necessarily count as the local authority's, i.e. as public sector debt. This affords scope therefore to explore private finance options to increase investment in the stock and for other purposes.

It may be that – given the nature of the relationship between the TMO and the council and its dependence on the management agreement fee – funders will look to the council for a guarantee. The TMO would need to consider the terms of that guarantee and how it would 'score' in the council's accounts. Much will turn on an accountant's assessment of the likelihood of the guarantee being 'called'.

However, K&C TMO's currently unique constitution means that it can potentially explore a private finance option to provide additional investment in its stock.

Rochdale Boroughwide Housing

RBH is exploring the potential for a mutual structure as a key element of an innovative stock transfer proposal for the council to put to tenants later in 2011. Rochdale's co-operative heritage has prompted the development of a tenant and staff co-ownership model, which a reconfigured RBH would adopt.

A 'Housing Commission' led by Professor Ian Cole recommended that the model be examined carefully. The government has shown a close interest in the initiative, as reflecting its Big Society and localism agendas. RBH and the council are now working with tenants and staff to agree the details which will underpin the formal stock transfer consultation process.

2 Empowering tenants – the role of ALMOs

As already noted, a distinctive success of ALMOs has been the extent to which they have involved tenants in their governance. Often they have built this up from a base in which, before the ALMO was established, although there may well have been tenants' and residents' associations, there was only limited or no direct involvement by tenants in making decisions on housing services.

Now most ALMOs have significant numbers of tenants involved in their governance structures, including several tenant chairs of ALMO boards. Although the ALMO model gives tenants a strong presence on ALMO boards, in most cases they have roles at other levels too, such as in neighbourhood boards or through service review panels and similar mechanisms. For example, many ALMOs use tenant review panels to ensure that their services are performing as effectively and efficiently as possible:

- **Salix Homes** is one of those leading the way in consulting with tenants on service delivery, having recently won a UK Housing Award for its 'customer senate'.
- **Homes for Islington** tenants have been involved in selecting contractors, with decisions based on quality and value for money, to deliver a range of services to their properties.
- **Sheffield Homes**, **Your Homes Newcastle** and **Barnet Homes** have all consulted with their residents on community initiatives and services that matter to them and in some cases have given them control over the distribution of funds.

In qualitative as well as quantitative terms, the role played by tenants has developed markedly as ALMOs have matured as organisations.

However, new models in which the ALMO is able to borrow privately and has to redefine its relationship to the local authority necessarily present a challenge to tenants to make a further step-change in the degree of responsibility they take on within the ALMO. This is a critical issue to be explored, affecting not only tenants' and local authorities' attitudes towards alternative models, but also the potential viability of the models in the longer term. Fortunately, ALMOs' experience to date provides a strong platform on which to build, and there are precedents in Tenant Management Organisations (including Kensington and Chelsea TMO, the only ALMO which is a TMO) and in the small number of stock transfers which have so far followed the Community Gateway Model (and have built into their long-term plans the ongoing capacity-building and empowerment of tenants which the model requires).

These issues are explored further in relation to the report's detailed proposals, in section 10.

3 The challenges of off-balance-sheet borrowing and private finance

As described above, the self-financing proposals are based on local authorities having HRA debt to service. This will be public sector borrowing and it will be cheaper than borrowing achieved in any other way, even after the increase in PWLB lending rates.

It has already been argued that following the introduction of self-financing, many local authorities will need to do *more* borrowing to invest in their stock than is likely to be agreed in the initial settlement (the cap). The Treasury is imposing this cap on HRA borrowing because all borrowing by the local authority will count towards public sector debt, which the Treasury is determined to reduce. The only alternative is to seek private finance, which is off-balance-sheet for the local authority. The current example of this is the HRA Private Finance Initiative (PFI), which is considerably more expensive than borrowing from the PWLB, has onerous terms and conditions to be negotiated, and is not currently favoured as an option by the coalition government.

To be financially viable for the council housing service, it is therefore important that any off-balance-sheet finance aimed at investment in council housing stock, which will be more expensive, is in *addition* to the Treasury-capped public sector borrowing, rather than a substitute for it.

Such private finance requires a non-public sector borrower. An ALMO could be the borrower if it is able to demonstrate that it is not majority-owned or controlled by the public sector. This would involve tests at three levels:

- the governance arrangements would have to ensure that the day-to-day operations of the ALMO borrower were not capable of being controlled by the local authority (or by any other public sector organisation)
- the local authority would not be able to take control of the ALMO, beyond the arrangements in the management agreement; and
- 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), save in defined circumstances in accordance with arms-length and previously agreed commercial terms.

The financing risk would therefore need to remain with the ALMO, and funders would have no general recourse to the local authority or its assets.

If these tests were passed, the Office for National Statistics (ONS), which has responsibility for classifying bodies according to their public spending and public borrowing status, would be likely to change the status of ALMOs.

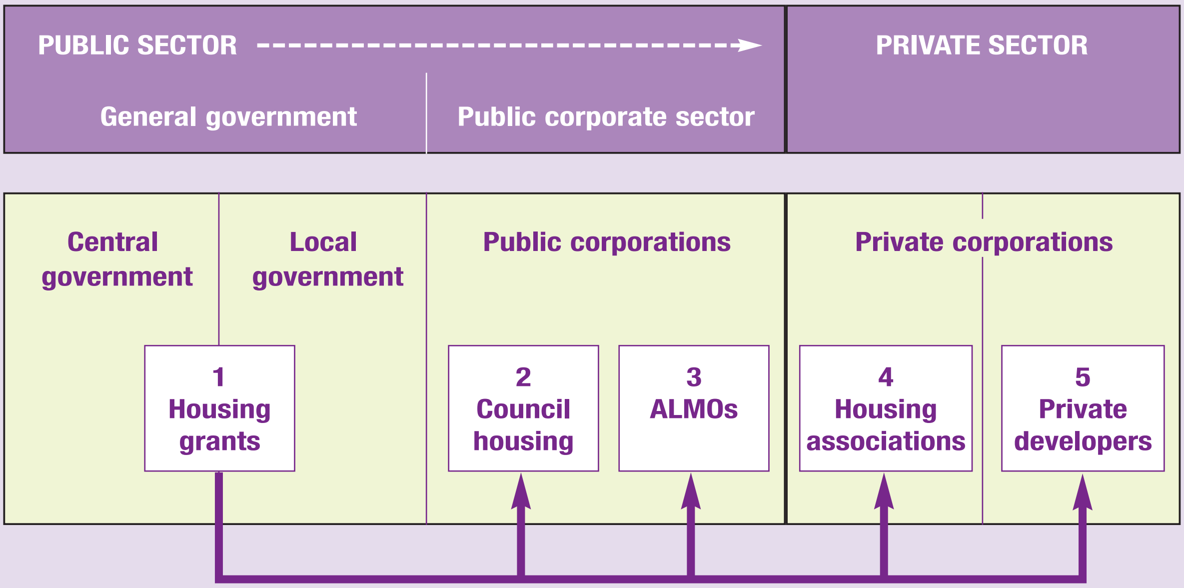
Currently all ALMOs are classified individually by the ONS to the ‘public corporate’ sector; that is they are not part of general government but they are still part of the broader public sector for public expenditure and borrowing purposes. By satisfying the tests, ALMOs would aim to be reclassified as private non-profit corporations, as housing associations currently are.

The implications are summarised in Figure 3.1 on the next page.

Clearly ALMOs do not currently meet these tests. However, for stock-retaining councils, those with ALMOs have distinct advantages:

- They already have (in the ALMO) a body which is a ‘public corporation’ in its own right, and has the potential to be reclassified as a non-profit private corporation provided that it can redefine its relationship to the council.
- They have a business with a track record of delivering services within tight financial constraints, and of providing both tenant satisfaction and significant efficiency savings.
- They have a board which already has business experience, including tenant members who have developed skills at board level (and at other levels) and in some cases a tenant has become the chair of the board.

Figure 3.1: Public borrowing definitions and housing



The diagram shows the classifications currently used by the Office for National Statistics and how they relate to the Treasury conventions about spending and borrowing:

- Government grants (1), such as Social Housing Grant, are part of the general government sector.
- Council housing (2) is regarded as part of the public corporate sector, not part of local government, because of its independent revenue stream (rents).
- ALMOs (3) are currently classified individually as public corporations.

For the Treasury to move them from the public to the private sector for spending purposes (top band), ALMOs would have to have the same classification as housing associations (4), i.e. become private, non-profit corporations.

The challenge is therefore to achieve the greater financial freedom of being classified outside the public sector, without sacrificing ALMOs' essential characteristics of being locally owned and community-based. Indeed, the aim should be to build on current accountability to tenants by giving them an even bigger role in governance of the ALMO, while retaining a more limited but still significant link to the local authority. Any changes must not undermine the ALMO's desire to continue to provide excellent services, but must facilitate the resourcing of the investment which tenants want in their homes and their estates.

This report develops three models that involve re-structuring the ALMO, so enabling it to deliver additional investment by using private finance that is additional to the local authority's borrowing when limited by the cap.

4 Why retain ALMOs?

Against the background of change just described, some authorities have decided to end their ALMOs. The question therefore arises, why should authorities maintain ALMOs or indeed consider creating new ones? Apart from their potential for raising private finance (just discussed), what can ALMOs do that councils are restrained from doing, or may not be able to do so well? Here are some advantages that ALMOs have, both locally and at national level:

What can ALMOs offer to councils?

ALMOs can:

- 'bear the brunt' – deal with complaints and free-up the council from the large volume of calls/enquires which tenants generate
- focus on cost-effective service delivery
- offer opportunities for trading and income generation (as many ALMOs have done)
- bring in other income streams
- create and embed procurement expertise
- provide more systematic asset management
- manage the Housing Revenue Account
- provide and maintain contact with communities
- deliver other services on a cost-effective basis.

What are ALMOs' unique selling points at national level?

ALMOs:

- deliver on efficiencies and provide demonstrated value for money
- are based in the community and link to councils' strategic aims
- empower residents – meeting the 'localism' agenda
- focus on excellence in service delivery
- provide local accountability
- have greater flexibility, enabling speedier decision-making
- are entrepreneurial
- allow the council to concentrate on strategy.

So it is not surprising that some authorities have already positively decided to keep their ALMOs. Why can't the ALMO model simply be left as it is? Decisions about the future are for each local authority to take in conjunction with tenants. But because the context in which ALMOs operate is changing so rapidly, many will want to consider how best to adapt the successful ALMO model to new circumstances.

The difficulties with simply keeping an ALMO as it is include:

- limited resources for those who need to complete their decent homes programmes
- the cap on borrowing that will apply after April 2012 (see above)
- insufficient funds for many authorities in future to:
  - tackle earlier backlogs and/or do work outside the Decent Homes Standard
  - achieve decent estates
  - promote ongoing tenant empowerment
  - tackle challenges such as fire safety and making homes more energy-efficient.

The issues about future resources are critical ones: the investment made in the decent homes programme must be protected so that council housing does not slip back into providing poorly maintained properties that do not adequately meet tenants' expectations. If authorities with ALMOs are to have a sustainable housing service in future, many will have to look at ways to raise more funds to invest in their stock.

Part Two of the report therefore offers alternative models for local authorities and tenants to consider, which are based on the successful ALMO model but seek both to address the issues and maintain the advantages which have been described in Part One.

5 Common features of the models

5.1 Aims of the different options

The overall objective of the project has been to investigate ways in which local authorities that need a greater level of investment after April 2012 than self-financing can otherwise provide are able to access additional private finance outside the public sector borrowing envelope.

Three potential alternative financing models have been developed, all intended to achieve five specific aims:

- First, building on the expected outcome of council housing finance reform, to enable additional, private sector, off-balance-sheet financing where this is needed to meet important investment requirements.
- Second, taking as a starting point the experience of ALMOs in engaging with tenants, to provide opportunities for greater tenant empowerment.
- Third, retaining the strong element of partnership with the local authority.
- Fourth, providing one or more models which will – by meeting the other aims – offer sustainable options to local authorities, and their tenants, for ALMO management of their council housing in the long term.
- Fifth, examining the options in sufficient detail to enable councils, their ALMOs and tenants to make informed local choices and – if appropriate – adopt and adapt one of the options so that it suits their requirements.

The options concerned will only be applicable to authorities that are already at the limit of their debt cap but which nevertheless have other pressing housing investment needs. These could include sustaining decent homes; remodelling or replacing stock that is not viable in the longer term and in which continued investment fails to deliver value for money; regeneration; retrofit or new build.

The project also aims to build on the strengths of the ALMO model in terms of further developing tenant involvement in the management of their homes and of being embedded within local communities. However, in order to comply with the terms required to access additional funding (private finance), outside public sector borrowing, local authorities will have to give up their total control of the ALMO and tenants will need to agree to take on an additional degree of risk.

Each of the three different options put forward in this report has pros and cons. Whether they are suitable in any particular area will depend on each authority's individual position, in terms of their debt and future investment needs, and also on the level of confidence and competence amongst residents in taking on greater responsibilities. For these reasons the options will all not be suitable or even necessary in every case. Nevertheless, the NFA considers that every authority that is carrying out a stock option review or a review of its ALMO management agreement should, together with its residents, consider these options before making a final decision.

From the outset the models recognise the basic tenets concerning self-financing: that there will be no additional government debt write-off for stock transfer or any other models that raise private finance, and that any additional funding would need to be provided by the local authority (probably through the HRA).

The NFA is also confident that the proposals set out in this report fully comply with the rules regarding private sector borrowing and that there are no public sector spending implications. Instead, the public purse will be protected and these options will help to ensure the asset value of the public sector housing stock is improved as well as providing a better quality of life for residents.

5.2 The models in outline

In summary the three models are:

- **Model 1 – long-term management contract –** based on the ALMO having a much longer contract and on the local authority having a one-third (rather than sole) interest in the ALMO's ownership.
- **Model 2 – long-term management contract and transfer of some vacant properties or land –** based on Model 1, but with the ALMO also having an asset base through transfer of void properties and/or vacant land to achieve estate renewal or new build.
- **Model 3 – transfer to a Community- and Council-Owned Organisation (CoCo) –** represents a more fundamental change both in the ALMO's constitution and in the fact that it would become the owner of the stock, but on a different basis to current stock transfers.

The models are described in detail in sections 6-8 below.

5.3 New governance arrangements

The common characteristic of all three models is a change in governance arrangements to give a bigger role to tenants and community representatives. There are two elements to the new constitutional make-up of the models:

- At *board* level there is a three-way split between tenants, council nominees and independent members. The first two categories speak for themselves but the term 'independents' deserves an explanation. Conventionally, new transfer landlords have so-called independent board members, bringing various types of professional expertise and experience to the board. The changed ALMO will aim to capture those skills while at the same time ensuring that the board members are also closely connected with the local community, by residence or by involvement in community organisations and activities.
- At the *general membership* (or 'ownership') level there will be the same three-way split. All tenants will have the right to become members and the council will be a member in its corporate capacity. The third set of members will be the independents from time to time, i.e. the independent board members will also be members while they are on the board. Members – or owners – are custodians, so to speak, of the organisation. They do not direct its affairs. The 'thirds' membership structure allows the tenants and the council each to have a third share of the votes at general meetings to prevent fundamental changes to the constitution and other key constitutional decisions.

The tenant and council board members will also have an important say in the selection of independent members. Therefore allocating the remaining third of the votes at a general membership level to the independents consolidates the collective influence of the tenants and the council over the new organisation. It also avoids classification difficulties inherent in a two-way split, while at the same time embodying the 'community' ethos that the new models represent.

5.4 Key legal issues about the models

If an ALMO is to be the local authority's chosen vehicle to raise private finance for the HRA, the local authority would need to accept a loosening of its control over the ALMO to take its borrowing off the local authority's balance sheet (see section 3 above). This would include a change in ownership so the local authority would no longer own a majority interest in the ALMO.

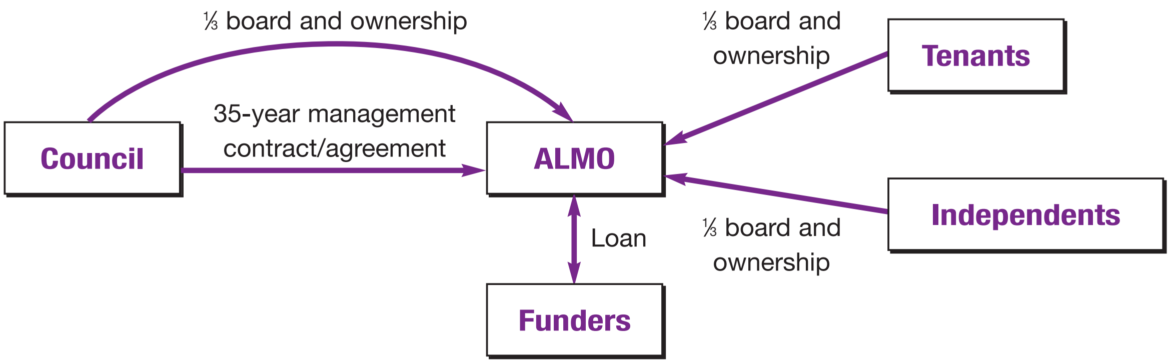
The three models all require this, and achieve it through the different governance arrangements just described – but with different legal consequences:

- In Models 1 and 2, the ALMO is primarily still a management vehicle, but no longer majority-owned by the local authority. The authority could no longer award the management contract to the ALMO without a tendering process that complies with EU procurement rules. They would need to assess the risk that potentially another housing management provider could be awarded the contract. However, steps can be taken to reduce this risk while still complying with the rules.
- In Model 3, where the ALMO takes ownership of the stock, there is no requirement for a tendering process. But it would mean that tenancies would no longer be secure council tenancies. However, legal steps can be taken which effectively give all tenants the same security in future as they enjoy now.

A range of other issues arise, such as the ALMO's tax status, if it has a different constitution and hence relationship with the local authority. These will be considered in discussing the different models in Part Three of the report.

6 Model 1 – long-term management contract

Model 1: Long-term management contract



In Model 1 the council would have a one-third interest at general membership level as well as at board level – as opposed to the current arrangement where ALMOs are 100% council-owned (i.e. there is only one general member or 'shareholder'). Providing other tests are met, this would mean the ALMO would no longer be classified as part of the public sector for borrowing purposes.[3]

As noted above, following council housing finance reform, local authorities will retain all of their rental income.[4] Being able to do this, on a basis which will be much more predictable than under the current HRA system, should enable a council to enter into a long-term management contract with its ALMO, with a negotiated contract fee. Potentially, the ALMO could then raise finance on the basis of this fee.

Under Model 1 the council would remain the landlord, there would be no TUPE transfer of staff, and VAT on the management fee would still be recoverable by the council so there would be no additional VAT costs in implementing the option.

Since the council would remain the landlord, no tenant ballot would be required. However, given the change in ownership of the ALMO and the extension to the management contract, tenant consultation under section 105 of the Housing Act 1985 may be required (or would, at the very least, be good practice).

To be able to raise private finance, the management contract between the local authority and the ALMO would need to be of a longer duration than the period over which the ALMO's borrowing is to be repaid. The contract would therefore need to be of a substantial duration since borrowing for less than 30 years is unlikely to be good value for money for the ALMO, as larger principal repayments would need to be made in the early years than on longer loans. However, there is no legal impediment to (say) a 35-year management contract, even if this exceeded the time period of the business plan.

To satisfy government that the ALMO would be the risk-taker, the management contract fee from the local authority would need to be performance-related. To calculate the fee on that basis, the management contract between the ALMO and the local authority would have to include an output specification for the service, as with PFI. This would be based upon achieving and then keeping the properties up to a certain standard (whether in terms of repairs, energy-efficiency ratings or good and tenantable condition generally). There would be a reduction in the fee if the specified standards were not met.

3 Model 1 is essentially the same as option 3 in the 2005 report *ALMOs – A new future for council housing.* This report examined several options, of which the third was the ALMO administering the HRA on the council's behalf, with a long-term management contract against which it would borrow. The ALMO would become majority-owned by tenants and independents, to allow borrowing outside public sector controls.

4 Although, following the announcement in the CSR, they will not be able to retain their full right to buy capital receipts, as was originally proposed as part of the reform plans (at least in the current CSR period up to 2015).

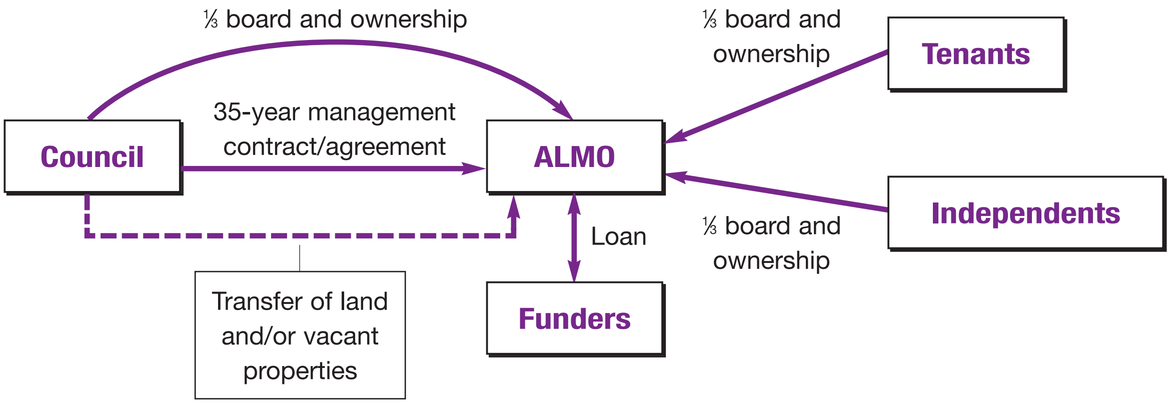
The ALMO would need to demonstrate that it has adequate governance arrangements in place with a suitably skilled board and executive team. Responsibility for improving performance if the ALMO were to suffer performance-related penalties under the HRA contract with the local authority would need to be clearly ascribed.

Ongoing approval of the ALMO's business plan by funders would be required, involving regular monitoring reports. Funders would rely on such reports from an independent body, e.g. the ALMO's auditors, including an annual report on the financial viability of the ALMO and its ability to meet its business plan.

The ALMO's loan agreement would need to include step-in rights for the funder in the event that the ALMO were to default on its loan. It would also need to provide that, ultimately, if the funder's step-in rights were to fail to remedy the ALMO's default, the funder would have the ability to sell the right to provide the contracted works or services and receive the income for the remaining contract period from another contractor.

7 Model 2 – long-term management contract with some asset transfer

Model 2: Long-term management contract with some asset transfer



This model is similar to Model 1 and again takes advantage of a local authority's post-reform 30-year self-financing business plan. However, under this model some vacant properties and/or vacant sites would also transfer to the ALMO, enabling it to undertake some asset-backed borrowing.

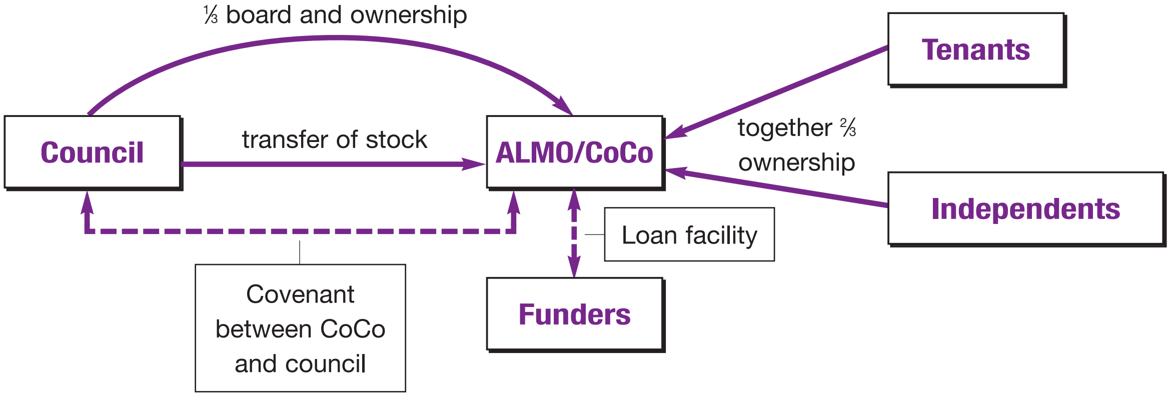
Since the ALMO would own land against which to secure its borrowing and it would have an income stream from its business, it is likely to be able to bring in greater levels of private investment than Model 1. It would not be a whole-stock option and it is likely to require more than a few void properties to be transferred in order to be worthwhile; but this model could be used for new build and/or estate renewal where the council would transfer land to the ALMO and/or decant an estate and transfer it to the ALMO for redevelopment.

The properties transferred to the ALMO would be vacant so no tenant ballot would be required in respect of them. However, as noted above, given the change in the ALMO's ownership and the extension of the management contract, tenant consultation under section 105 of the Housing Act 1985 may be required for those properties – the majority – retained by the council but managed by the ALMO.

Consent from the Secretary of State under section 32 of the Housing Act 1985 would be required for the transfer of the vacant properties. This would need to be granted for each such transfer.

8 Model 3 – Transfer to a Community- and Council-owned Organisation (CoCo)

Model 3: Transfer to a Community- and Council-owned Organisation (CoCo)



Under this model the council would transfer its stock to the ALMO, which would be restructured into a jointly-owned Community- and Council-owned Organisation (CoCo). The CoCo would not be a conventional stock transfer because it would retain a financial relationship with the council. It would do this through a covenant to service the council's HRA debt, which would remain with the council after transfer. The CoCo would covenant to meet the council's interest and repayment obligations on its HRA loans (most of which are likely to be from the PWLB).

This model would have several advantages compared with either conventional stock transfer or with taking the management service back in-house:

- The CoCo would take advantage of the council's borrowing rates by leaving the council's HRA debt in place after the stock transfer. This would potentially enable the CoCo to raise additional finance in a more cost-effective way than is possible with the other two models. The CoCo would service its debt and the covenant to the council from its rental income and, in time, it would aim – through efficiencies – to generate headroom in its business plan to finance further investment.
- Unlike council borrowing, all CoCo borrowing would be off the public sector balance sheet so it would not be subject to borrowing restrictions imposed by Treasury under the self-financing settlement. It could therefore use its surplus rental income to raise as much debt finance as it could afford, from a private lender, to invest in the stock.
- At the same time, the retention of HRA debt by the council and the existence of the covenant with the CoCo would mean the council keeping a form of pecuniary interest in the stock, albeit no longer as its owner. This would provide greater comfort to the council (and to tenants) about the council's strategic relationship with the CoCo than would be the case with conventional stock transfer.

The CoCo would retain the ALMO's current board composition (assuming one-third council board membership) but the general membership would change to include tenants and independent members with relevant expertise. Although this could possibly be a 50% council, 50% community split in ownership, two-thirds community and one-third council is proposed to ensure that the structure is sufficiently independent from the public sector to be classified by the Office for National Statistics as a private non-profit corporation (as are stock-transfer housing associations), and hence be recognised by the Treasury as off the public sector balance sheet.

It would of course be possible to have a greater proportion of tenants on the board and/or at general membership level of the CoCo if a council is keen to promote greater tenant involvement in ownership and tenants also want a bigger role in management. The regulatory requirements and/or those of the Charity Commission also point in this direction (see section 12 below).

Since the landlord would change from the council to the CoCo, a tenant ballot would be required to demonstrate tenant support. The new landlord would of course be the former ALMO (albeit with a change in its general membership), but in all likelihood with the same name and identity, and largely the same personnel and tenant board members. Assuming that it has been a successful organisation and is of course already very familiar to tenants, as should be the case with any successful ALMO, tenants are likely to be reassured and prospects of securing a positive ballot result are likely to be good.

Since most, if not all, staff who would be required to run the housing service provided by the CoCo would have already transferred from the council to the ALMO when it was set up, there would be no (or very few) staff who would TUPE transfer from the council under the new model. There would also be no transfer of staff involved in changing the governance structure of the ALMO into the CoCo.

9 The ability to borrow to carry out further investment

Council housing finance reform imposes a cap on public sector HRA-related borrowing. For all but a small number of authorities, there is headroom 'beneath the cap' for some borrowing post-self-financing but for most this is not a significant amount.

In some cases, the cap might mean that an ALMO and its authority would not be able to reach the Decent Homes Standard or address other investment needs. In others, although the ALMO has achieved the Decent Homes Standard, the opportunity to invest further in regeneration or sustainability will be constrained. In both cases, it is likely that there will be sufficient value in the business plan to meet these sorts of needs 'up front', if there could be additional borrowing not constrained by the cap, rather than having to defer investment many years. Deferring investment in this way can lead to inefficiency as work costs more when it is finally carried out.

This section comprises two case studies to illustrate the possible impact of the HRA borrowing cap and how new ALMO models might be able to lever-in investment outside the cap. The first of these focuses on Model 1 and the second on the CoCo model (Model 3). Model 2 can be seen as a variant of Model 1 with financial characteristics between the two case studies below. Both case studies are based on an exemplar business plan derived from a range of different HRA business plans gathered together to analyse the key financial factors associated with each of the models – the essential statistics are property numbers of 18,000 and a HRA debt settlement of £180m with a cap allowing only a small amount (£10m) of borrowing headroom.

The Appendix provides a schedule of all the assumptions underlying the analysis with a short commentary on the methodology adopted for the modelling of the case studies.

9.1 Case study 1 – how Model 1 might deliver extra investment

Authority A has an early round ALMO which has achieved the Decent Homes Standard. Outstanding backlogs of post-decent homes investment works can be contained within the HRA self-financing business plan. HRA debt is able to be serviced and reduced in the context of a viable long-term plan. The plan is however based on stock 'as is', with no regeneration or redevelopment and no new build. Although in the medium to long term there will be opportunities to bring forward new investment schemes, there are pressing needs for regeneration and new supply now.

For Authority A and its ALMO, Model 1 offers the potential to lever in additional finance 'up front' to deliver 'spend-to-save' efficiencies down the line. Because the private finance would be secured against the contract income stream rather than assets owned by the ALMO, the price of finance will be more expensive than for housing associations at about 2% above the level of HRA borrowing rates.

There are additional procurement and set up costs (factored into the Model 1 scenario). Model 1 is however tax-efficient, retaining the current HRA in place with the stock owned by the council. Core costs are therefore unchanged throughout the lifetime of the plan.

The table sets out the key features of the case study comparing facts about the base self-financing business plan and what Model 1 could deliver for this ALMO. The charts highlight the position under HRA self-financing contrasted with an illustrative Model 1 business plan with additional investment.

Case study 1: key facts

Description	HRA self-financing	With Model 1 investment	Difference
Investment over 10 years	£197m	£244m	+ £47m
Investment over 30 years	£688m	£735m	+ £47m
Total maximum borrowing	£180m	£228m	+ £48m
Year that private finance repaid	-	18	-
Year all debt able to be repaid	20	27	+ 7 yrs

Figure 9.1a: Case study 1: stock investment needs against self-financing resources

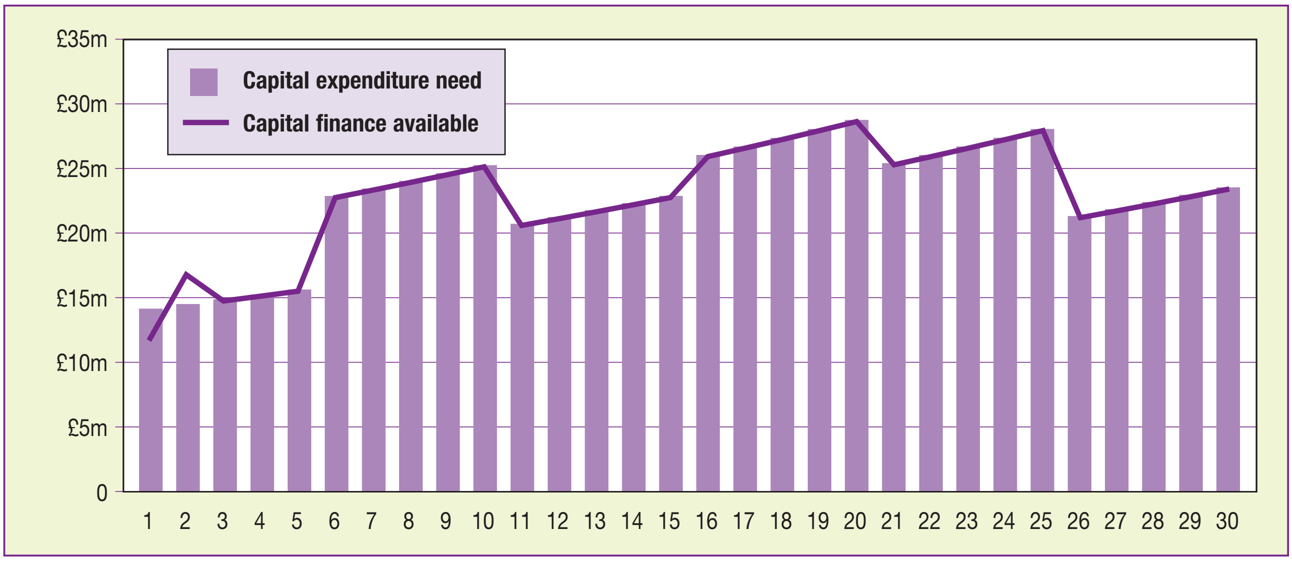


Figure 9.1b: Case study 1: self-financing debt profile

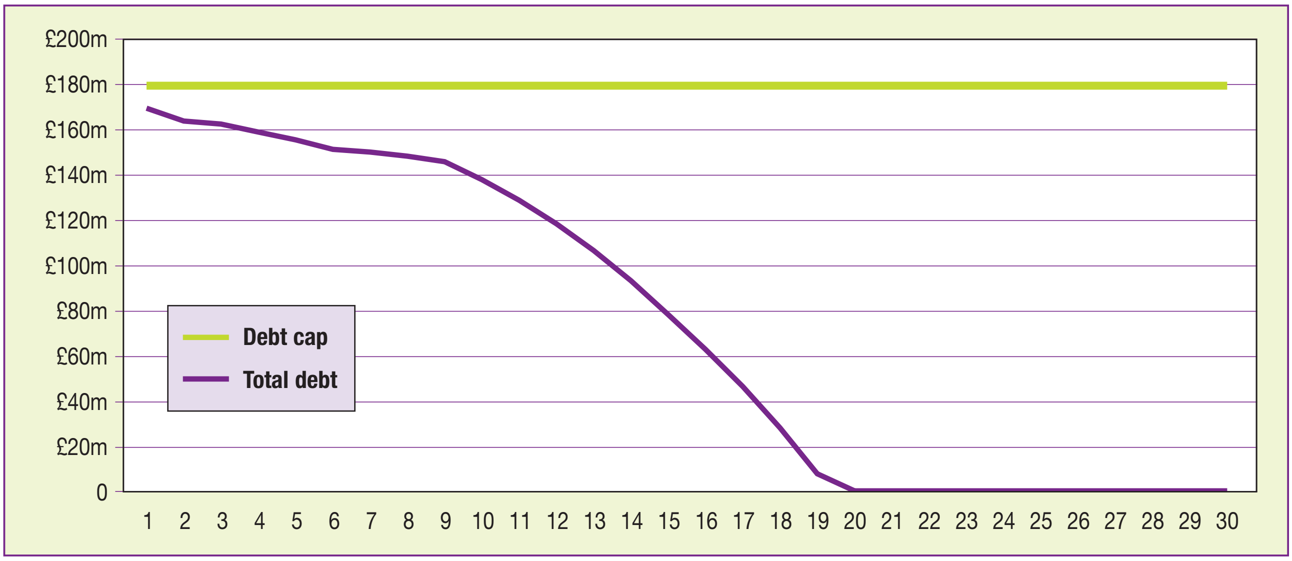
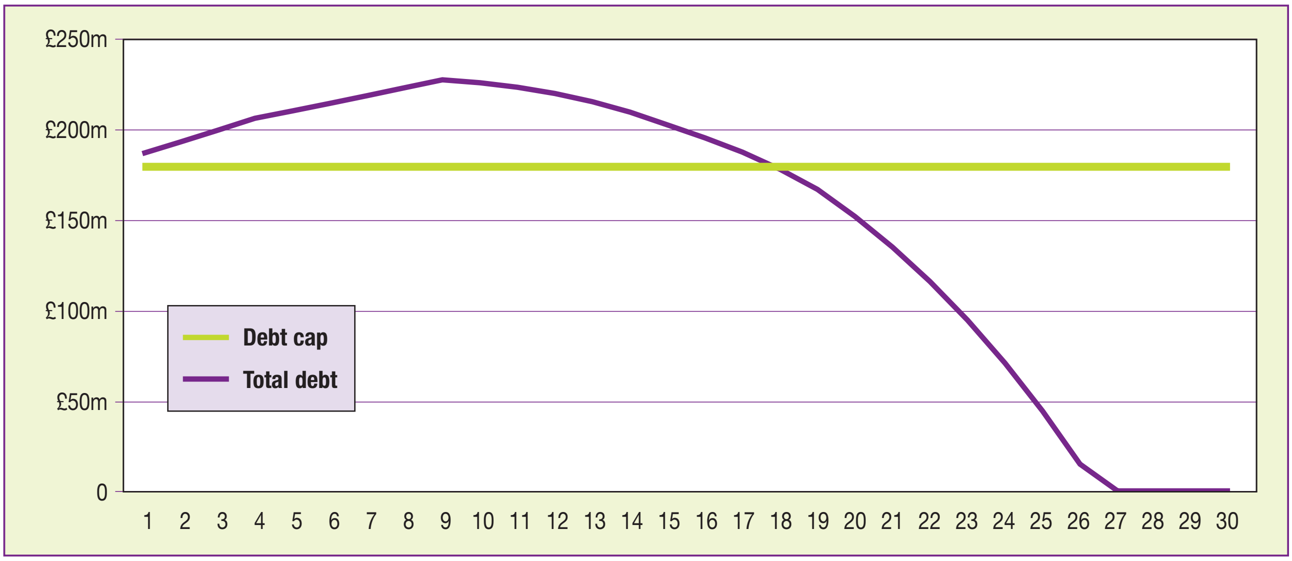


Figure 9.1c: Case study 1: enhanced investment can be delivered through Model 1



In this case study, Authority A is therefore able to secure additional investment of £47m in regeneration and development, repaying the private finance within 20 years and still able to cover repayment of the council's debt within 30 years. The case study highlights how there is potential for investment in the plan which would otherwise be constrained by the public sector debt cap.

The main factor affecting the amount of additional investment that is deliverable is the ability of the plan to service the borrowing at a relatively high interest rate.

9.2 Case study 2 – how the CoCo model might make an unviable business plan viable

Authority B has a later-round ALMO which is part-way through its decent homes programme. The decent homes funding bid was unlikely to fully cover the backlogs of investment in the stock which also include works to non-traditional stock and remodelling/conversions for obsolete property types. Reductions in decent homes funding in the latest round (2011-15) mean that even more investment cannot be undertaken and may need deferring to future years. Having previously bid for £170m ALMO resources, the latest decent homes funding backlog allocation is £100m. The need to lever in finance above the borrowing cap is therefore pressing so as to avoid deteriorating conditions for many tenants in the short term, as well as the longer-term inefficiencies brought about by repairing properties too late.

For Authority B and its ALMO, the CoCo model (Model 3) presents an opportunity to raise the finance that is desperately needed. There are financial challenges and the ALMO/CoCo must be prepared to meet those challenges head on. Whilst the cost of private finance might be expected to be closer to that seen in traditional stock transfers (our estimate is 1.3% above HRA interest rate levels), the transfer of stock means that the CoCo would be liable for unrecoverable VAT.

Authority B's CoCo business plan would not be able to sustain borrowing for the investment needed and cover all the VAT payable throughout the whole plan – the main issue is that the HRA debt settlement for the authority has been calculated without inclusion of VAT on any expenditure.

For Authority B to meet its challenges head on and to achieve the investment needed, further support is required. In this case study, this is delivered via a reduction in HRA debt equivalent to VAT on the allowances – amounting to a reduction of the debt settlement at self-financing from £180m to £133m, ie a cut of £47m. Further VAT mitigation should also be delivered if the CoCo becomes charitable and enters into a VAT shelter agreed with HMRC (HM Revenue and Customs) – in recent stock transfers VAT shelters have run for 15 years. This means that Authority B's CoCo bears irrecoverable VAT on capital works in the second half of the plan. There are also additional set up and balloting costs (factored into the CoCo scenario).

The table sets out the key features of the case study, comparing facts about the base self-financing business plan and what the CoCo model could deliver for this current ALMO authority. The charts highlight the position under HRA self-financing contrasted with an illustrative CoCo model business plan with additional investment.

Case study 2: key facts

Description	HRA self-financing	With CoCo investment	Difference
HRA debt cap	£180m	£133m	– £47m
Investment over 10 years	£317m	£377m	+ £60m
Capital shortfall over 10 years	£60m	-	- £60m
Investment over 30 years	£885m	£885m	-
Total maximum borrowing	£180m	£213m	+ £33m
Private finance	-	£80m	+ £80m
Year that private finance repaid	-	23	-
Year all debt able to be repaid	28	29	+ 1 yr

Figure 9.2a: Case study 2: stock investment needs against self-financing resources

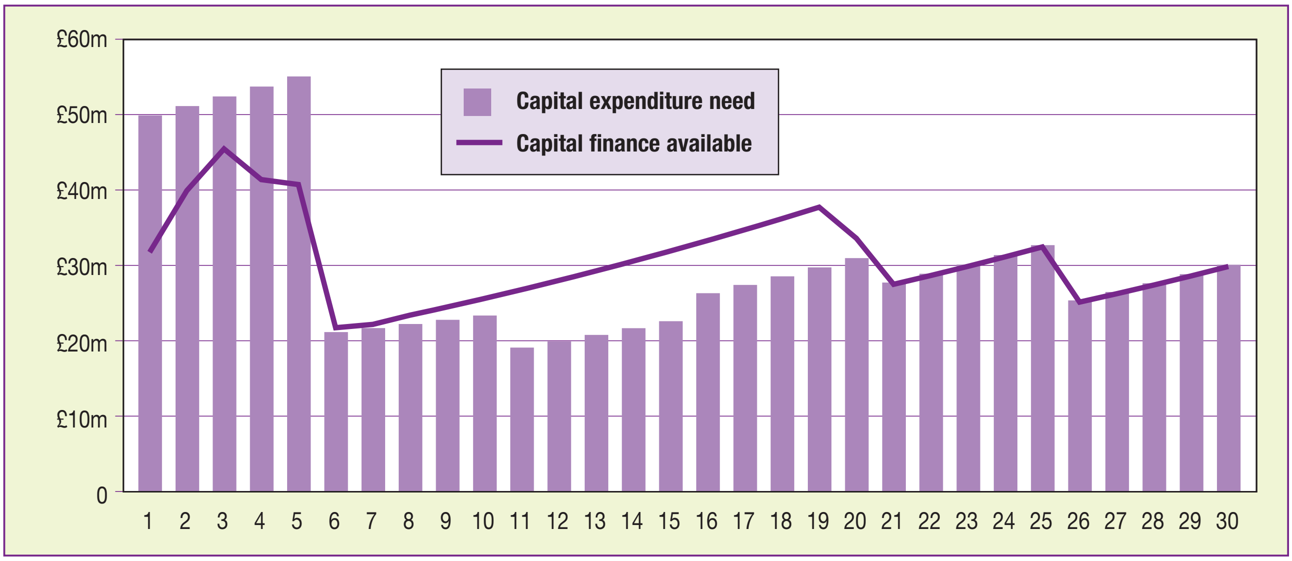


Figure 9.2b: Case study 2: self-financing debt profile showing borrowing constrained

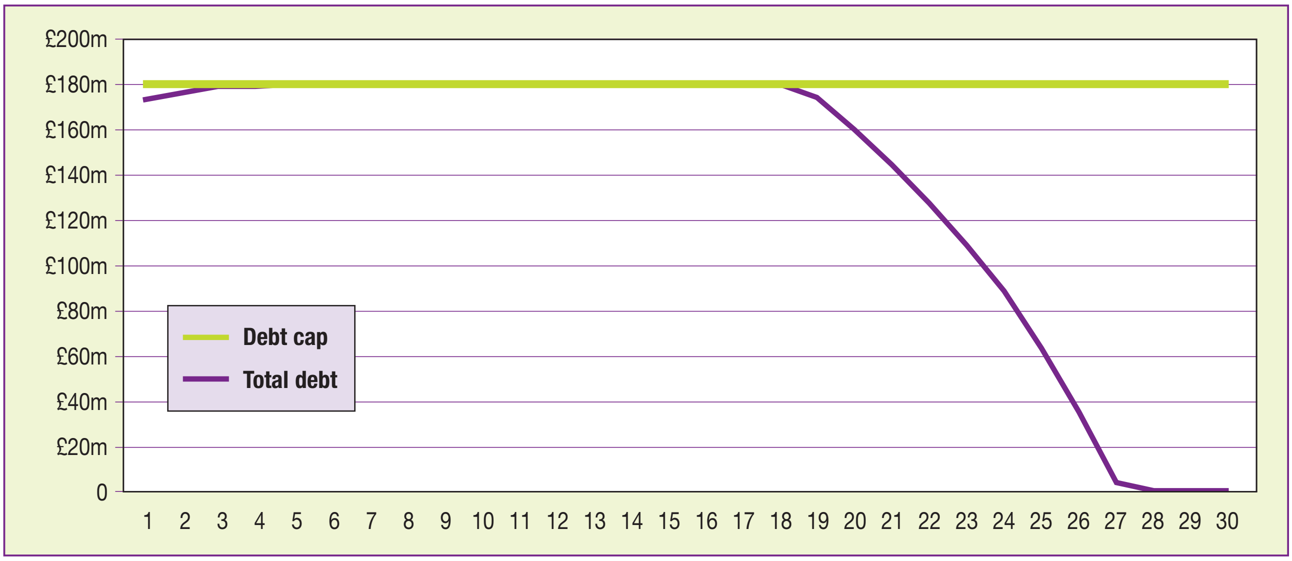
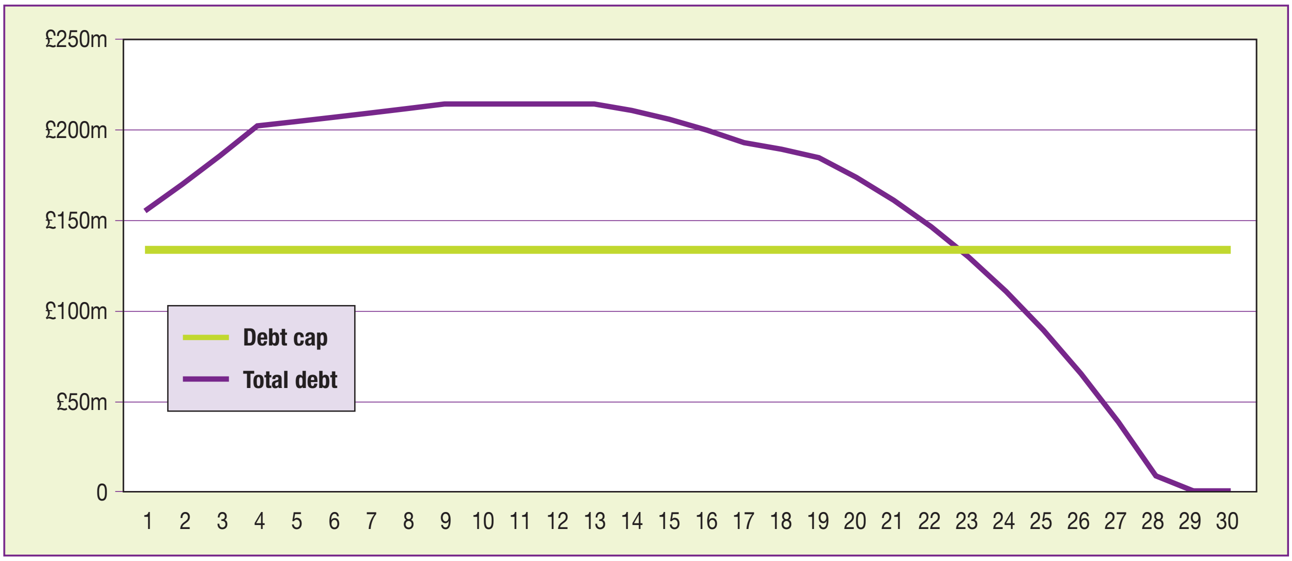


Figure 9.2c: Case study 2: enhanced investment delivered through the CoCo model



In this case study, Authority B's CoCo business plan is therefore able to secure additional investment of £60m to meet its funding backlogs, repaying the private finance within 25 years. It is still able to cover down all debt within 30 years (if desired). The case study highlights how with the right phasing of investment, plans can be made to work without the inefficiency of deferring much-needed backlog works.

There are two main factors affecting the amount of additional investment that is deliverable in this case study – the private finance is at a relatively high interest rate compared to HRA debt (albeit not as high as Model 1) and the need to provide for irrecoverable VAT on an element of service costs throughout all years of the plan and on capital costs in the second half of the plan.

In order for Authority B's CoCo plan to work, support from government (or other sources) to assist in dealing with VAT is required amounting to £47m on the transfer date. Although this may seem a high price to pay for transfer, the government will receive significantly more VAT than this from the CoCo over the life of the business plan, which would not be payable if there were no transfer.

9.3 Comparing the CoCo model to traditional stock transfer

A final analysis – based on case study 2 above – has been prepared to highlight the differences between the CoCo model and a traditional stock transfer. This is important because the recent government announcements on HRA self-financing confirm that, from 2012, all future stock transfer proposals will need to be clearly comparable with what self-financing would provide.

In the traditional stock transfer, the valuation of Authority B's stock would be based on the full stock investment needs, phased according to when needs arose, including provision for irrecoverable VAT. If we assume that the decent homes funding of £100m would be available to the transfer association as it would be to both a CoCo and to Authority B's HRA, the valuation of the stock would be £66m. Put another way, a stock transfer carried out along traditional lines would have required £114m of overhanging debt clearance (assuming that £180m is the self-financing settlement). Overhanging debt support for transfer after self-financing is unlikely, with government expecting the council to provide most of any subsidy that is necessary, which must be justified on value-for-money grounds.

Following self-financing, it is expected that LSVTs will have to apply their VAT shelters towards their business plans and this is assumed for our CoCo modelling. A traditional stock transfer would require additional support compared to the CoCo model because of the additional cost of private finance on the whole future debt for LSVT (as opposed to a large proportion retained at HRA debt rates).

The table below summarises the differences and shows that the support required for a stock transfer on this basis is estimated at £68m compared to £47m for the CoCo model.

Case study 2: comparing traditional transfer with CoCo

Description	Traditional LSVT	CoCo	Comments
Valuation delivered from rents and costs – before self-financing – after self-financing	 £66m £112m	 £133m	LSVT valuation includes up-front phasing of capital and based on actual spending not allowances
Requirement for additional support – before self-financing – after self-financing	 £114m £68m	 £47m	
Decent homes funding	£100m	£100m	Assumed available to either/both

9.4 Initial conclusions from the financial modelling

None of the three models developed in this report would be attractive to those local authorities where the debt cap will not be a significant constraint to investment, except where there is a case for considering the ownership and management benefits alone.

However, for the many local authorities where the cap will be a significant constraint, the case studies show the potential for additional investment which is affordable and sustainable using the new models for ALMOs described in this report.

Model 1 offers a way of levering in additional investment paid from future revenue streams for authorities and ALMOs where some additional investment is needed, and where the HRA self-financing plan provides sufficient income to meet the borrowing costs. Perhaps as for case study 1 this model might be best suited where additional needs are relatively modest, or linked to 'spend-to-save' initiatives, or to provide the potential to build new homes. The key *financial* consideration would be financing additional borrowing at a relatively high cost.

Model 2 provides opportunities for estate regeneration and new build.

For authorities and ALMOs where needs are pressing and the achievement of decent homes might be decades away without further up-front investment, the CoCo model might offer a means of levering in the finance needed with a lower level of public support than would be required within a traditional stock transfer. The CoCo model could also deliver additional investment for regeneration, redevelopment or new build. The government is expected to confirm a role for stock transfers going forward after the implementation of self-financing. Recent announcements suggest that the assumptions around income and spending for future transfers will be similar to those made for HRA self-financing, with a focus on access to additional support being made via a robust business and value-for-money case. The development of the government's approach to transfer after self-financing therefore has implications for the CoCo model.

Support from the council (and probably other sources too) to accommodate the effect of the self-financing settlement would be required. The recent policy statement suggests that there will be the opportunity to engage positively with government to develop an approach which authorities and their ALMOs can work with as they think about planning a sustainable future.

10 Tenant empowerment

Earlier sections of this report emphasised the opportunities which now exist to build on ALMOs' experiences of empowering tenants, and the three models that have been developed have had this as one of their main aims. In all three alternative models offered in the report, the new organisations would be committed to a significantly bigger role for tenants, both in the governance of the new bodies and in their ownership. What is difficult to specify here is the precise detail of the organisational arrangements that might be followed, since each local authority and its ALMO will want to develop local proposals in conjunction with tenants, based on their joint experience to date and how all three parties want to build on the ALMO's current governance arrangements.

In addition to the organisational changes implied by whichever of the three models is chosen for local adoption, it is envisaged that as a minimum the proposals would:

- adopt the devolution provisions to be found in many stock transfer constitutions
- commit to continuing with any existing TMO arrangements (on the basis set out in most consultation documents)
- support the creation of new TMOs (subject only to the usual governance and value-for-money tests and the requirements of the regulator and funders).

In the CoCo model, as with any stock transfer, the Right to Manage would no longer apply statutorily, but the commitment to devolution would embody the principles of the Right to Manage.

Because of the crucial importance of tenant empowerment to the debate, a special paper by Nic Bliss of the Confederation of Co-operative Housing has been prepared to supplement the considerations in the report, and this follows.

Tenant empowerment and the proposed models

Nic Bliss, *Confederation of Co-operative Housing*

Over the last few years, there have been substantial advances in terms of enabling tenants to be involved in decision-making in landlords, and many ALMOs have been at the forefront of these. However, the Tenant Services Authority (TSA) reported in 2009 that only one out of every two tenants were satisfied with their opportunities for involvement and only one in six tenants feels that their landlord takes notice of their views: this reminds us that there is still a long way to go.

For any landlord to be at the forefront of tenant empowerment now requires them to go much further than was expected when ALMOs were first being set up. Back then, great emphasis was placed on tenant board membership, and certainly those ALMOs that have had effective tenant leadership on their boards, especially those with tenant chairs, have enabled a substantial cultural change in the involvement of tenants.

For landlords that wish to excel at tenant empowerment now, tenant board membership is only one part of a much wider spectrum of ways to involve tenants in decision-making and governance. Most landlords will now have some form of tenant panel playing an increasingly important role in the organisation; sounding boards, focus groups, tenant inspection, mystery shopping, tenant involvement in service review processes are all beginning to lead to effective tenant scrutiny of landlords; and some landlords are involving tenants in all aspects of the business – from tenant-led communications to involvement in asset management, value for money, diversity and many other issues. The bar has been pushed higher than it was even two years ago.

➔

A small number of landlords (some of them ALMOs, such as Salix Homes in particular) have started to understand the sound business case for encouraging and supporting widespread tenant involvement in governance. And the Community Gateways, and Community Mutuals in Wales, have set the precedent of tenant majority membership and ownership of housing organisations – quite possible with the proposals in this paper. These types of organisation are raising the tenant empowerment bar even higher. And if tenants are properly enabled to play their new intended role in regulation of their landlord – tenants will be demanding higher and higher levels of involvement in all parts of decision-making by their landlord.

This much wider array of tenant empowerment opportunities needs to be available to any structures chosen to take forward ALMOs into the new environment, and it is likely that new models for ALMOs will only win tenant support if wide empowerment options are part of proposed arrangements. And in the new environment, winning support from tenants for proposed changes will be fundamental.

First, strong and demonstrably widespread tenant support for any model ought to be the strongest card to gain support from the council.

Secondly, the process to win tenant support will of itself be an empowering process. Some authorities with ALMOs originally had ballots to determine whether or not the ALMO was set up, and of course all stock transfers took place only after a successful tenant ballot. The processes used in these ballots enabled tenants to have their say and shape the resulting organisations in ways that had never been possible before. Whether or not tenant ballots are required to make changes to existing ALMO arrangements, new structures should be built on an extensive process of debate and consideration between the tenant constituency, ALMOs and landlord authorities that explores every aspect of the new organisation.

Thirdly, as part of a general requirement to enable tenants to 'influence strategic priorities, the formulation of housing-related policies and the delivery of housing-related services', it is now a regulatory requirement that landlords 'consult with their tenants, setting out clearly the costs and benefits of relevant options, if they are proposing to change their landlord or when proposing a significant change in their management arrangements'.[5] Any of the three models proposed in this report would be a significant change to management arrangements which would require an extensive debate with tenants.

It should also be noted that it is a regulatory breach (and bad practice) for a local authority to take management of their homes back from an ALMO without a similarly extensive debate with their tenant constituency that clearly sets out the costs and benefits of management through the ALMO and directly through the council (even where this is as a result of the ending of the existing ALMO contract).

It would be good practice that this 'consultation' goes way beyond old-style 'consultation' where decisions have by and large already been taken. Tenants should be involved from the 'blank sheet of paper' stage, and the whole tenant constituency should have opportunities and be encouraged to get involved. The process to develop 'offer documents' with tenants in stock transfers – where tenants are able to consider all parts of the service and adapt and make changes – is now well charted and would apply in Model 3 in this report. But the same approach should also take place under the 35-year management agreement proposals of Models 1 and 2. Tenants and the landlord should jointly work on the deal that would be offered to tenants as part of adopting the changed arrangements. As a minimum, this 'offer document' should detail how the regulatory standards will be applied in the chosen option, and what steps can be taken if tenants consider that they are not being applied. It should also be legally enforceable – through a legal agreement with the council in the case of Model 3, and through the 35-year management agreement in the case of Models 1 and 2.

It should also be noted that, whilst a council would be expected to involve an ALMO in 'consultation' arrangements, it is the council's duty to 'consult' with its tenants about future structures. Where it is proposed that tenants will continue to be council tenants with a 35-year management agreement, the council will have continuing responsibilities to its tenants that it will need to be satisfied will be properly discharged through the agreement. The agreement should detail how tenants can raise regulatory compliance issues with the council, and expect that the council will take appropriate action, that could extend as far as terminating the agreement, to ensure compliance if necessary.

5 See the TSA regulatory requirement at www.tenantservicesauthority.org/server/show/nav.14690.

Some councils (e.g. Sandwell) have ongoing positive and constructive relationships with their tenants and ALMOs, and this should have been the case with all ALMOs. Councils should treasure and support their ALMOs and recognise how they have improved services for their tenants. Establishing a 35-year management agreement ought to be a means to strengthen, reinforce and clearly delineate the three-way relationship that should exist between tenants, ALMOs and councils.

The 'offer document' should also set out how the 'annual report to tenants' will be developed each year – ensuring that tenants are leading partners in assembling the report (and ensuring that the council effectively discharges its responsibility to produce an annual report to its tenants). The National Tenant Organisations have identified in a review of the first-year annual reports some excellent practice in the ALMO sector (e.g. the tenant-led reports produced by Salix Homes, Sandwell Council & Hackney Council/Hackney Homes), but it should be noted that this excellent practice was not shared by all ALMOs – a small number did not refer to any tenant involvement in the development of their annual reports.

Developing tenant support for any of the three models outlined in this report is likely to be dependent on (a) whether the package on offer to tenants is what tenants want and (b) on whether tenants trust that the package will be delivered – which is likely to be dependent on a combination of who is giving them the message and whether they trust them, and who is being proposed to deliver the package and whether they trust them. It is probably the case that the more that the message and delivery vehicle are tenant-led and are seen as being tenant-led, the more chance there is that tenants will support change.

Trust in the delivery organisation is vital. Because tenant empowerment is never a pass or fail standard and because it takes years to develop, it is not possible to craft written assurances in offer documents or agreements that will necessarily guarantee that the new organisation will genuinely involve tenants in decision-making. Whether it does or not will depend on the culture of the organisation – whether it genuinely chooses to place tenant involvement in decision-making at the heart of the organisation and shape everything it does in accordance with that goal. Tenants need to trust that this will happen. A change process of the nature proposed in this report is the best time for tenants and landlords to work together to build the culture and the trust necessary to deliver real tenant empowerment, but it is not and cannot be legally guaranteed.

Part tenant ownership and membership of the resultant organisation in any of the three models may serve to build some trust amongst tenants. The experience of the Community Gateway transfers was that proposing transfer to a tenant majority membership organisation – where tenants own the transfer organisation – provided some reassurance. However, it should be noted that just making a housing organisation 'mutual' will not of itself achieve very much unless there is a process to empower tenants and make membership meaningful, that runs alongside the proposed mutuality.[6]

Tenant Management Organisations

Tenant Management Organisations (TMOs) would face particular issues in relation to the three models set out in this report. The early days of ALMOs saw some difficult relationship problems between ALMOs and TMOs, where TMOs had existing relationships with their councils, and of course council tenants continued to have the legal Right to Manage their homes. The three-way relationships between councils, TMOs and ALMOs sometimes became confused – although these problems were at least partially resolved through joint work between the National Federation of ALMOs, the National Federation of TMOs and the Councils with ALMOs Group.[7] There is however no reason why an appropriate three-way relationship cannot be made to work between the council, an ALMO and TMOs.

The position of TMOs under any of the proposed models in this report would be potentially knotty.[8] If a council were to agree a 35-year management agreement with an ALMO, a TMO would have the following options (none of them particularly attractive – and some of them may not be possible):

6 It is possibly the case that, almost by definition, tenants may be least likely to support Model 2 – the option to transfer empty homes to a new organisation. This model may be considered where it is thought that it would be difficult to win tenant support for a transfer of ownership of tenanted homes. In such circumstances, those same tenants are unlikely to support the transfer of empty homes and will see it as transfer by the back door. For this reason the NFA would envisage use of this model where there is clear support from tenants for transfer of land and/or blocks of property as part of wider regeneration plans for an estate or neighbourhood.

7 NFA, NFTMO, CWAG (2009) *Local authority, ALMO & TMO relationships; a good practice guide*. London: NFA, NFTMO, CWAG.

8 The NFTMO is intending to consult its members about issues raised in this report.

a) Seek an equivalent 35-year management agreement and loan funding in the same way as is proposed for the ALMOs in Models 1 and 2. This may not be legally possible at the moment, because TMOs are currently bound by the Right to Manage framework which requires them to hold a continuation ballot once every five years.
b) Explore whether they could be part of the ALMO's loan funding arrangements on the understanding that if a TMO were to lose a continuation ballot, management of the homes in question would become part of the 35-year ALMO contract. At best, this sounds legally messy – so much so that it would potentially confuse lenders.
c) Retain their existing status but accept that they would not receive the funding necessary to modernise and improve their homes, whilst watching the ALMO homes around them being modernised and improved.

Depending on how it were to be used locally, the consequences of Model 2 could be even stranger for TMOs. Would their empty homes be transferred to the ALMO ownership vehicle as they became vacant? If so, would the TMO then lose management of them? If it did, what would be the consequence to the fabric of the TMO communities? It would be important to have an agreement in place to reassure the TMO of its position. For example, if properties or land are to be included in a regeneration scheme as Model 2 envisages, how will this affect the TMO-managed homes? What role will they have in managing any new homes intended to be built?

It would appear that all of the consequences to TMOs of Model 2 would need to be carefully considered in deciding how the model is to be used.

Under Model 3, a TMO would face the following options:
a) To discuss with the council the possibility that the TMO managed homes could be transferred separately. There are a number of precedents for this: WATMOS Community Homes – where a group of eight TMOs transferred to their own registered provider set up specifically for that purpose; Wilfrid East Co-op – where an individual TMO transferred to a fully mutual housing co-op registered provider – again set up specifically for that purpose; and Beechwood & Ballantyne EMB, which transferred as a subsidiary to a pre-existing housing association.
b) To be part of the ALMO proposed transfer. Experience has shown that it is not possible for a legal guarantee to be given by a stock transfer housing association that tenant management agreements will be maintained because such a guarantee always has to be subservient to the business plan of the stock transfer vehicle. Sadly it is also the case that many TMOs have disappeared without trace following stock transfer (even where clauses about TMOs were included in 'offer documents') and so existing TMOs are likely to be extremely cautious about any proposal that would involve transferring their homes. Again, the likelihood is that TMOs will only be maintained post-transfer if the culture and ethos of the transfer body supports the principle of tenant management (as was the case at Preston Community Gateway – which meant that the Moor Nook EMB continues to exist and is probably now a stronger organisation).

The implications for existing (and prospective) TMOs under all three of the options proposed in this report are difficult. What this means is that if an ALMO wishes to explore any of the three options, there should be early discussion between TMOs and the council whose homes they manage to consider how they would want to proceed, and then three-way discussions between the council, TMO and ALMO.

Tenant empowerment and the proposed options

This section has aimed to set out some of the key issues regarding the development of tenant empowerment in the light of the proposed three options in this report. It is certainly the case that some ALMOs are now leading players in the field of tenant empowerment and it is probable that those ALMOs will be better placed to gather tenant support for proposed options. But not all ALMOs are as good as the best – and anyway no landlord can rest on their tenant empowerment laurels – the field is fast-moving and what was innovative two years ago is now old hat.

This section makes it clear that if an ALMO wants to look at any of the three options in this report, its first step ought to be to work with its tenants – as widely as possible – from a blank sheet of paper towards making decisions that are supported and campaigned for by tenants.

11 Views of lenders

Informal discussions have been held with the Council of Mortgage Lenders and with potential lenders. Banks are keen to pursue this new lending market.

Lenders are cautious about the pricing of loans for Models 1 and 2. This is partly because the size of initial loans will be relatively small compared to other lending for social housing. Also, lenders do not like the complexities of PFI for housing and are concerned at the absence of private sector involvement in Model 1. With Model 2, they point out that a significant financial buffer would be necessary as there would be no additional assets available if the project being financed were to experience difficulties.

Lenders like stable sources and flows of new business. They have therefore been supportive of stock transfers but, since the credit crunch, there has been a reduction in the number of lenders bidding to fund transfers because of the length of loans required. The starting point for funders for the CoCo model (Model 3) will be the current LSVT model, so there will need to be clarity about the differences for a CoCo. As the core funding for CoCos will be the council's long-term debt, CoCos may be willing to raise shorter private sector loans than a new LSVT association, for which there should be a larger group of lenders.

Lenders would like to see a standard funding solution for each model that is pursued. So early engagement with potential funders during the development of all three models for ALMOs will be worthwhile.

As with loans to housing associations, initial lending margins will be high until the ALMO has a track record of private finance and of the activities being financed, e.g. new build and regeneration. If the ALMO does well, lenders will support refinancing after a few years to increase the size of loan facility and to reduce interest costs.

12 Legal and regulatory issues

As mentioned in section 3 above, if an ALMO is to raise private finance the local authority could no longer own a majority interest in the ALMO. A consequence of the change in the ALMO's ownership, relevant to Models 1 and 2, would be that the local authority could no longer award the management contract to the ALMO without an EU-compliant procurement process. This is because the so-called 'Teckal exemption' would cease to apply (see box).

The Teckal Test

In the case of *Teckal (Teckal Srl v Commune di Viano, Azienda Gas-Acqua Consorziale (AGAC) di Reggio Emilia* (C107/98 [1999] ECR I-8121), the European Court decided that a contract entered into between a public authority and a person legally distinct from that authority might be regarded as an 'internal award' that did not need to be the subject of a regulated procedure where the public authority:

(i) exercises over the person concerned a control which is similar to that which it exercises over its own departments; and

(ii) at the same time that person carries out the essential part of its activities with the controlling local authority or authorities.

The loosening of the local authority's control over the ALMO, including the change in the ALMO's ownership, to allow the ALMO to raise private finance means that the first Teckal test would not be satisfied and the management contract would therefore need to be tendered.

However, when starting to frame its tender procedure, the local authority would be able to take account of a range of social issues, including those that have become important to the authority and tenants as a result of the ALMO's work to date. The important proviso is that, in order to be able to evaluate tenders in respect of such issues, they need to be a core requirement of the service that is being procured. Such requirements therefore need to be established well in advance so that they are properly reflected in the tendering process. Here are examples of how social issues might be included:

- Tenant involvement throughout the duration of the contract (such as participation in performance management of the service provider) can be accommodated in the contract terms. In order to ensure that the service provider adopts a certain approach to tenant involvement, the local authority is able to set a series of minimum requirements via the tender process to ensure that it 'weeds out' potential service providers that are not able to provide such performance levels. These minimum requirements can include matters such as the involvement of tenants in performance monitoring, and empowerment of tenants through various governance structures, provided such requirements are core to the contract.
- A social clause can cover aspects of the service that need to be delivered in particular ways because of the nature of the client group. For example, suppose the contract covers an area that has significant numbers of residents for whom English is a second language. In such a case the local authority could stipulate a requirement for the service provider to employ frontline staff that speak those primary languages and evaluate tenders/support the tender process with a set of proportionate contract conditions accordingly.
- A local authority might wish to achieve wider social aims through the contract, such as a certain number of apprenticeships or training places per £1 of money spent. It would be able to set these as a minimum requirement and ask each bidder to provide an unequivocal statement that it will ensure that these are provided. These will then be tracked through into binding contractual obligations.

For further information on social clauses in procurement there is guidance from the Office of Government Commerce (2006) on *Social Issues in Purchase* and the topic is also included in the Homes and Communities Agency (HCA) regulatory procedure guidance and toolkit.

The risk that another housing management provider could potentially be awarded the contract therefore needs to be assessed by the local authority and the ALMO. However, taking account of the above issues in the specification of the contract and the tendering process may assist the local authority to satisfy itself that, post-tender, the management services would still cover the key social issues and offer the same level of tenant accountability which are provided by the ALMO at present. Further, the ALMO may also derive comfort from such requirements being included in the specification as it should be able to demonstrate a strong track record of tenant participation and accountability, and ability to deliver on other social aspects of the contract.

For both Models 1 and 2 an output specification would be required and this would be more detailed than ALMOs may presently be used to in their contracts with their parent authority. The output specifications would be more akin to those used in HRA PFI contracts even though such contracts are, without exception, not whole stock contracts. The output specifications would be linked to a payment mechanism with appropriate deduction arrangements and ratchets to deal with under-performance.

A privately financed ALMO would be taking on more responsibility and risk. In such circumstances the government would probably require similar ongoing economic and governance regulation of the ALMO to that which applies to housing associations, to protect tenants and the public purse. This would be particularly important should service delivery deteriorate significantly. Under the future arrangements for cross-domain regulation,[9] when the Homes and Communities Agency takes over these responsibilities from the TSA, it would not ordinarily have direct oversight of an ALMO. But it would be straightforward for the HCA to be required to regulate ALMOs which are no longer wholly (or majority) owned by their councils.

In Model 3, the CoCo will need to be a registered provider under current DCLG requirements. It should be noted that, prior to 1st April 2010, TSA policy would have required that one-third of the board and one-third of the quorum of general and board meetings of the CoCo must comprise people independent from the council and tenants, and that the council's general membership or 'shareholding' is a minority interest. However, these requirements are no longer explicit under the registered provider regime. That said, it is still true as a general principle that the governing body of an organisation which is a registered provider ought not to be subject to undue influence by any one particular interest group. Furthermore, DCLG guidance still provides that it will normally be most appropriate for one-third of the board to comprise tenants, no more than one-third council nominees and at least one-third other community representatives, and that the council's general membership or shareholding must be a minority interest.

For all of the models it is suggested that tenant board membership might be increased above one-third, where tenants and the local authority want them to take a bigger role. In this context, it should be noted that the 2006 Review of ALMOs treated one-third as a minimum requirement, recognised that some ALMOs had opted for greater tenant board representation, and said it was 'supportive of this trend'.[10]

It is also standard practice for registered providers who receive tenanted stock from councils to have or acquire charitable status. In the context of this model, the benefits of the CoCo being a charity include the ability to operate a VAT shelter, which will be essential for viability, as well as no corporation tax being payable on income derived from charitable activities. The Charity Commission would need to be satisfied that the CoCo is sufficiently independent from the council, which will have a bearing on the level of the council's interest in the CoCo. It may therefore be preferable for the CoCo's ownership to be structured with the council, tenants and other community representatives each having a one-third interest. That said, it would also be potentially possible for tenants to be majority board and majority owners of the CoCo but again, Charity Commission concerns regarding potential conflicts of interest will need to be considered.

By stock transfer convention, there would be no EU procurement process to select the new landlord, so there would be no risk to the ALMO/CoCo of a competitive tendering process that would result in the stock transferring to another housing provider. (There might however be an informal process which could lead to a new 'trust' or parent, as in the case of Stockton-on-Tees.)

9 As set out in the government's *Review of Social Housing Regulation* (DCLG, 2010).

10 DCLG (2006) *Review of Arms Length Housing Management Organisations*. London: DCLG, para. 32.

The possibility of the local authority's HRA loan debt from the PWLB being assigned to the CoCo on transfer has been explored. The PWLB's power to lend money to registered social landlords (RSLs) under section 23 of the Housing Act 1996 would previously have applied, but now that the new registered provider system has replaced RSLs in England (since 1st April 2010), section 23 only applies in Wales. Furthermore, the PWLB's power to lend money under section 451 of the Housing Act 1985 will also not apply as this section explicitly does not cover loans to 'housing associations' (or registered providers).

It therefore appears that the power for the PWLB to lend to registered providers may have slipped through legislative cracks. However, this can be overcome (as earlier sections assume) by the CoCo covenanting with the council to service and repay the debt in consideration for receiving the stock. Clearly, the council would need to be satisfied with the strength of the CoCo's 'covenant'. It is assumed that the authority will require a first charge on the CoCo's assets ranking equally with the first-charge security required by funders for their loan facility. It is further assumed that there is no obstacle to an authority keeping its HRA open, notwithstanding the transfer of the HRA stock, as this may be the most convenient way of accounting for the transactions on the local authority side of the financial arrangement with the CoCo.

As with the original ALMO initiative almost a decade ago, there is scope for developing model rules and standard documentation to facilitate the changes outlined in this report, if they were to receive significant support from ALMOs and their authorities, as well as government backing to go ahead.

13 Summary of advantages/disadvantages of proposed models

A summary of the advantages/disadvantages of each model is provided in Figure 13.1. It includes comparison with three other options – keeping the ALMO as it is, taking the service back in-house, and conventional transfer to a registered provider based on the ALMO.

Figure 13.1: Comparison of models in this report with other options for ALMOs

Factor	Alternative models in this report			Other options		
	A. Model 1 – 35-year management contract	B. Model 2 – 35-year management contract and some transfer	C. Model 3 – Transfer to CoCo	D. Retain ALMO in present form	E. Take housing management back 'in-house'	F. 'Conventional' transfer of stock to new landlord based on ALMO
OVERALL STRUCTURE						
1. Whole or partial stock option?	Could bring in modest levels of investment for whole or partial stock options	Whole stock but extra investment likely to be for estate renewal in only part of stock	Yes	Yes	Yes	Yes
2. ALMO management contract subject to EU competition?	Yes	Yes	No	No	No	No
TENANT EMPOWERMENT						
3. Tenants take bigger role in ownership and management?	Yes	Yes	Yes	Possible	No – more difficult: housing service will lose distinct status	Possible
4. Potential to adopt Community Gateway/other tenant-led model?	Yes – but only for management	Yes – but (largely) only for management	Yes – ownership as well as management	No	No	Possible
5. Ballot required?	No – but should be extensive consultation	No – but should be extensive consultation	Yes	No	Same degree of consultation as took place when ALMO established, including ballot if applicable	Yes
FINANCIAL ASPECTS						
6. Additional loan finance possible, not counted as council borrowing?	Yes	Yes	Yes	No	No	Yes

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Factor	Alternative models in this report			Other options		
	A. Model 1 – 35-year management contract	**B. Model 2 – 35-year management contract and some transfer**	**C. Model 3 – Transfer to CoCo**	**D. Retain ALMO in present form**	**E. Take housing management back 'in-house'**	**F. 'Conventional' transfer of stock to new landlord based on ALMO**
7. Retains the advantage of PWLB interest rates for the HRA debt?	Yes	Yes	Yes	Yes	Yes	No
8. Extent/cost of private finance?	Some potential but at higher interest rates	Some potential but at higher interest rates	Favourable	Not available	Not available	Favourable
9. Irrecoverable VAT on split of management and ownership?	No	No, although some VAT may be irrecoverable if this model is used for estate renewal and work is outsourced	Yes – will need to be taken into account in the transfer	No	No	Yes – will need to be taken into account in the transfer
10. Council continues to service its (post-reform) HRA debt?	Yes	Yes	Yes – but CoCo would covenant to service the council's outstanding debt	Yes	Yes	No – debt paid off and refinanced by stock transfer landlord at higher interest rate
OTHER FACTORS						
11. TUPE transfer of staff?	No	No	No (or very limited)	No	Yes	No (or very limited)
12. Registration required with regulator?	Not because of stock transfer but may be needed for other reasons	Not because of stock transfer but may be needed for other reasons	Yes – because of stock transfer	Not because of stock transfer but may be needed for other reasons	Automatic	Yes – because of stock transfer
13. Registration required with Charity Commission?	Desirable	Desirable	Desirable	Not appropriate	Not appropriate	Desirable
14. Amendments required to ALMO constitution?	Yes	Yes	Yes	No	ALMO is wound up	Yes
15. Retains secure tenancies?	Yes	Yes	No – but equivalent legal protection can be given	Yes	Yes	No – but equivalent legal protection can be given
16. Viable on the basis of known government HRA reform proposals?	Yes – within overall limitations of this model	Yes – within overall limitations of this model	Potentially a stronger option than ordinary stock transfer if financial support is available on transfer – depends on transfer rules after April 2012	Yes – but only if HRA settlement provides sufficient potential to invest in stock	Yes but only if HRA settlement provides sufficient potential to invest in stock	Yes, if financial support is available on transfer – depends on transfer rules after April 2012

14 Conclusions

14.1 Overall conclusions

The report offers new options for councils, ALMOs and tenants that go beyond the alternatives currently available and will better enable them to provide a sustainable future for their local housing service. It supports the government's agenda of allowing tenants to have much wider opportunities to become involved in managing their housing stock and housing services. It also enables authorities to meet the investment needs in their housing stock, in cases where the financial settlement offered by council housing finance reform will create a gap between the investment needed and the amount they will actually have available to them. Although the report was primarily produced with local authorities with ALMOs in mind, there is no reason in principle why local authorities without ALMOs that have additional investment needs beyond self-financing should not also consider these options.

Clearly, decisions on these or other options will be made at local level, and indeed we would anticipate that further detailed work will be required to assess the costs and benefits of different options, especially in the context of council housing finance reform. The report is intended to provide sufficient detail so that local authorities, ALMOs and tenants can broadly review these new options compared with those of continuing with the existing ALMO model, taking the service back in-house, or conventional stock transfer. However, we fully expect that if one of the options is chosen it will need detailed adaptation to the different circumstances in each local authority.

14.2 Conclusions on the alternative models

The report puts forward and tests three alternative models aimed at meeting the objectives set out in section 5. All three models have potential for exploration by local authorities, their ALMOs, and tenants. Their appropriateness will depend on their local needs, attitudes towards the future of the ALMO, and their likely investment requirements after April 2012.

Of the models, the CoCo model (Model 3) is the one most likely to provide a solution to the authorities which require borrowing in future that would be significantly above the 'cap' that will apply to each authority after April 2012. It is a model which can offer a significantly bigger role to tenants while also being attractive to the private lenders from which the CoCo would aim to borrow. It requires a government policy decision on stock transfer after self-financing, in particular to enable a solution to the additional VAT costs.

In addition, Models 1 and 2, which do not require transfer of tenanted stock, provide more limited options which may nevertheless be attractive to authorities where the additional investment needs are more modest and/or are restricted to particular estates or neighbourhoods. While avoiding tenanted transfers, they are both likely to require tendering of the housing service to meet EU procurement rules, which can be done in ways aimed to safeguard local services.

15 Recommendations

To local authorities, ALMOs and tenants

1. All local authorities, when considering the implications of council housing finance reform for the HRA, should consider these three models and discuss them with their tenants.
2. Local authorities with ALMOs who are reviewing the ALMO management agreement and the ALMO's future should include these three models in the options to be reviewed and should discuss them with their tenants and with the ALMO.
3. Authorities and ALMOs should pay particular attention to the needs of TMOs in any discussions about these options.

To central government

4. The government is recommended to consider the options set out in the report, with a view to all three models being available as options to all stock-retaining local authorities after self-financing, from April 2012.
5. The models should be included within the framework of government advice that will be issued to local authorities to assist them, their ALMOs and their tenants in local decision-making on the future of ALMOs once council housing finance reform has been implemented.

To TSA and HCA

6. The TSA and HCA are recommended to consider the implications of the report as an additional vehicle for investment in the council housing stock and, in particular, as a means of furthering the regulatory standards on tenant empowerment, quality of accommodation and value for money.

APPENDIX: Assumptions and methodology supporting the financial evaluation

The material below supports the discussion of the two case studies set out in the body of the report (section 9), including the main assumptions, the rationale for the modelling and the way in which the outputs are generated.

In order to assess the feasibility and costs of the private finance options for alternative ALMO structures, a 'live example' has been generated to model the potential impact of the options upon which two case studies have been developed to highlight contrasting ALMO experiences.

Schedule of assumptions

The two case studies are for a 'typical' HRA based on the features of six ALMO/LA business plans. The ALMO authorities concerned vary from relatively small stock sizes up to above 30,000 units, and include ALMOs at varying stages of the delivery of their decent homes programmes. The aim is to capture a composite schedule of features and factors in order to illustrate some broad initial conclusions about the main issues and implications of the alternative private finance models.

Exemplar business plan: basic facts and assumptions

- Number of properties: 18,000 with right to buy sales at 0.2% per year.
- No other stock loss, disposal or demolition.
- Rents at c£60, around £2 below target, converging in 2015/16 (in line with the government's plans for self-financing).
- Rent increases at formula are RPI + 0.5% in line with current policy – no adjustment or sensitivity has been run relating to the potential introduction of CPI for rents and benefits at this stage.
- Management and maintenance costs of c£1,650/unit.
- Underlying operating surpluses therefore (before debt servicing) – rents and income less management and maintenance – start at approximately £24m (£1,300/unit).
- Self-financing debt settlement = £180m debt, or £10,000/unit with borrowing cap set at this level for the lifetime of the plan.
- PWLB interest rates are 6% all years.
- Inflation is 2.5% all years.
- For case study 1, capital programme needs total £490m at today's prices over 30 years (or £26,000/unit), relatively evenly phased over the plan lifetime.
- For case study 2, capital programme needs total £580m at today's prices over 30 years (or £31,000/unit), but with a significant 'up-front' phasing element within this profile; part of this is met by assumed ALMO funding via grants of £100m after self-financing is introduced (i.e. that the ALMO in case study 2 is part-way through its decent homes programme).
- No right to buy receipts are allocated to the HRA capital programme.

Commentary on methodology

To examine the implications of using private finance, in the context of the two case studies, a 'base case' scenario is compared with scenarios based on the models.

The 'base case' is the HRA self-financing business plan on the terms of the indicative settlement published by the government in February 2011 and assumes the business plan is 'debt-capped' following the self-financing settlement. No alternative private finance options are assumed to be available under the base self-financing plan.

Scenarios have then been developed to illustrate the operation of the alternative ALMO private finance models. The assumptions for the scenarios are that:

- Any borrowing requirement above the 'cap' is achieved through private finance.
- In the 'debt-capped' base self-financing plan where capital shortfalls are carried forward (especially in the early years of the plan), there is an assumption of inefficiencies (e.g. inflation is added to the backlogs so that they are more expensive to deal with when the finance eventually becomes available). This is to reflect the fact that works undertaken beyond life cycle will inevitably incur greater costs when they are actually carried out and to illustrate the possible impact of borrowing being capped.
- For Model 1 in case study 1 (long-term management contract), private finance rates are estimated to be about 2% above PWLB rates, and the first call on revenue surpluses available to repay debt is assumed to be private finance debt then to redeem HRA debt.
- For Model 2 (based on Model 1 but involving some asset transfer), the rates are assumed initially to be the same as in Model 1 and therefore this model is not presented with its own separate case study.
- For Model 3 in case study 2 (CoCo stock transfer with the LA's HRA debt covenanted) the cost of private finance is estimated to be about 1.3% above PWLB rates. There are a number of ways in which the LA's debt could be managed, with the extremes being that:
  - the initial HRA self-financing debt is amortised over 30 years – all new borrowing is therefore privately financed and all revenue surpluses committed to redeem private finance debt at the same time as meeting the amortised HRA amount
  - or, the LA continues to borrow up to the limit of the cap throughout the business plan period, so minimising the use of more expensive private finance.

  The issue about whether to redeem HRA debt or maintain at cap is primarily one for the legal contract that would be in place between the council and the CoCo. In the former case, the contract would last 30 years and could presumably be ended at the time; in the latter case, the contract would need to be renewed or extended in line with the HRA debt remaining 'on the books'. In case study 2, the debt is redeemed as and when resources are available to do so, rather than amortised over the life of the plan. In the case study, HRA debt and private finance are cleared to zero within 30 years.
- Where the business plan is able to draw down borrowing to meet capital needs 'in-year', capital and maintenance costs are assumed to rise with inflation only. As there is no assumption of a private finance borrowing cap, the alternatives to HRA self-financing are able to meet capital needs in-year.
- A key issue arises in the treatment of the various potential tax liabilities which might arise if the ALMO/CoCo moves into private finance and owns the assets. For the purposes of modelling, the following have been assumed:
  - Base case self-financing: HRA and ALMO relationship as now with no net VAT or corporation tax liabilities.
  - Model 1: VAT chargeable by the ALMO is recoverable in full by the council as the assets remain in the HRA; corporation tax mitigated by charitable status.
  - Model 2: although not presented as a separate case study, irrecoverable VAT could arise on that proportion of the ALMO's business that is related to the assets transferred to it, the remainder stays VAT efficient; corporation tax mitigated by charitable status.
  - Model 3: there is a liability towards irrecoverable VAT mitigated by an assumption of reduced HRA debt on transfer to provide for VAT on allowances and the negotiation of a VAT shelter (similar to stock transfers) with HMRC (assumed for modelling purposes to be 15 years). The addition of VAT into the modelling means that some of the HRA debt will need to be repaid at transfer – in that the HRA debt at self-financing will have been calculated without reference to the inclusion of VAT on any expenditure. Corporation tax is assumed to be mitigated by charitable status.

Nearly 900,000 council homes are now managed by ALMOs – partnerships between the local authority, tenants and the local community which provide the landlord service. ALMOs have invested £6 billion in improving these homes, have achieved marked improvements in services for tenants and have gained high levels of tenant satisfaction.

Yet partly because of their success, ALMOs are now at a crossroads. They not only need further resources to complete their improvement programmes in many cases, but also want to invest more in their estates and in new housing. At the same time, the coalition government has made it clear that it wants to provide many more opportunities for tenants to run housing services directly and to 'take control over their own homes'.

This report, prepared by four experts in the field, examines models which would give tenants an even bigger say in their ALMOs, by building on the skills and capacities that ALMO tenants have developed over the past nine years.

The research takes full account of the government's proposals for council housing finance reform. It is intended to offer councils, which will be in charge of their own finances from April 2012, a range of options that will both enable them to bring more investment into housing as well as to give an even bigger role to tenants.

The options have been the subject of financial modelling, have been discussed with lenders and have been assessed from a legal perspective. A special part of the report looks at the implications for tenant empowerment.

The National Federation of ALMOs expects this report to be of importance to all local authorities which have council housing, to ALMOs who are currently considering their futures and above all to the tenants who want to see a financially viable and successful landlord service over the decades to come.

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