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.