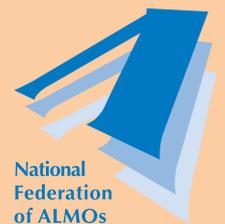




ALMOs – a new future for council housing

Report of a research project by the
National Federation of ALMOs,
Chartered Institute of Housing
and HouseMark



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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 existing and prospective ALMOs to operate effectively. The NFA aims to establish a vibrant and innovative independent ALMO sector that will provide decent homes, raise standards across the public rented housing sector, achieve excellence in service provision, promote tenant empowerment and help to deliver broader national and local policy priorities.

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The Chartered Institute of Housing

The Chartered Institute of Housing is the professional organisation for people who work in housing. Its purpose is to maximise the contribution housing professionals make to the wellbeing of communities. The Chartered Institute has over 19,000 members across the UK and the Asian Pacific working in a range of organisations – including housing associations, local authorities, arms length management organisations, the private sector and educational institutions.

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HouseMark provides performance and efficiency improvement services for the social housing sector. We provide a range of services to our 500 plus member organisations including: efficiency guidance, benchmarking, good practice, performance improvement clubs and service improvement workshops. We also offer consultancy services for the social housing sector including peer review and procurement advice. HouseMark is a joint venture by the Chartered Institute of Housing and the National Housing Federation, two not-for-profit organisations dedicated to improving housing standards.

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Foreword

This report for the National Federation of ALMOs, CIH and HouseMark puts the case for significant financial freedoms for local authorities with high-performing ALMOs that will enable those ALMOs to deliver even better services to council tenants and the local community. The report is aimed principally at influencing the ODPM's *Review of the Long-Term Future of Arms Length Management Organisations*.

This is the full research report, with detailed appendices, being made available through the websites of the sponsoring organisations. A much shorter summary version, also available on the websites, is available in printed form (email: policy@cih.org).

The authors of the report are Rachel Terry (consultant), Ian Doolittle (Trowers and Hamlins, solicitors) and John Perry (policy adviser, CIH). Various other practitioners have made inputs to the study, notably David Hall of Tribal HCH and Adrian Wills of KPMG and we are very grateful for these contributions. The ALMOs which agreed to be case studies for the research also made a vital contribution, without which the detailed financial analysis would not have been possible.

Finally, the steering group (listed below) also wishes to thank the various officials in the Office of the Deputy Prime Minister (ODPM) and in the Treasury, and representatives of various major lenders, who gave their time in discussing and providing views on our proposals as they developed.

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1 Introduction

- 1.1 ALMOs are delivering government policy and contributing to local authority priorities in a most successful way. They provide the separation of the management from the strategic housing function, as well as tenant empowerment. They are improving services and bringing council properties up to the Decent Homes Standard (DHS), quickly and cost-effectively. But all this is potentially at risk because ALMOs currently do not have the prospect of a long-term future. Tenants want to see the investment in their estates protected and to ensure that the decency standard is maintained beyond 2010. If awarded appropriate financial freedoms, ALMOs could better meet the needs of tenants, as well as becoming important partners in helping to deliver other local authority, regional and government objectives in areas such as the provision of affordable housing, regeneration and community safety.
- 1.2 When the initial ALMO guidance was issued by government in 2001, ALMOs were described as having a more business-like structure than traditional local authority management, concentrating on delivering high quality services. They would provide value-for-money and meet the aspirations of tenants. However, although ALMOs are already demonstrating improvements in performance the current legal and financial frameworks for their operations do not enable the original objectives to be fully realised. Additionally, for some ALMOs the potential for stock to fall outside the decency standard after 2010 is a key issue.
- 1.3 ALMOs have only been in business since April 2002 but have already demonstrated their worth as effective delivery agents of both decent homes and better services. Tenants appreciate their greater involvement in decisions and the board structure has helped to streamline administration. Once the DHS is met, it is essential that the benefits delivered by ALMOs are not lost. There should continue to be a substantial role for ALMOs as the providers of high quality, large-scale services, which ultimately are critically important to the customers of both local authorities and ALMOs. ALMOs' purposefulness and energy must continue to be harnessed to assist the local authority in achieving its strategic housing plan.
- 1.4 The requirement to achieve a 2* rating before securing decent homes funding has been a significant factor in driving performance upwards. Nevertheless, even those 2* ALMOs who have obtained additional resources still aspire to further improvement and the achievement of a 3* rating. This is partly due to the government's commitment to offer additional freedoms and flexibilities to 3* ALMOs.
- 1.5 Once ALMOs have achieved decent homes and can no longer access the additional funds, ALMO management agreements will expire, with the effect that the housing management function will come back in-house and the ALMO will no longer have a role. This is likely to create tensions with tenants who have been empowered through the ALMO. ODPM could usefully encourage authorities to accept that such a substantial change in management arrangements requires the authority to consult with tenants under s105 of the 1985 Housing Act. Tenants may also be concerned that there will be no incentive to continued improvement in performance unless the government delivers the long promised freedoms and flexibilities for ALMOs, sufficient to persuade the local authority to renew the management agreement with the ALMO. If ALMOs generally came to an end, this would also be contrary to government policy of separating the landlord and strategic housing roles.
- 1.6 This report explores ways of ensuring the future viability of well-managed ALMOs. It sets out the principal freedoms and flexibilities that local authorities and ALMOs require, in order to ensure a long-term sustainable future for the ALMO sector. The freedoms and flexibilities identified would facilitate sound business planning by reducing uncertainty, and have the potential to improve efficiency and facilitate access to funding, particularly for proactive asset management and wider action projects.

- 1.7 The report is the result of a joint project by NFA, CIH and HouseMark, aimed at making a positive contribution to the ODPM's review of the long-term future of ALMOs. Case studies have been developed, using ALMO business plans, to analyse the policy, legal, regulatory and financial impact of a number of possible changes. The project has concentrated on the 'big picture' options that will determine the long-term future of the sector.

ALMOs – the story so far

- November 2001 – first ALMO bidding round
- April 2002 – first eight ALMOs go live
- June 2005 – fifth ALMO bidding round announced and 58 ALMOs or shadow ALMOs in 53 local authorities, managing 870,000 council homes, incorporated into the programme
- When it proceeds, Round 6 will ensure that one million council homes, half of all council housing, will be managed by ALMOs
- By 2004/5, tenant satisfaction rates at 77% exceed those for both council housing generally and for housing associations (according to HouseMark data)
- ALMOs, while currently managing one-third of the council stock, are contributing two-thirds of all local authority housing efficiency savings (according to HQN data)
- By November 2005, out of 40 ALMOs inspected, ten (one in four) had achieved a 3* housing inspection rating and 27 had achieved a 2* rating
- The first ALMOs will achieve decent homes in the whole of their stock by 2006

2 Background

- 2.1 In the two years or so that ALMOs have been in business, they have made major improvements to local service delivery. Data collected for the HouseMark ALMO Performance Improvement Club shows the extent and pace of those improvements (see box below).
- 2.2 ALMOs with two or three stars have enhanced investment programmes, and expect to be given sufficient resources by central government to bring their stock up to the Decent Homes Standard. Already considerable progress has been made: they are bringing homes up to the standard at the rate of more than 4,000 per month.

ALMO Performance in 2004/05

For the third year in a row, ALMOs improved their housing management performance in 2004/05. Data for 43 round one to round four ALMOs for the that year, collected and recently analysed by HouseMark, continue to show improvements across the sector even compared with the high levels achieved in the previous two years.

Particular performance improvement was demonstrated in the following areas by 32 of the 43 ALMOs which have been in operation long enough to submit year-on-year data:

- repairs appointments (made and kept) – median performance improved by 7%;
- average relet times – median performance improved by 5%;
- proportion of non-decent homes – median performance improved by 7%; and,
- energy efficiency – median performance improved by 6%.

Overall tenant satisfaction has risen to 77% and compares favourably with satisfaction levels of council tenants generally with their landlords – 66% according to the latest government *Survey of English Housing*. It is also slightly ahead of levels for housing associations. This result is particularly encouraging given the amount of disruptive construction work taking place.

Of the thirteen indicators, only one – time to complete non urgent-repairs – showed a slight decline in performance in 2004/05, and even here the majority of ALMOs improved on their 2003/04 position.

- 2.3 The direct link between good performance and funding for investment has provided the impetus for proactive and focussed boards, improved tenant involvement and better motivation of staff. It is generally agreed that any significant new freedoms or flexibilities should be available to well-performing ALMOs only.
- 2.4 The funding regime for ALMOs has been designed to achieve the Decent Homes Standard for all the housing managed by 2* and 3* ALMOs by 2010. But little consideration has been given to what should happen after that has been achieved. There has even been a suggestion that the ALMO will have served its useful life at that point. This perhaps underestimates the strength of feeling among tenants and others on the ALMO boards, who have a shared sense of purpose and achievement.

3 A long-term future for ALMOs

- 3.1 ALMO business plans should reflect local priorities from the strategic housing plan, with activity and investment to ensure long-term community sustainability, in areas where the ALMO is the major social landlord. Estate-based environmental works, and remodelling of estates to respond to diversity issues, are often necessary as well as new build or replacement housing. These are important elements in many housing strategies and ALMOs want to be able to respond to these needs. Several large scale voluntary transfer (LSVT) housing associations provide a good example of how this can be achieved and it is proposed that a financial framework similar to that used by ODPM for transfer is made available to successful ALMOs.
- 3.2 ALMOs will always be different from registered social landlords (RSLs) and it is acknowledged that – without significant change to their legal arrangements (see section 8.7) – they will continue to be subject to public sector constraints on borrowing because of their local authority ownership. But local authorities do now have a prudential borrowing regime and are encouraged to invest, through partnership with the private sector, via Private Finance Initiative (PFI) funding. This report explores these issues and describes the changes needed for ALMOs to be able to access private finance.
- 3.3 ALMOs face a number of challenges relating to service delivery. Responding to them is made more difficult because of their lack of control over income, caused principally by the Housing Revenue Account (HRA) subsidy regime. For example, the volatility of management and maintenance allowances (M&M) in recent years has undermined HRA business planning for a number of local authorities.¹ The financial framework for local authorities with well-performing ALMOs put forward in this report gets them out of the HRA subsidy regime altogether. This is considered to be the best way for ALMOs to achieve more financial certainty and it would enable ALMOs to better respond to the aspirations of tenants for improved service delivery.
- 3.4 It is acknowledged that if ALMOs are to take on more responsibility and risk, an appropriate regulatory framework needs to be in place to protect tenants and the public purse. This would be particularly important should service delivery deteriorate significantly.
- 3.5 ALMOs accept the need to have a comprehensive stock condition database to inform their business plan on investment needs, consequential rent increases and future maintenance costs. As housing manager, the ALMO is in a good position to judge whether it is cost-effective for houses to be modernised or whether they would be better replaced. Currently, the financial regime for local authority capital does not enable ALMOs to use this information constructively for proactive management of the assets on behalf of the local authority, and does not facilitate robust long-term planning.
- 3.6 Most ALMOs have an increasing demand for their properties and would like to replace those lost under the right to buy (RTB) as well as reconfigure their stock so that it better reflects current demand (eg for larger properties). Each of the options developed in this report includes the ability for local authorities with well-performing ALMOs to reinvest their non-RTB capital receipts in full on new properties or the remodelling of existing properties where appropriate. In respect of RTB receipts it is anticipated that a sharing agreement with government would be put in place.
- 3.7 ALMOs need to have the prospect of a long-term future. This is particularly so for tenants in ALMOs which are close to achieving the DHS for all their stock. By 2006, it is expected that more than half the remaining council-owned housing stock will either already be managed by ALMOs or be in firm programmes leading to ALMO management. But at the same time, without action from government to introduce freedoms and flexibilities for ALMOs, successful ALMOs from round 1 can expect to be wound up as the service is taken back in-house to save costs.

¹ An issue referred to as well in the recent Audit Commission report on housing finance: Audit Commission (2005) *Financing Council Housing*.

- 3.8 As noted in section 1.5 above, s105 of the 1985 Housing Act requires a local authority to consult with its tenants where the local authority changes its practice or policy relating to the management of its dwelling houses, and such change will substantially affect its tenants. In such instances the local authority is required to inform its tenants of the proposals and must consider any representations made in a specified period. The local authority is permitted to consult tenants by using such arrangements as it considers appropriate. Given that the original change in management (i.e. the delegation of housing management functions to the ALMO) followed either a test of opinion or ballot of tenants, it seems appropriate for a similar test of opinion or ballot to be carried out before the management reverts to the council. The consultation needs to be organised well in advance (perhaps six months), given the TUPE and other implications. (Similar consultation should take place prior to the council deciding whether to extend the management agreement for a further term.)
- 3.9 There is therefore an urgent need for government policy setting out details of freedoms and flexibilities for well-performing ALMOs. Local authorities have valued the improved services to tenants and will expect to share the benefits which will come from any new regime. This could also encourage well-performing local authorities which can achieve DHS without additional funding, to set up an ALMO.

4 Problem areas to be addressed by new freedoms

- 4.1 This section of the report addresses in more detail the constraints ALMOs are currently experiencing, and how they might be addressed.
- 4.2 ALMOs are currently restricted by government policy on the range of services they can manage for the local authority.**
- 4.2.1 There is widespread support from local authorities and their ALMOs that the scope of their services should be extended to include regeneration, new build and financial services for tenants and leaseholders.
- 4.2.2 Regeneration initiatives are an essential tool for sustainability. An earlier CIH report² illustrated what inner city stock transfer RSLs, with strong community links, have been able to achieve in wider regeneration, because of the extra resources and freedoms available to them. In many respects ALMOs face similar problems and want to be able to tackle them in similar, innovative ways.
- 4.2.3 The ALMO needs to be a partner in local initiatives where requested by the local authority and be in a position to take the lead as the local regeneration company. The responsibilities of the ALMO in individual projects and their role could be included in the ALMO's delivery plan. For example, this could include tenant welfare services, providing financial assistance to homeowners and responsibility for the licensing of houses in multiple occupation. The ALMO is potentially restricted in taking this regeneration role on two fronts. First, the limits on the delegation of powers under s27 of the Housing Act 1985 and, second, by virtue of the limitation of its activities as agreed between the ALMO and the council as part of the delivery planning process.
- Section 27 of the Housing Act limits the delegation of local authority powers to an ALMO to "such of the authority's management functions" in relation to houses or other land held for related purposes as specified in the management agreement. It is therefore necessary for any activity undertaken by the ALMO under a s27 delegation to be a management function of the local authority as landlord.
 - The delivery plan (and ultimately the management fee) will determine what the ALMO can do (and whether it can afford to do it by the local authority paying for it). Unless the local authority is prepared to entrust wider regeneration activities to the ALMO, the ALMO is left without any possibilities to undertake this kind of work.
- 4.2.4 New build is an important element in many local housing strategies. It does not make sense to require the new build partner to be an RSL, when the ALMO may be in a better position to manage and preferably own the new housing cost-effectively. It may also be sensible in terms of rational and efficient stock management. The government has in fact acknowledged this in including ALMOs as potential recipients of Social Housing Grant (SHG) in the Housing Act 2004.
- 4.2.5 Financial exclusion is a problem on many social housing estates. Tenants can be exploited by loan sharks and a number of leaseholders find they have no way of paying for repairs. Tenants avoid taking out contents insurance because of the cost. Specific financial services for tenants and leaseholders could helpfully be included in the ALMO's management contract. The ALMO could then provide financial products to remedy such situations. This would of course require the ALMO to have qualified staff and to work within the regulatory framework of the Financial Services Authority (FSA).³

² CIH (2002) *Beyond Bricks and Mortar – Bringing Regeneration into Stock Transfer*.

³ Current advice is that, in relation to content insurance schemes for tenants, ALMOs are not carrying out regulated activity by way of a business and so the regulations do not apply in this instance.

4.3 ALMOs are losing properties through the right to buy and currently have no means of replacing them – putting pressure on unit costs.

- 4.3.1 A full paper on these issues was prepared by the NFA for the second meeting of ODPM's ALMO Review Group in November 2004. This paper is reproduced in appendix 1.
- 4.3.2 ALMOs' high quality service will become more and more difficult to afford. Therefore ALMOs have a vested interest in improving service delivery by becoming more efficient. They are following the Gershon agenda and are already working together on procurement. ALMOs have demonstrated their willingness to learn from other organisations, to improve cost-effectiveness and efficiency, by setting up the ALMO performance improvement club, run by HouseMark. This is already providing good benchmarking information that will lead to improved practices. They are currently investigating the treatment of overheads.⁴
- 4.3.3 One or two ALMOs are providing services for other landlords to reduce the impact of right to buy sales on ALMO overheads, by improving economies of scale. Most ALMO constitutions are currently restrictive on where an ALMO can operate and with whom the ALMO can do business, including restrictions on ALMOs providing services to third parties. Some local authorities, when agreeing their ALMO's constitution, have clearly relaxed these restrictions. For example, where an ALMO is continuing an existing practice of its local authority by providing services outside the area *where the local authority owns or manages housing* (the current constitution restriction) the ODPM has allowed a widening of the geographical remit of the ALMO. Not to do so would mean that some of the required transferred functions would have to stop or would otherwise be ultra vires for the company. The ODPM has been reluctant to allow such a relaxation where out of borough/district activities are a potential rather than an actual activity.
- 4.3.4 ALMOs are only able to engage in trading (where the primary purpose is to make a profit), if their local authority qualifies to do so under s95 of the Local Government 2003 Act and the recent trading order. If an ALMO does qualify (by dint of the local authority's own CPA rating) and can utilise this power to trade, it can trade in activities related to the wellbeing function. A more detailed analysis of the trading provisions is contained in appendix 2.
- 4.3.5 In time, an ALMO may consider merger with another ALMO to form a larger management company. Issues to be addressed when considering merger with another ALMO are set out in appendix 3. Merger with a housing association management subsidiary or a private sector management company would not be possible because of the ALMO's local authority ownership. However, contractual arrangements with other ALMOs or with housing associations could provide economies of scale and other benefits.⁵
- 4.3.6 Most ALMOs have an increasing demand for their properties and would like to replace those lost under the right to buy or to rationalise their stock portfolios. Each of the 'big picture' options developed in this report and supported by the NFA's board includes the ability for a 2* ALMO to reinvest its capital receipts in full. This could be in appropriate new properties or in the remodelling of existing properties. Right to buy receipts would be an exception, as it is anticipated that as part of the remodelling exercise needed to achieve the new options, the government would require a sharing agreement to be put in place.
- 4.3.7 ALMOs want to have the ability to manage key worker or market rented housing, where this is a need identified in the local housing strategy. It would also be beneficial as a cost-effective way for the ALMO to spread overheads. Local authorities may have land that could be used for such developments or properties may be available as the result of a s106 agreement. Appendix 4 sets out the issues for the local authority in taking ownership and having a separate management agreement with the ALMO for them. It also addresses the possibility of such properties being in ALMO ownership.

4 HQN has also found that ALMOs, while managing one-third of the council stock, are delivering two-thirds of LA housing efficiencies.

5 Out of the first three Efficiency Challenge Fund grants awarded, two involve ALMOs (a London ALMO group, and councils and ALMOs in South Yorkshire).

4.3.8 For local authority housing which needs a large sum for investment, PFI is currently the only source of additional finance. ALMOs are restricted by their constitution from being a PFI contractor, whereas it would benefit all parties for an ALMO to manage the local authority's housing that is subject to a PFI contract. The main obstacle to an ALMO managing housing provided by or subject to a PFI contract relates to risk transfer. Obtaining PFI credits from the government requires, among other things, a balanced transfer of risk to the party best able to manage that risk so that ultimately the asset is not on the council's balance sheet. If the ALMO were to become the managing agent of the properties in the PFI contract, the local authority would effectively retain the housing management risk. There is unlikely to be much appetite from the private sector to be involved in a PFI project where the housing management is outside the private sector partner's control.

4.4 ALMOs are not in a position to undertake cost-effective asset management.

4.4.1 ALMOs are committed to meeting the Decent Homes Standard (DHS) for all the local authority's housing by 2010. However, investment only to the DHS does not necessarily make houses comfortable, safe and attractive, or reflect the lifestyle needs of tenants. Also, for long-term sustainability, some properties would be better remodelled, or demolished and replaced. This means that precious investment resources could be wasted if asset management decisions had to be put off until after the DHS works are complete.

4.4.2 ALMOs accept the need to have a comprehensive stock condition database to inform their business plan on investment needs, consequential rent increases and future maintenance costs. As housing manager, the ALMO is in a good position to judge whether it is cost-effective for houses to be modernised or whether they would be better replaced. Currently, ALMOs cannot use this information constructively. Although the government has announced that ALMO funds can be used for demolition, the financial regime does not allow the local authority landlord to reinvest capital receipts in full and therefore dwellings cannot readily be replaced. The ALMO cannot make capital investment decisions outside those agreed with the authority in the delivery plan. Local authorities can only invest 25% of RTB receipts locally (where receipts exceed £10,000), even if there is a demonstrable need for replacement affordable rented housing. The HRA subsidy system is another constraint on local authorities, and hence their ALMOs, acting in a business-like way. These shortcomings are addressed in the 'big picture' options for the future of ALMOs developed in this report.

4.4.3 Examples of proactive asset management decisions which could properly be delegated to the ALMO (acting as agent for the local authority) and which are essential for good quality service delivery include:

- identifying investment additional to that needed to meet the Decent Homes Standard to ensure letability;
- recommending replacement of poor quality housing or otherwise out-of-date stock and then minimising investment in advance of sale or demolition;
- recommending remodelling of estates prior to significant investment, including infill with new housing where appropriate;
- property swaps (sale and re-purchase of properties) in mixed tenure blocks to facilitate the investment in tenanted properties; and
- purchase of new properties which can be financed from the additional rental income, after allowance for marginal management and maintenance costs.

4.4.4 Local authorities need the financial freedom to sell vacant properties on the open market and replace them with open market purchases, or new build, where this can be demonstrated to be cost-effective over a 30-year period. The current stock may not be the appropriate mix for today and some of it may have higher maintenance costs than alternative properties with a similar value. Some housing association properties could usefully be swapped with local authority housing for both landlords to achieve more cost-effective management.

- 4.4.5 The Housing Act 2004 allows for ALMOs to bid for and receive Social Housing Grant (SHG). For this to be a viable option, a change is needed to the HRA subsidy regime to recognise that the local authority will have to borrow alongside SHG to achieve affordable rents. The level of SHG should be sufficient for the debt charges to be affordable out of the net rental income from the properties. However, under the present rules, the additional income would be absorbed and lost in the subsidy system and would not be available to finance the debt.
- 4.4.6 Some capital expenditure, such as the remodelling of properties, can be self-financing at today's borrowing rates. Further cost-effective investment could be made by ALMOs, if the MRA could be used to support local authority or ALMO borrowing. It is recommended that the government allow local authorities to treat the MRA in the same way as housing associations account for depreciation. This would assist ALMOs to make more business-like decisions about investment in the stock.
- 4.4.7 PFI is seen as a 'last resort' form of finance for housing investment. This is principally because of the experiences of the initial PFI housing pathfinders. ALMOs need a simplified PFI product, to enable them to increase their investment programmes beyond what is possible using local authority borrowing. Several banks are known to be keen to work with ALMOs on the development of a straightforward PFI product, tailored to the requirements of ALMOs and their local authorities.

4.5 ALMOs have very limited powers and finance to respond to the on-going needs of community sustainability.

- 4.5.1 Community sustainability is likely to require action such as making environmental improvements and tackling wider regeneration issues where the ALMO is the major housing manager, changing the tenure mix, or providing key worker housing. It is in the nature of such wider regeneration that needs will vary considerably from area to area and a degree of flexibility is needed in the powers available to address local needs.
- 4.5.2 The current 5% limit for environmental or other works relating to community safety and sustainability is inadequate for many ALMOs (and only applies to ALMOs from round 3 onwards). The financial framework needs to be changed to enable ALMOs to invest in environmental improvements and to contribute to wider regeneration initiatives.
- 4.5.3 ALMOs need the ability to accelerate tenure mix on estates, where this is an important outcome for community sustainability. Similarly, ALMOs need the ability to introduce low cost home ownership, key worker and student housing into estates. The government's recent proposals for Social Homebuy should help this a little. These initiatives would require changes to the financial regime and delegation from the local authority, enabling:
- the ALMO to act as its agent on mixed tenure initiatives, without having to refer back to the local authority on each transaction; and
 - the local authority to reinvest the capital receipts from sales and partial sales in full, for the provision of replacement rented housing elsewhere, where there is a demonstrable long-term need.
- 4.5.4 ALMOs are seeking a greater role in regeneration, to ensure the sustainability of local communities within their housing estates. ALMOs would like the ability to enter into partnership with other organisations, to contribute to regeneration and wider action initiatives, thereby improving service delivery to tenants. They would like the ability to bid for funding, enter legal agreements to provide facilities or services, and establish subsidiary organisations at community level, in the ways that inner city RSLs are able to do.⁶ The current constitution of most ALMOs does not allow for this, but could be renegotiated to do

⁶ See examples in *Beyond Bricks and Mortar*, referred to earlier.

so (see previous comments in 4.2.3 and 4.3.3 above.) The ability of ALMOs to trade under s95 of the Local Government Act 2003 significantly widens the options for ALMOs (and the parent authorities) to do anything which is likely to promote the economic, social or environmental wellbeing of their area (see appendix 2).

4.5.5 ALMOs have an obvious role in market renewal, working closely with their local authority (First Choice Homes Oldham is already planning to be part of the local market renewal consortium). Some ALMOs would like to act as intermediaries for loans to leaseholders. Section 450A of the Housing Act 1985 provides the power for a local authority to grant a loan to a right to buy leaseholder and by virtue of the Housing (Service Charge Loans) Regulations 1992 in certain circumstances such a loan is a leaseholder's right. The delegated authority given to an ALMO under s27 of the Housing Act 1985 could include the management functions relating to properties disposed of by the local authority under a leaseholder proposal under the right to buy. Providing leaseholder loans under the relevant regulations is a function of the local authority which is attributable to its position as the landlord and as such administering those loans can be delegated under s27 to the ALMO.

4.6 Tenants have higher expectations in terms of service from their landlord as properties are improved.

4.6.1 Yet at the same time ALMOs have very little control over their income and are under pressure to deliver both greater efficiency and improved services. Indeed, there is considerable financial uncertainty for ALMOs. First, there is the relationship with the local authority, which may have different priorities (now or in the future) from the ALMO. Second, future repair projections suggest that significant additional expenditure will be needed after 2010, even if all properties meet the DHS by that date. Third, there is also going to be pressure on revenue resources for ALMOs as a number of local authorities are predicting that their HRA will go into deficit around 2010. The second and third 'big picture' options for the future of ALMOs, developed in this report, show what would be involved for ALMOs to be given more long-term financial certainty by taking control of the HRA, i.e. by it becoming arms length to the local authority and managed by the ALMO.

4.6.2 New local authority borrowing for housing, under the prudential regime, is only supported by HRA subsidy if it is eligible as Supported Capital Expenditure. The government is considering a change to capital grants for ALMO local authorities rather than revenue subsidy. In the longer term this must be a better solution, as it would:

- provide certainty for the local authority;
- reduce the local authority's future indebtedness; and
- reduce the local authority's (and indirectly the ALMO's) on-going dependence on central government.

4.6.3 If ALMOs had control of their income, they would have confidence to borrow to achieve their business plan. The prudential regime for local authorities does not provide much scope, as the major repairs allowance (MRA) cannot be used to support borrowing and capital receipts are not freely available to lever in borrowing. Two of the 'big picture' options, considered later in this report, would give ALMOs control of their income and hence the ability to borrow.

4.6.4 The HRA subsidy system is a constraint on ALMOs acting in a business-like way. They cannot spend additional money this year to save money in subsequent years.

4.6.5 Some ALMOs would like to be able to carry out income-earning activities such as consultancy, selling services or partnership work with other organisations on a commercial basis, to help pay for the services which tenants want. One or two ALMOs are already providing services for other landlords. Management agreements for most ALMOs do not automatically allow for this, but could be renegotiated to do so (see comments in 4.3.3 and appendix 2).

- 4.6.6 The rent-restructuring regime is an impediment to meeting the aspirations of tenants for service delivery. It is not always appropriate for the local authority/ALMO to introduce a service charge for a number of separate items, which together enable a better service to be provided. Unlike the situation with RSLs, there is no benefit to local authorities in using the 5% tolerance on rent levels allowed under rent restructuring as an additional resource for investment, as it leads to loss of HRA subsidy.
- 4.6.7 ALMOs are required by virtue of the new UK accounting standard FRS17 to account in their balance sheets for pension deficits whereas local authorities do not (technically rendering an ALMO potentially insolvent). It is usual under TUPE arrangements for transferring staff to an ALMO to have the same protected pension rights as apply by law to local government staff. This means the ALMO being tied in to the local authority pension fund. If there has been any under-funding or other under-performance by the fund in the past which now requires increased contributions by the employer, the ALMO has no choice but to pay its proportion of what is due.
- 4.6.8 The actions available to ALMOs facing increased pension payments are limited because the obligations on them, at least in the short term, may well be as binding as those on the council itself. If the situation is serious, and the potential payments jeopardise the ALMO's viability, there may be possibilities of negotiating re-phased payments with the local authority or otherwise mitigating the impact of the higher costs. Depending on the obligations under TUPE and in the ALMO's contract with the council, there may be the possibility of exploring different pension terms for new staff, either now or when the contract is renegotiated.
- 4.6.9 There is presently a potential disincentive for an ALMO to outperform its business plan, as an ALMO is potentially liable to pay Corporation Tax on any surpluses and this cannot be avoided by covenanting the surplus to the council. An ALMO could, however, be regarded as either a mutual entity or a non trading entity in respect to their local authority and thus be exempt from corporation tax on any such profits arising. Clarification is currently being sought from HM Revenue & Customs concerning how these preferential statuses may be achieved by ALMOs. As a 100% local authority owned company, charitable registration is highly unlikely as The Charity Commission has to be satisfied that the ALMO is an independent body able to take decisions in its own best interest, free of controls from any third party i.e. the local authority.
- 4.6.10 There are a number of management issues which ALMOs would like to see addressed in order to improve service delivery:
- ALMOs want the ability to apply for anti-social behaviour orders;⁷
 - ALMO staff do not have a right of audience at some courts;
 - some ALMOs have reported difficulties in carrying out duties relating to leaseholders – in particular, conducting the s20 consultation process or bringing leaseholder forfeiture proceedings; and
 - some ALMOs would like to increase their powers to deal with a range of environmental issues including: imposition of fines for littering offences, imposition of fines for dog fouling offences; and removal of abandoned vehicles.

These are currently being considered by ODPM and other departments.

- 4.7 There is also a desire on the part of ALMOs to carry out or be involved in new build. The question arises whether land could be transferred to the ALMO from the council for nil consideration. Section 123 of the Local Government Act 1972 requires the disposal to be for the best consideration that can be reasonably obtained. A nil valuation could well be

⁷ ODPM has now (November 2005) issued a consultation paper with proposals for ALMOs to be able to do this.

justified on the basis of nomination rights granted to the local authority and the building obligations that may have been imposed, otherwise the consent of the Secretary of State is required. For HRA land the local authority would need to obtain Secretary of State consent under s32 of the Housing Act 1985 and under s133 of the Housing Act 1988 (in order to permit a subsequent disposal by the ALMO). For non-HRA land s32 consent is not required; but consent will be required under s43 of the Housing Act 1985.

- 4.8 Before embarking on new activities, local authorities and ALMOs will need to obtain corporation tax and VAT advice as these issues are in many cases not straightforward.

5 'Big picture' options to improve the long-term viability of ALMOs

- 5.1 This project has concentrated on four 'big picture' options which would change the existing financial framework for local authorities with well-performing ALMOs. The greater financial certainty which these options would bring, would lead to improved local authority business planning, enabling ALMOs to plan and manage their operations in a more business-like way. Their business plans would be focussed on delivering high quality services in sustainable communities. ALMOs and their local authorities see this as essential for their long-term future viability.
- 5.2 The options considered are set out in the box below.

Options considered		
Option 1	Self-sufficient HRA 1a: based on delivering DHS 1b: based on delivering sustainable communities	section 6
Option 2	ALMO responsible for managing the HRA – achieved with public sector ALMO borrowing	section 7
Option 3	ALMO responsible for managing the HRA – achieved with private sector ALMO borrowing	section 8
Option 4	Stock transferred or leased to the ALMO	section 9

- 5.3 A variant on option 4, involving stock leased to a Community Regeneration Company (CRC), is considered in section 10.
- 5.4 The financial implications of these options have been assessed with six local authorities and their ALMOs as case studies. The case study authorities have used their HRA business plan data and stock condition information as the main inputs for the computer models developed by Tribal HCH for each option. The base case assumes the inclusion of decent homes funding and HRA subsidy. Tribal HCH has prepared a full report on the case studies and this is reproduced in appendix 5. The following table gives a brief profile of the case study organisations.

Case Study	Region	Opening Stock
A	London	12,600
B	South West	3,700
C	London	9,900
D	East Midlands	14,500
E	North West	20,000
F	North East	12,300

- 5.5 In all four options, the aim is to create more financial certainty and autonomy – both capital and revenue funding – for local authorities and their ALMOs. Each option requires the government to agree a financial framework for the local authority, similar to that achieved by ODPM for LSVT organisations. The HRA debt would be reduced (or increased) to a level

which could be afforded by the business plan without any HRA subsidy. There may be situations where the HRA would need a dowry; it would be for government to decide whether it would provide gap funding, as with transfer. The local authority would retain the remodelled HRA, which would be financially self-sufficient (i.e. outside the HRA subsidy system). The business plan would need to include sufficient resources to deliver the investment and maintenance needed beyond 2010.

- 5.6 Each of these options builds on the successful formula of having tenants on the ALMO board, allowing the local authority to delegate to the ALMO and focus on the strategic role. The options involve all future income from rent increases being retained in the HRA. It is important to tenants that rent income is seen to be available in full for the benefit of the local authority's tenants.
- 5.7 The proposed new financial framework involved in all four options, could include RTB receipts in the HRA remodelling calculation or they could be excluded, with a sharing agreement for RTB proceeds (as with LSVT). In either case the local authority would no longer receive interest on HRA RTB receipts in the General Fund.
- 5.8 The new regime would facilitate the use of Social Housing Grant (SHG) by well-performing ALMOs, as a mechanism to provide replacement housing for local authorities.
- 5.9 The status quo base case figures in the case studies have been amended for each of the four options as follows.

Options	Major Works	Management Costs	Interest rates	VAT
base & 1a	decent homes only	business plan	new borrowing 6%	assumed to be negligible
1b	enhanced works programme (as for transfer)	business plan + 5%	all loans 6%	
2			all loans 7%	
3			all loans 6.5%	on works & some management costs
4 (transfer)				

- 5.10 Options 1 and 2 retain the following key benefits to tenants of local authority ownership of the ALMO and of the stock:
- All the existing legislation and regulations governing local authority tenants' rights and the landlord's obligations remain applicable. These include:
 - secure tenancies;
 - tenant participation compacts between the landlord authority and recognised representative tenants' groups;
 - the right to manage; and
 - RTB.
 - The provisions of Best Value apply.
 - Public sector efficiencies are required.
 - Formal inspections by the Audit Commission continue.
- 5.11 The second and third options show what would be involved for ALMOs to be given more long-term financial certainty by managing the HRA. That is, the HRA would become arms length to the local authority and would be managed by the ALMO, but the assets would be

retained by the authority. The management agreement would give ALMOs financial control of HRA income and capital expenditure, and hence the ability to borrow. They would then be financially stronger partners for regeneration and could expect to bid successfully for SHG for new build.

- 5.12 In option 3, the local authority retains ownership of the stock, but if the ALMO is to be able to raise private finance the local authority has to become a *minority* shareholder of the ALMO. Tenants would retain their secure tenancies.
- 5.13 In option 4, the local authority no longer owns the stock after transfer, or for the period of the lease in a leasehold transfer. Tenants would become assured tenants. Depending on progress with the Law Commission's proposed changes to legislation governing rented homes, this distinction may in due course no longer apply.
- 5.14 It is proposed that the first three options would be available to 2* ALMOs, continuing the accepted government principle of 'earned autonomy' and ensuring continued incentives to maintain and raise standards. The fourth option is not expected to appeal to any local authority, its tenants or to ALMOs at this stage. The CRC lease option may be welcomed by local authorities with aspirations for large-scale regeneration
- 5.15 Each of the options would involve a shift in the balance of risk, which would require appropriate risk management by local authorities and their ALMOs. Because of the methodology proposed for calculating the remodelled HRA, each option would be viable regardless of the regulatory framework in place.
- 5.16 The improvement in financial certainty and greater autonomy provided by these options would provide a strong incentive for local authorities with well-performing ALMOs to continue with their ALMOs after DHS has been achieved. In particular, the ALMO's ability to bid for SHG competitively, and have the financial regime to deliver new properties and manage them well, could be crucially important. These freedoms might also persuade well-performing local authorities which can meet DHS *without* ALMO funding, to consider the ALMO option because of the potential benefits to the council and its tenants in terms of improved service delivery and an operational capacity to help deliver local and national priorities.

6 Option 1: Self-sufficient HRA

- 6.1 In the first option, the local authority would retain control of the remodelled HRA, which would be financially self-sufficient (i.e. outside the HRA subsidy system), to achieve decent homes and maintenance of the stock to that standard thereafter.
- 6.2 The case studies have been worked up on two bases:
- *option 1a* with capital expenditure at the same level as for ALMOs currently, i.e. sufficient to meet DHS; and
 - *option 1b* with capital expenditure at the level required for transfer, i.e. sufficient to deliver DHS and sustainable communities.

The six local authorities and their ALMOs have interpreted these definitions of investment need in different ways, and investment needs beyond 2010 have not been thoroughly investigated. To improve the accuracy of the figures, stock condition surveys would be required, particularly to give better maintenance and repair estimates beyond 2010.

- 6.3 ALMOs are committed to meeting the DHS for all the local authority's housing by 2010. However, investment only to the DHS does not necessarily make houses comfortable, safe, attractive or reflective of the lifestyle needs of tenants. Also, for long-term sustainability, some properties would be better remodelled, or demolished and replaced. This means that in option 1a precious investment resources could be wasted if asset management decisions have to be put off until after the DHS works are complete.
- 6.4 Community sustainability is likely to require action such as making environmental improvements and tackling wider regeneration issues where the ALMO is the major housing manager, changing the tenure mix, or providing key worker housing. It is in the nature of such wider regeneration that needs will vary considerably from area to area and a degree of flexibility is needed in the powers available to address local needs.
- 6.5 The current 5% limit for environmental or other works relating to community sustainability, assumed in option 1, is inadequate for many ALMOs and is not applicable to those in rounds 1 and 2. The financial framework needs to be changed to enable them to achieve investment in environmental improvements and to contribute to wider regeneration initiatives, so as to create sustainable communities. This is addressed in option 1b by including the additional expenditure needed in the business plan used for the remodelling of the HRA by ODPM.
- 6.6 The main features of options 1a/1b are:
- 6.6.1 ALMOs would work within the existing financial relationship with their local authority.
- 6.6.2 The HRA business plan would be re-worked on LSVT business plan principles. The local authority, working closely with the ALMO, tenants and leaseholders, would undertake the reworking. Fundamental information for this would include comprehensive data on stock condition and future investment needs, based on achieving the DHS for all of its housing for option 1a, and on achieving both DHS and sustainable communities for option 1b.
- 6.6.3 This re-worked HRA business plan would require a transfer-type sharing agreement with government for RTB receipts, if RTB receipts are excluded from the re-worked business plan, and free reinvestment of all other housing capital receipts. The re-worked HRA business plan would then be used as the basis for a negotiation with government, for the local authority to come out of the HRA subsidy system permanently.

- 6.6.4 This would require the government to restructure the local authority's HRA debt (reducing it in most cases, but increasing it for some others), so that the debt would be serviced and repaid over the 30-year life of the business plan, together with new borrowing needed to finance the capital expenditure in the business plan.
- 6.6.5 To avoid the authority having to borrow to service debt (which is what LSVT RSLs do, but is not open to local authorities under the prudential regime), the government may need to give a formal commitment to specific amounts of capital grant in years of projected high capital expenditure. This capital grant could be repayable after peak debt has been reached. The need for capital grant could be eliminated, if the CIPFA guidance on depreciation was amended to reflect the fact that there would no longer be an MRA, allowing more repair expenditure to be capitalised and funded by borrowing.
- 6.6.6 The HRA would retain all rental income.
- 6.6.7 The local authority would no longer have an MRA from government, but would instead allow for depreciation in the remodelled HRA accounts.
- 6.7 This option does not require any changes to the regulatory regime for ALMOs because the local authority remains in control of its remodelled HRA business plan and HRA financing. The management agreement sets out the procedures to be invoked if the ALMO fails to meet its delivery plan.
- 6.8 In both options 1a and 1b, the local authority would have the ability to raise private finance by bidding for PFI revenue funding for capital projects. In most instances, the ALMO would be the appropriate housing management partner in any PFI schemes relating to residential properties on or close to estates that they manage. This has been achieved by one ALMO where the repairs and maintenance risk was out-sourced to the private sector – this was necessary for The Office of Government Commerce to be satisfied that there was sufficient transfer of risk to the private sector.
- 6.9 The case study authorities have included the following additional expenditure items for option 1b:
- community safety measures and improved security;
 - remodelling of unpopular properties to improve marketability;
 - upgrading common parts of flats (e.g. lift renewal);
 - higher standard of home facilities (e.g. bathrooms); and
 - wider community regeneration measures appropriate to each locality.

Issues for option 1

- 6.10 The risks falling on the local authority would be less than with the current financial framework, because removal of the HRA subsidy regime would eliminate considerable financial uncertainty. Appendix 6 provides a risk assessment for option 1.
- 6.11 The main advantages of this option in addition to those listed in section 5.10 are:
- It would be a straightforward exercise for ODPM to enable local authorities to achieve this option.
 - Local authorities would have control over their income (subject to the rent restructuring regime), because they would neither incur negative subsidy nor have the uncertainty about future subsidy arrangements (e.g. M&M allowances).
 - Local authorities would be able to use revenue to support borrowing for works such as the remodelling of estates.

- Local authorities would have greater control of their investment decisions, which would enable them to take a longer-term view of asset management, beyond 2010, which would be strongly influenced by the impact on their 30-year business plan.
- Local authorities would have greater long-term certainty about their finances, which would be reflected in the ALMO's delivery plan, enabling the ALMO to plan more realistically and provide better services to tenants.
- More use of the prudential regime for borrowing may be possible, particularly for new development identified in the authority's housing strategy, because the income stream is more certain (than being reliant on the HRA subsidy system).
- It provides an incentive for ALMOs to achieve continuous improvement and creates a more challenging operating environment.

6.12 The main disadvantages of this option are:

- Option 1a does not enable the ALMO to engage properly in the remodelling of estates, or in wider regeneration. Neither does it offer any solution for additional expenditure needed on environmental and other wider action projects, but this is addressed in option 1b.
- Option 1a does not address the problem of wasted expenditure on making homes decent, when they would be better sold or demolished and replaced, but this is addressed in option 1b.
- Authorities would be constrained in the financing of investment by the prudential borrowing regime. ALMOs would have no control over this.
- The borrowing would score in public expenditure control totals.
- The ALMO would still be subject to the agreement of the local authority on any changes to the delivery plan, which can cause delays.
- The re-distributive elements of the subsidy system would no longer apply, once the initial settlement had been reached to come out of subsidy.
- No housing subsidy payments would be available to protect against rising interest rates.

6.13 The most significant financial implication of this option is the replacement of HRA subsidy with an affordable level of HRA debt. Clearly, option 1b would be more expensive in the short term for government than option 1a – see table in section 11.2 – but it would help local authorities to deliver key government objectives for sustainable communities.

6.14 A change in respect of pooling of RTB receipts would be required by the local authority, to ensure that the authority would be no worse off. This could be achieved by an RTB sharing agreement to compensate the authority for loss of income in the General Fund from RTB receipts.

6.15 There are no significant accountability or regulatory implications for the implementation of this option. The management agreement sets out the procedures to be invoked if the ALMO fails to meet its delivery plan.

6.16 Option 1 has the following legal aspects and practicalities:

- The government would probably require the comfort of a warranted stock condition survey in favour of the local authority and possibly a collateral warranty in favour of the government, as a pre-requisite to remodelling of the HRA.
- The local authority capital finance regulations would need to be amended to reflect the fact that 75 per cent of capital receipts would not necessarily be available for sharing with the government.
- In order to comply with its statutory duty to ensure that the HRA does not fall into deficit, the local authority would require sufficient reassurance from government as to future

capital grant payments (see section 6.6.5). The local authority officer appointed under s151 of the Local Government Act 1972 as responsible for the proper administration of the authority's financial affairs would need to be confident that the authority would be able to meet its statutory duties in respect of the HRA managed by the ALMO.

- Any conditions imposed upon the ALMO bidding for and receiving SHG must be acceptable to both the ALMO and the local authority parent.
- There may need to be an amendment to the capital finance regime to give effect to a RTB sharing agreement.

- 6.17 This option involves a similar change for high performing local authorities as is advocated by the Audit Commission in their recent report.⁸ The Commission reviewed the present working and likely future changes in the HRA, and one of its conclusions is that government should consider 'releasing from the [HRA] system those authorities that can be self-financing, linked to high performance'. It does not specifically refer to ALMOs in this context, but clearly making this reform in relation to ALMOs would meet the suggested 'high performance' test.
- 6.18 It is proposed that this option should be available to local authorities with 2* or 3* ALMOs.

⁸ Audit Commission (2005) *Financing Council Housing*, p55.

7 Option 2: Self-sufficient HRA, able to deliver sustainable communities within current ownership arrangements

- 7.1 The second option is based on option 1b, with the additional feature that the local authority puts the remodelled HRA at arms length to the authority, and delegates management of the HRA to the ALMO.
- 7.2 The main features of this option are:
- 7.2.1 Similar to the first (set out in section 6.6) in that the HRA is financially self-sufficient, i.e. the local authority is outside the HRA subsidy system. The significant difference from it is that the HRA is arms length from the local authority and managed by the ALMO. This would be achieved by the local authority delegating all aspects of managing the HRA to the ALMO, allowing the authority to focus more on its strategic role.
- 7.2.2 This makes the ALMO responsible for all decision-making for the remodelled HRA, within a framework agreed with the local authority and documented in an HRA management agreement. An annual delivery plan would still be agreed each year.
- 7.2.3 The ALMO is in control of the HRA, within the parameters of the management agreement and delivery plan. The local authority is in effect the principal regulator of the ALMO.
- 7.3 In this option, it would be possible for the restructuring of the HRA debt to be put in place as ALMO borrowing, secured on the ALMO's income and receivables (rather than on the HRA's income), instead of the direct local authority borrowing of option 1. This would put responsibility for the debt in the hands of the organisation responsible for the management of the landlord function. Funders would require a longer contract period for the management agreement than the business plan, say 35 years if the debt was to be repaid over 30 years. Funders would also require the assignment of all income and receivables on change of contractor. Funders would also require clarity about responsibilities for improving performance, if the ALMO were to fall below 2* in an Audit Commission inspection.
- 7.4 There are two different ways of achieving HRA remodelling with ALMO borrowing replacing HRA debt. Option 2 is where the ALMO borrowing would be classified as public sector borrowing. Option 3 is where it would be classified as private sector borrowing. In option 2, the local authority would retain control of the ALMO, as it does under the current legal arrangements, and it would be possible for the ALMO to borrow from the local authority. The local authority would continue to be regulator of the ALMO, to ensure that the ALMO's borrowing is within the prudential borrowing regime for the authority. This control would be exercised through the management agreement.

Issues for option 2

- 7.5 The local authority could assist the ALMO to achieve additional capital expenditure by the use of PFI – see section 6.8.
- 7.6 A change in respect of pooling of RTB receipts would be required by the local authority, to ensure that the authority would be no worse off. This could be achieved by an RTB sharing agreement to compensate the authority for loss of income in the General Fund from RTB receipts.
- 7.7 The local authority would encourage the ALMO to bid for SHG, for new housing development opportunities that are seen as important in terms of delivering the local strategic housing plan. The SHG would need to be at a level where the net rental from the new development would service sufficient new borrowing to finance the development.

In option 2 it would be possible for new housing to be owned by the ALMO rather than by the local authority. Legal issues around ALMO ownership of new housing are addressed in appendix 4.

- 7.8 The main advantages of option 2 in addition to those listed in sections 5.10 and 6.11 are:
- The ALMO has control of all the core landlord functions, without ownership of the properties.
 - As the ALMO has control over the remodelled HRA business plan, including capital expenditure, it can decide on spending priorities for the HRA (subject to prudential borrowing constraints). With only one body involved, there is less risk of competing priorities, more focus on tenants and a shorter process from service planning to delivery.
 - The ALMO has control over HRA overheads.
 - HRA income, including capital receipts, will always be available to the HRA.
 - The local authority may be able to justify borrowing and on-lending to its ALMO, so minimising the ALMO's cost of borrowing.
- 7.9 The main disadvantages of option 2 are:
- The ALMO would be responsible for treasury management with no housing subsidy payments to protect against rising interest rates.
 - The borrowing of the ALMO would score against the authority's prudential borrowing ceiling. Collectively, these loans may cause the government concern about the increase in public sector debt, causing the Treasury to impose limits on local authorities' prudential borrowing.
 - Option 2 would not be possible where some local authority stock was still managed by the local authority. Where the local authority has a number of ALMOs managing the whole stock full delegation of HRA functions split comprehensively between the ALMOs could be difficult, particularly if one ALMO was in effect cross-subsidising another.
- 7.10 An important financial implication of this option for some local authorities is that all HRA income would be retained by the ALMO, except for a small amount to fund the local authority client side. Currently, some authorities use HRA capital receipts for General Fund expenditure. The RTB sharing agreement could be used as a mechanism to ensure that the local authority is no worse off.
- 7.11 The effect on the General Fund of repayment of HRA debt would need to be evaluated. In this option there would not have to be a complete repayment of HRA loans if the local authority agreed to on-lend to the ALMO.
- 7.12 Option 2 has the following legal aspects and practicalities, in addition to those in section 6.16:
- 7.12.1 The government would probably require the comfort of a warranted stock condition survey in favour of the local authority and possibly a collateral warranty in favour of the government, as a pre-requisite to remodelling of the HRA.
- 7.12.2 No legislative change would be required to put the remodelled HRA at arms length to the authority. This would mean that the local authority retains the duty to balance the HRA. It would therefore be necessary for the local authority to ensure that the terms of the HRA service contract are robust and provide sufficient comfort to the local authority officer appointed under s151 of the Local Government Act 1972 to ensure that the council can satisfy its statutory duties.

- 7.12.3 The template management agreement and memorandum and articles of association would need to be re-visited to loosen some of the local authority controls around decision making, given that financial responsibility for the remodelled HRA would principally fall to the ALMO.
- 7.12.4 The HRA service contract would need to be for a much longer period than the template management agreement, to enable the ALMO to borrow for 30 years.
- 7.12.5 Consent under s32 of the Housing Act 1985 would continue to be required for any sale of properties, as part of the ALMO's asset management strategy agreed with the local authority. Whether a specific consent would be needed, or whether the general consents would apply, would need to be looked at on an individual basis.
- 7.12.6 Management of the HRA at arms length by the ALMO is unlikely to be regarded as state aid, as competition is unlikely to be distorted by the delegation of HRA management to a publicly controlled body.
- 7.12.7 Advice would be needed to ensure that there were no adverse corporation tax or VAT implications.
- 7.13 It is proposed that option 2 should be available to local authorities with 2* or 3* ALMOs.

8 Option 3: Self-sufficient HRA, able to deliver sustainable communities, HRA managed by the ALMO: *The private finance option*

- 8.1 In option 3, to make the case for classification of the ALMO borrowing as private finance under present rules, the ALMO would have to be able to demonstrate that it was not majority owned or controlled by the public sector. This would require tests at three levels. First, the governance arrangements would have to ensure that the day-to-day operations of the ALMO were not capable of being controlled by the local authority (or by any other public sector organisation). Second, the local authority as owner of the ALMO would not be able to take control of the ALMO, beyond the arrangements in the management agreement. Third, if anything were to go wrong, responsibility for sorting it out could not be in the hands of the local authority (or any other public sector organisation).
- 8.2 Although the ALMO would no longer be 100% local authority owned, legal ownership of the housing stock would remain with the local authority and the tenants would be secure tenants of the local authority. The ALMO could be either a 100% privately owned company, as currently with Kensington & Chelsea TMO, or have a minority local authority ownership, probably with a community or tenant majority. It is anticipated that in most cases the ALMO would continue to have a board membership of one-third tenants, one-third local authority nominees and one-third independents.
- 8.3 The local authority would manage the HRA through a long-term (35-year) HRA service contract with the ALMO, to include investment in the housing.
- 8.4 The ALMO would raise private finance on the strength of the service contract fee, which would be performance-related as with PFI. The service contract fee payments would be agreed at a level which could be afforded by the 30-year HRA business plan, out of the local authority's rental income, without any HRA subsidy. The ALMO's track record of managing the stock and the service contract fee payment arrangements would determine what the ALMO could borrow. The ALMO's loans would be secured on the ALMO's income and receivables.
- 8.5 The ALMO would be responsible for all day-to-day decision-making for the remodelled HRA, within a framework agreed with the local authority and documented in the HRA service contract. An annual delivery plan would still be agreed each year.
- 8.6 For the ALMO to borrow to finance investment in the HRA, lenders would require:
- The ALMO to have a 35-year HRA service contract with the local authority landlord if the ALMO's borrowing was to be repaid over 30 years. The contract fee for good performance would have to be sufficient to cover the ALMO's projected cash flow, including the servicing of its debt.
 - To agree the ALMO's business plan each year and to receive regular monitoring reports.
 - Clarity about responsibilities for improving performance, if the ALMO were to fall below 2* in an Audit Commission inspection or suffer performance-related penalties under the HRA service contract.
- 8.7 For the ALMO's borrowing to be classified as private finance:
- The ALMO must not be majority owned by the public sector, so the ownership and control would have to change in those ALMOs with 100% local authority ownership. A 51% community ownership would be possible, as long as the local authority with 49% ownership retained no controlling interest. Kensington & Chelsea TMO is 100% owned by tenants and so would not need a change of constitution to raise private finance, it could be a model for others.

- The management service contract would have to include sufficient risk transfer to the ALMO that an accountant could demonstrate under accounting standard FRS5 that, for the period of the contract, the properties were in effect an asset of the ALMO. That is, the ALMO would be exposed to the associated risks of the properties and would have access to the benefits it achieved through active management, such that in accounting terms the assets would be on the ALMO's balance sheet and not on the local authority's. Legal ownership would remain with the local authority and properties could not be sold other than as agreed in the management service contract. All the financing risk would be with the ALMO and lenders would have no recourse to the local authority, or its assets. This is what happens with HRA PFI if the local authority is to qualify for PFI credits.
- If the ALMO were to get into financial difficulties, or otherwise fail under the HRA service contract, the lenders would ultimately take responsibility for sorting things out. If the ALMO's business plan could not demonstrate repayment of their loans, lenders would discuss the situation with the local authority. They would together consider the possibility of bringing in a new contractor to take over the contract and the financial responsibilities of the ALMO. The local authority would have no controlling say in sorting out the financial affairs of the ALMO, although it would of course take responsibility for any contract negotiations.

- 8.8 Preliminary discussions with lenders suggest that they would lend to ALMOs which were not 100% owned or controlled by the public sector, so long as there were adequate governance arrangements in place. They would require regular inspections from an independent body such as the Audit Commission and an annual report on the financial viability of the ALMO to meet its business plan. If a default on the ALMO's borrowing were imminent, lenders would require to take effective control of the ALMO's income.
- 8.9 The preliminary discussions with lenders also suggest that they would have a light-touch control, focussed on monitoring the ALMO's business plan. If the ALMO's performance were to deteriorate, lenders would act quickly and ask the board for a remedial action plan which they would monitor closely. If this did not bring about the required outcome in the time agreed, lenders might suggest asking the Audit Commission to assist the ALMO's board to develop a further remedial action plan, or they might bring in an external adviser to work with the management team on producing one.
- 8.10 A tri-partite agreement would need to be in place between funders, the ALMO and the local authority owner of the properties, to address what would happen if the ALMO were to come close to default on its loan agreement – see section 8.23.5.
- 8.11 An example of a not-for-profit private sector organisation raising private finance for social rented housing is mhs homes, set up in 1990. This is an LSVT association not registered with the Housing Corporation. It has over 7,000 rented properties and has raised over £100 million of private finance from lenders active in the housing association loan market. It has raised additional funds on two occasions to develop the business further. Its tenants have accepted the control arrangements that are in place, which are set out in appendix 7. ALMOs raising private finance would have to have similar control arrangements to these.

Issues for option 3

- 8.12 The key financial implication of option 3 for the ALMO is that, if this way forward is to be effective from the date of HRA remodelling, ODPM can be more flexible in agreeing the underlying assumptions in the HRA business plan (than with options 1 or 2). This is because the ALMO borrowing will be off the government's balance sheet and there will no longer be any local authority (public sector) HRA debt.
- 8.13 As with the other options, the most significant financial implication of this option 3 for all parties is the replacement of HRA subsidy with an affordable level of ALMO debt,

eliminating local authority HRA debt. Because the interest costs on the private finance would be higher than on the public sector debt in other options, this one would have to bring with it efficiencies not available through options 1 and 2, so that value-for-money could be demonstrated. Otherwise, the government would have to write-off more HRA debt or accept a smaller increase in debt for this option. However, as with LSVT, this could be a price worth paying to get all the HRA debt off the public sector balance sheet.

- 8.14 An important financial implication of this option for some local authorities is that all HRA income would be retained by the ALMO, except for a small amount to fund the local authority client side. Currently, interest earned on RTB receipts is credited to the General Fund and some authorities use HRA capital receipts for General Fund expenditure. A change in respect of pooling of RTB receipts would be required by the local authority, to ensure that the authority would be no worse off. An RTB sharing agreement could be used as the mechanism to achieve this.
- 8.15 The effect on the General Fund of repayment of HRA debt would need to be evaluated by the local authority.
- 8.16 In this option, the local authority could assist the ALMO to achieve additional capital expenditure by the use of PFI – see section 6.8. It should be easier to persuade government that there was sufficient risk transfer for the ALMO to be the housing manager than in option 2.
- 8.17 The local authority would encourage the ALMO to bid for SHG, for new housing development opportunities that are seen as important in terms of delivering the local strategic housing plan. The SHG would need to be at a level where the net rental from the new development would service sufficient new borrowing to finance the development. In this option it would be possible for new housing to be owned by the ALMO rather than by the local authority, but the properties would have to be let on assured tenancies. For new build schemes with SHG, this could make the ALMO's private finance cheaper, as the houses could be pledged as security. It should also strengthen the ALMO financially, which would assist it in the pricing of all its private finance.
- 8.18 The key risks for the ALMO are set out in appendix 8.
- 8.19 The major risk likely to remain with the local authority is any significant cost arising from unexpected environmental contamination. The other risk for the local authority would be if the HRA remodelling exercise was, with the benefit of hindsight, too tight. The ALMO might then fail, the staff would TUPE to another contractor and that contractor may also be unable to deliver satisfactorily without dipping into its reserves.
- 8.20 Some of the demand risk would be taken by the local authority. This is to ensure that the output specification in the contract, specifying the number of properties of various sizes to be provided by the ALMO would be adjusted as local circumstances change. This is common in HRA PFI contracts.
- 8.21 The main advantages of this option 3 in addition to those listed in sections 5.10 and 6.11 and 7.8 are:
- The ALMO would be free of public borrowing constraints. In many cases, this would enable additional expenditure to be achieved.
 - It gives more financial certainty to the local authority and to the ALMO, with less risk to the local authority than other options.
 - As the ALMO would have control over delivery of the remodelled HRA business plan, including capital expenditure, it would make decisions on spending priorities for the HRA (subject to borrowing constraints). This should in time bring with it savings to compensate for the higher borrowing costs (compared to local authority borrowing).

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

8.22 The main disadvantages of this option 3 are:

- As with option 2, the ALMO would be responsible for treasury management with no housing subsidy payments to protect against rising interest rates. The ALMO would need to have access to hedging instruments to protect against this risk.
- The borrowing would be more expensive than the public sector borrowing in options 1 and 2. This difference in cost would be reduced as the ALMO develops a successful track record. The introduction of the Basel II Accord for banks in December 2006 should also reduce the difference, as would refinancing with bonds. The ALMO could be asked to share the benefits achieved from refinancing with the local authority, as with PFI.
- As with option 2, this option would not be possible where some local authority stock was still managed by the local authority. Where the local authority has a number of ALMOs managing the whole stock full delegation of HRA functions split comprehensively between the ALMOs could be difficult, particularly if one ALMO was in effect cross-subsidising another.

8.23 Legal implications of option 3:

8.23.1 The government would probably require the comfort of a warranted stock condition survey in favour of the local authority and possibly a collateral warranty in favour of the government, as a pre-requisite to remodelling of the HRA.

8.23.2 No legislative change would be required to put the remodelled HRA at arms length to the authority. This would mean that the local authority retains the duty to balance the HRA. It would therefore be necessary for the local authority to ensure that the terms of the HRA service contract are robust and provide sufficient comfort to the local authority officer appointed under s151 of the Local Government Act 1972 to ensure that the council can satisfy its statutory duties. At the same time, the template management agreement and memorandum and articles of association would need to be re-visited to loosen some of the local authority controls around decision making, given that financial responsibility for the remodelled HRA would principally fall to the ALMO. In particular, the local authority would have to give up all control, which is currently available with its golden share.

8.23.3 There would need to be significant changes to the company structure of the ALMO, giving the local authority minority ownership. There would also have to be changes to the control mechanisms within the template management agreement. The most significant issue would be the releasing of controls by the local authority in the event of an ALMO failure.

8.23.4 The HRA service contract would need to be for a much longer period than the template management agreement. It would include an output specification for the service, as with PFI, based on keeping the properties in a good and tenantable condition, but allowing replacement of properties as necessary to respond to changing demands. The contract fee would be performance related. The ALMO's loan agreement would require step-in rights to be given to funders in the event of default on the loan. This is common in PFI deals.

8.23.5 The main ingredients of the tri-partite agreement between the ALMO, the local authority and the ALMO's lender would include:

- the local authority would delegate to the ALMO all decisions on demolitions or sales of vacant properties where there was a commitment to replace them with more appropriate properties or to achieve remodelling of an estate; and
- the local authority would agree not to oppose a change to ALMO board membership if this was required by funders under prescribed conditions. (The local authority could seek comfort from the Audit Commission that the proposal was reasonable).

- 8.23.6 The local authority capital finance regulations would need to be amended to reflect the fact that 75 per cent of capital receipts would not necessarily be available for sharing with central government. Consent under s32 of the Housing Act 1985 would continue to be required for any sale of properties, as part of the ALMO's asset management strategy agreed with the local authority. Whether a specific consent would be needed, or whether the general consents would apply, would need to be looked at on an individual basis.
- 8.23.7 In changing the ALMO's ownership to take it outside public sector ownership, the state aid impact of awarding the management services contract without competition would need further consideration, in particular by the Department of Trade and Industry (DTI).
- 8.23.8 ALMOs are currently contracting authorities for the purposes of the Public Services Contracts Regulations 1993 (the Regulations). The Regulations provide an exemption from the requirement to advertise in the official journal of the European Union in respect of services to be provided by the ALMO to the council. The exclusion applies where 'services are to be provided by another contracting authority because that contracting authority had an exclusive right (i) to provide the services or (ii) which is necessary for the provision of the services pursuant to any published law, regulation or administrative provision which was compatible with the EEC treaty'. As matters stand, this exclusion is argued to apply on the basis that the ALMO has been given the right to manage the properties pursuant to s27.
- 8.23.9 However, under option 3, the exemption would only be available if the minority local authority owned ALMO could still be categorised as a contracting authority. An analogy can possibly be drawn with RSLs, which were recently declared by the UK government to be contracting authorities on the basis that they are subject to 'management supervision' by the Housing Corporation. The combination of Audit Commission's inspection powers and the local authorities' management agreement with the ALMOs might well allow the same conclusion to be drawn.
- 8.24 Advice would be needed to ensure that there were no adverse corporation tax or VAT implications.
- 8.25 In some cases, the local authority and the ALMO might see the benefits of the ALMO accessing private finance as more important for tenants (because of the additional expenditure that could be achieved) than the local authority being in control of the ALMO. In such cases, the authority could work with its tenants to assist the ALMO to achieve this option.

9 Option 4: Stock transfer to the ALMO, subject to a positive tenant ballot

- 9.1 The fourth option has the HRA at arms length to the authority, delegates management of the HRA to the ALMO and, with the support of tenants, transfers the housing stock to the ALMO.
- 9.2 The main features of this option are:
- 9.2.1 Similar to option 3 in that the HRA is financially self-sufficient, i.e. the local authority is outside the HRA subsidy system, the HRA is at arms length from the local authority and managed by the ALMO, but in addition the housing is transferred to the ALMO after a successful ballot of tenants, or other appropriate test of opinion. There would no longer be a management agreement between the local authority and the ALMO. Similar ownership and control arrangements to those in option 3 would be needed for the ALMO borrowing to be private finance.
- 9.2.2 The main differences from option 3 are that:
- tenancies would change from secure to assured as the ALMO would be the landlord; and
 - the stock-owning ALMO could then borrow on the security of the assets rather than just on the basis of its revenues.
- 9.3 A leasehold transfer might be possible. Rather than transferring the properties freehold to the ALMO, the council could instead grant a 999-year lease to the ALMO – this is in practical terms indistinguishable from a freehold transfer but it would show that the council's 'family silver' had not been sold. Such a leasehold disposal would of course constitute a disposal for the purposes of schedule 3A to the Housing Act 1985 and would thus require a tenant ballot or other test of opinion.

Issues for option 4

- 9.4 For a leasehold transfer, specific issues relating to both tenants and funders would need to be addressed:
- Tenants – the fact that the landlord has a 999-year lease as opposed to the freehold title makes little practical difference. The legal position needs to be explained in consultation but the position is no different from some other (estate-based) stock transfers. The need to preserve RTB is important but the RTB is preserved if the landlord has more than 50 years of its lease to run and of course the 999-year lease would more than adequately address this point. RTB would be implemented by a partial surrender of the leasehold interest and the RTB carved out against the freehold.
 - Funders – provided the lease has the same practical effect as a freehold transfer, there is no reason to believe that the 999-year lease will be less fundable than normal LSVT freehold transfers. The funders and the valuers will need to see the detailed lease terms; but experience in other circumstances suggests that it will be possible to satisfy them within the parameters of the structure described here. It is not unusual for funders to accept long leases, at minimal rent, as security for loans provided that any rights of termination on the part of the council would be subject to the approval of funders. The terms of the 999-year lease envisaged here should be satisfactory to all the usual banks and building societies involved in stock transfer funding.

A shorter leasehold term might be considered provided tenants' rights to an RTB leasehold disposal were unaffected.

- 9.5 There are one or two differences from an LSVT:
- an ALMO taking ownership of the stock would not incur many of the costs of large scale voluntary transfer to an RSL; and
 - with a leasehold transfer, the housing stock reverts to the public sector in the long term.
- 9.6 The risks for the local authority and the ALMO are as in option 3.
- 9.7 The main advantage compared to the previous options is the ALMO's greater ability to manage the assets effectively, given that they would be under the ALMO's control rather than the subject of the tri-partite agreement described in section 8.23.5.
- 9.8 A further potential advantage is the possibility of developing the ALMO along the lines of the Community Gateway Model currently being developed by some authorities, which paves the way for extensive tenant involvement.⁹
- 9.9 The main disadvantages are:
- the loss of secure tenancies, which could be resolved by the government introducing legislation for a unified tenancy, as in Scotland;
 - the local authority would no longer have direct control of HRA assets;
 - it might be seen (incorrectly) by some tenants as a step towards privatisation, because of the sale of the properties to the ALMO, and
 - VAT on repairs would no longer be reclaimable by the ALMO, as there would no longer be a management fee with VAT. This means that the government would have to write-off more HRA debt or accept a smaller increase in debt for option 4 than for option 3.
- 9.10 The other significant financial implications of this option are the same as those of option 3 (sections 8.12–8.15). Preliminary discussions with lenders suggest that similar amounts of private finance could be raised for option 4, where the assets would be directly pledged as security as for option 3, if the VAT treatment of the two options were to be the same. As mentioned above, option 4 would incur VAT, so the amount of borrowing that could be afforded would be less than in option 3. The interest cost of the ALMO's borrowing might be lower initially for option 4 than for 3.
- 9.11 The local authority may see it as no longer attractive to take the main regulatory role itself. So it might require a change to the regulatory regime for the ALMO, as a condition attaching to transfer.
- 9.12 Option 4 has the following legal aspects and practicalities in addition to those listed in sections 6.16, 7.12 and 8.23:
- The main legal issues associated with a leasehold transfer are identified in section 9.4.
 - There would no longer be a management agreement between the local authority and the ALMO.
 - A local authority would require Secretary of State consent under s32 of the Housing Act 1985 for the disposal of the stock to the ALMO whether on a freehold or a leasehold basis.
 - The ODPM stock transfer guidance for local authorities would have to be amended to accommodate such transfers.
- 9.13 *It is proposed that this option should be set to one side and not pursued any further, as the disadvantages far outweigh the advantages.*

⁹ See *Empowering Communities – The Community Gateway Model* (2003).

10 A further option: Stock leased to a community regeneration company, subject to a positive tenant ballot

- 10.1 This option has been developed by a local authority and pre-dates ALMOs. It would be a leasehold transfer of the local authority's stock to a not-for-profit private sector community regeneration company (CRC), with minority local authority ownership. The board would probably be similar to that of most ALMOs, with one-third tenants, one-third local authority nominees and one-third independents.
- 10.2 The local authority would retain the freehold ownership of the housing stock and the CRC would have a 35-40 year leasehold interest. During the lease period the tenants would become assured tenants of the CRC. It is envisaged that tenants would therefore be balloted on the proposal.
- 10.3 A proposal for a CRC was made to government by Bolton MBC (now with an ALMO), when it was considering stock transfer. Their proposal was on the basis that the HRA debt should be viewed as the 'value of the lease' and hence be subject to repayment over time by the CRC. The problem for replicability is that for many LAs the HRA debt is currently too large for this to be a viable approach.
- 10.4 This option has many features in common with option 4 (freehold or leasehold transfer). The key differences are that the lease would be only for 35-40 years and the local authority's HRA debt would be kept in place, with interest payments and repayments of principal made by the CRC so that all the HRA debt would be repaid in 30 years.
- 10.5 The company would share all the features of the ALMO in option 3, to ensure that its borrowing would be classified as private sector.
- 10.6 In order to be a key player in supporting sustainable communities, including funding urban regeneration activities, it is envisaged that the company would have a group structure.
- 10.7 The leasehold transfer would require a positive ballot of tenants.
- 10.8 It is envisaged that the staff currently working on the HRA would TUPE transfer to the new company.
- 10.9 As with option 4, it is likely that the government would want to include this leasehold option in the annual transfer programme, even though the financing would be different from the remodelling of the HRA proposed for options 1-3 and from LSVT.
- 10.10 The benefits compared to option 4 are that the council and tenants would probably welcome the shorter lease period and the cost of borrowing would be cheaper.

11 Results from the case studies

- 11.1 This section of the report is an extract from a detailed report on the six case studies produced by Tribal HCH (appendix 5). The case study figures give a broad indication of some of the financial implications for central government and for the local authority in six different situations. To improve the accuracy of the figures, stock condition surveys would be required, particularly to give better maintenance and repair estimates beyond 2010.
- 11.2 To get out of HRA subsidy, each local authority's debt would need to be adjusted as follows. A positive figure indicates the amount of debt write-off by government, plus in some cases a dowry. A negative figure indicates the additional amount of debt the HRA could support, which would be a receipt to government. An RTB sharing agreement is assumed for all sales.

Table 11.1: Total HRA debt and amounts of government adjustments needed for HRA remodelling

Case Study	Current HRA Debt	Options : debt to be repaid (£ millions) negative = debt added				
		1A	1B	2	3*	4*
A	130	130	220	252	251	443
B	-2	-15	-3	0	3	24
C	237	297	320	331	335	419
D	123	-3	37	48	59	126
E	117	90	148	161	172	285
F	112	-20	13	21	36	87

Table 11.2: Debt per unit and amounts of government adjustments per unit needed for HRA remodelling

Case Study	Current HRA Debt per unit	Options : debt to be repaid (£) negative = debt to be added				
		1A	1B	2	3*	4*
A	10,294	9,713	17,420	19,954	19,875	35,078
B	-530	-4,033	-795	0	795	6,359
C	23,267	27,512	31,416	32,496	32,888	41,135
D	8,440	-194	2,539	3,294	4,048	8,646
E	5,828	4,228	7,373	8,020	8,568	14,197
F	9,086	-1,523	1,055	1,704	2,920	7,058

* This achieves private finance for all the replacement borrowing

- 11.3 The interest rate risk is of concern to local authorities and ALMOs as the HRA subsidy system currently protects against this risk. To evaluate the risk of an adverse change in interest rates the peak debt has been calculated for each option, and the year of peak debt.

Table 11.3

Case Study	Peak Debt Per Unit (£)				
	1A	1B	2	3	4
A	12,115	3,484	1,900	1,584	never
B	12,984	9,804	9,274	8,744	5,829
C	9,621	6,970	6,676	6,381	2,356
D	15,095	11,459	10,635	10,086	6,175
E	11,059	6,924	6,277	5,729	1,494
F	15,332	11,519	10,870	9,816	5,922

Case study A will never reach peak debt under option 4 as it requires a grant just to keep its operating account in balance.

11.4 The year that peak debt would occur is as follows in each case:

Table 11.4

Case Study	Year of Peak Debt				
	1A	1B	2	3	4
A	13	20	22	22	never
B	15	16	16	18	20
C	11	18	20	20	20
D	11	13	13	15	15
E	9	9	9	11	12
F	7	7	7	7	6

11.5 If the average interest rate were to be 1% higher than the rate used in the remodelling exercise, the debt would need to be rescheduled. Instead of being repaid in year 30 it would be repaid as follows:

Table 11.5

Case Study	Year of Debt Repayment if interest 1% higher				
	1A	1B	2	3	4
A	36	32	29	27	never
B	38	39	39	39	38
C	35	34	34	34	never
D	36	35	35	36	32
E	37	36	36	37	31
F	39	40	41	42	43

11.6 The uncertainty about capital expenditure requirements is another concern. The normal sensitivity test for an LSVT is to assess the effect on peak debt if capital expenditure overall is 5% higher than the figures in the business plan.

The effect of a 5% increase in capital expenditure for each of the options would be as follows:

Table 11.6

Case Study	Year of Debt Repayment				
	1a	1b	2	3	4
A	45	51	never	never	never
B	39	42	43	47	never
C	37	38	39	42	48
D	33	34	34	35	38
E	35	36	36	38	48
F	35	36	37	38	48

Table 11.7

Case Study	Year of Debt Repayment if 5% increase in capital expenditure				
	1A	1B	2	3	4
A	45	51	never	never	never
B	39	42	43	47	never
C	37	38	39	42	48
D	33	34	34	35	38
E	34	37	37	39	54
F	35	36	37	38	48

Impact on central government

11.7 An area of significant uncertainty with the figures is the amount of HRA subsidy a local authority can expect to get over the next 30 years. This is a very important ingredient in the base case calculations, for comparisons of the cost to central government of each option. After discussion with ODPM officials, the following assumptions have been made:

- target rents (based on current LA formula) increase by 1.5% above RPI until 2011/12 and 0.5% thereafter;
- guideline rents: convergence with target rents by 2011/12 and 0.5% increase pa thereafter;
- limit rent: convergence with target rents by 2011/12 and 0.5% increase pa thereafter;
- M&M target: increases by 2% pa to 2011/12 in line with rents rebasing;
- M&M allowances: convergence with target by 2011/12 and 0.5% increase pa thereafter;
- major repairs allowances: increase by inflation only;
- new supported borrowing after 2010 would be sufficient with the MRA and other resources to meet the decent homes capital expenditure programme;
- all RTB sales being retained by the council to be split between the housing stock and other non-HRA capital investment; and,
- VAT on the transfer option only and no corporation tax on any option.

Using these assumptions, the revenue cost to central government of option 1a would be broadly neutral compared to the status quo.

It has been assumed that, as with stock transfers, right to buy sales would be the subject of a separate sharing agreement. Under present subsidy rules the ODPM recompenses authorities for the net loss of rent income after a right to buy sale but receives 75% of the capital receipt from these sales. After being released from the system the amount which will need to be retained within the HRA will vary according to the authority.

Cost to central government for the other options

As all the other options would have a higher capital expenditure programme than option 1a, they would potentially be more expensive to government by the net present value of the increased expenditure. This additional expenditure would therefore have to be justified in terms of efficiencies, which could be achieved by the local authority having control of all expenditure and income.

Option 3 would also have higher management costs and higher interest rates compared to option 1a. The local authority wishing to pursue option 3 would have to demonstrate that the benefits from being outside public sector borrowing constraints would justify the higher costs.

The RTB sharing agreement would be neutral to central government if 75% of each RTB receipt was given to ODPM for pooling, and only 25% shared between the HRA and the General Fund. This would not be possible for some of the case studies, as the table 11.8 shows.

Impact on the local authority's General Fund

11.8 The main impact on the local authority will depend on its policy on the use of capital receipts from RTB sales. The following table shows the approximate percentage of capital receipts that would be the subject of the sharing agreement. (The balance would be needed to ensure that the HRA would be no worse off.) Hence, this is the maximum percentage of each receipt that could be retained by the council for expenditure outside the HRA, or shared with ODPM for pooling.

Table 11.8

Case Study	% of RTB receipts available for sharing				
	1A	1B	2	3	4
A	91%	95%	95%	95%	100%
B	76%	78%	78%	81%	87%
C	91%	94%	95%	95%	100%
D	56%	61%	61%	63%	68%
E	15%	30%	31%	35%	49%
F	15%	27%	27%	31%	42%

Conclusions from the case studies

11.9 The following broad conclusions can be drawn from the case study analysis:

- The remodelling exercise will need good data to minimise risks for all parties. The capital expenditure projections are particularly critical to long-term viability of the HRA (table 11.6).
- The remodelling exercise will need some write-off of debt by government in many cases (three out of the six case studies for option 1a, five for 1b and 2, and in all six cases for options 3 and 4) and a dowry to the HRA in some cases as well (one out of six cases for option 1a, two for 1b and 2, four for option 3 and for five out of the six cases in option 4). But in all cases, for all of options 1a to 3, the amounts are significantly less than would be needed for LSVT (same as option 4). Option 3 would then attract private finance for all new borrowing, as with LSVT. (Table 11.2).
- On assumptions discussed with ODPM for estimating future HRA subsidy payments (see section 11.7), option 1a would be broadly neutral to central government compared to the status quo. The other options would potentially be progressively more expensive for central government.
- In making the case for a new option, the local authority would have to demonstrate that the potential additional cost to central government would not materialise because of the financial advantages to the HRA of the flexibilities, which would come with the new option.
- The RTB sharing agreement would be critical to the negotiation of any new option. It would be the mechanism for ensuring that the local authority's General Fund could afford the implications of remodelling the HRA. It would also determine whether central government would lose out compared to the status quo. (Table 11.8).

12 Conclusions from the overall research

- 12.1 Local authorities and ALMOs want to build on the success of ALMOs as effective vehicles for delivering excellent services within the local community. ALMOs are concerned that without freedoms and flexibilities from government for well-performing ALMOs, management agreements will be terminated, or allowed to expire, when DHS has been reached. Tenants will not want to relinquish the greater involvement they have now come to expect, nor to see an end to incentives for good performance.
- 12.2 It is a requirement of s105 of the 1985 Housing Act that local authorities must consult their tenants before the management agreement with the ALMO expires.
- 12.3 Many local authorities will need an incentive to renew the management agreement with the ALMO. As they need more financial certainty for business planning than can be achieved within the HRA subsidy regime, all the financial options presented in this report rely on the local authority being able to be free of the HRA subsidy regime if they have a well-performing ALMO. This would require the government to restructure the local authority's HRA debt (reducing it in most cases, but increasing it for some others), so that the debt would be serviced and repaid over the 30-year life of the business plan, together with new borrowing needed to finance the capital expenditure in the business plan.
- 12.4 Because of the methodology proposed for calculating the remodelled HRA, each option would be viable regardless of the regulatory framework in place.
- 12.5 Each option would be at the discretion of the local authority and with the agreement of its tenants, the ALMO and central government. The option chosen in each case would probably depend on the extent of any difficulties expected in balancing the HRA in the future, based on HRA projections with anticipated HRA subsidy.
- 12.6 Option 1a, where the HRA business plan is remodelled on the basis of meeting the Decent Homes Standard and the local authority retains control of the remodelled HRA, is the most basic of the options. It may not have sufficient advantages for the local authority or its ALMO to be attractive on any scale.
- 12.7 Option 1b, where the HRA business plan is remodelled on the basis of delivering sustainable communities and the local authority retains control of the remodelled HRA, would provide a significant incentive for local authorities to keep their ALMOs in place after decent homes have been achieved. It would provide more financial certainty than currently, and would ensure an adequate level of investment for long-term viability, which would not necessarily be the case in option 1a.
- 12.8 Option 1b might be sufficiently attractive to encourage other local authorities to set up ALMOs.
- 12.9 Options 2 and 3 are likely to involve considerable discussion and negotiation between the local authority and the ALMO before a decision is made to go ahead. This is because they would involve all the business planning and remodelling of the HRA as with option 1b, but in addition the local authority would put the remodelled HRA at arms length to the authority, and delegate all management of the HRA to the ALMO. Some functions currently retained by the authority may need to be included in the new management agreement, involving a minor reorganisation.
- 12.10 Option 2, where the HRA debt is refinanced with public sector ALMO debt, would avoid the need for outside lenders as the ALMO could borrow from the local authority. The potential problem is that this option could involve significant increases in local authority borrowing which the Treasury might want to constrain.

- 12.11 Hence the development of option 3 which aims to get the borrowing of the ALMO outside public spending constraints without a transfer of the stock. Tenants would need reassurance about the need for, and benefits of, substantial changes to the ownership and control arrangements that would be necessary. Local authority members may see their loss of majority ownership of the ALMO as a step too far. If this option were to be chosen, it would offer the most financial certainty possible without stock transfer.
- 12.12 Option 4 explores the benefits to be achieved by transfer of the stock to the ALMO. This option is dismissed at this stage as the disadvantages far outweigh the advantages. Local authorities with large investment requirements for regeneration might consider a leasehold transfer to a CRC.
- 12.13 The options are not necessarily mutually exclusive. The ideal outcome would be that the principles of options 1a, 1b, 2 and 3 were endorsed by government and allowed to be evaluated with better information than was available for this short project. This would give a degree of choice to local authorities, their tenants and ALMOs. It would also provide the possibility of moving from one option to another as the local authority becomes more comfortable with the ALMO having greater autonomy. In each case, the local authority would have to demonstrate value-for-money for the option chosen. (Appendix 9 sets out in more detail some of the advantages to local authorities of the wider options proposed in this report.)

13 Summary of recommendations

13.1 For government:

- 13.1.1 To include options 1-3 developed in this research in the review of the long-term future of ALMOs.
- 13.1.2 To publicise the requirements of s105 of the 1985 Housing Act that local authorities must consult their tenants before the management agreement with the ALMO expires.

13.2 For local authorities:

- 13.2.1 To consider whether any of the options described in this report would provide better value-for-money for the authority in the longer term than the status quo, as well as assisting in more effective delivery of the authority's housing strategy.
- 13.2.2 To jointly consider with their ALMOs what they could achieve in terms of local sustainability if these options were available to them.
- 13.2.3 To use material in this report to assist the authority in its response to ODPM's consultation paper on the future of ALMOs.

13.3 For ALMOs:

- 13.3.1 To consider what value-for-money could be achieved with proactive asset management of the council's housing.
- 13.3.2 To work closely with the authority and its tenants on assessing the value locally of the options in this report.
- 13.3.3 To use material in this report to assist the ALMO in its response to ODPM's consultation paper on the future of ALMOs.

Appendix 1

ODPM's ALMO Review Group

November 2004

RIGHT TO BUY

Paper by National Federation of ALMOs

1. Many ALMOs are facing substantial losses of properties under the right to buy and demolition. In the future RTB sales may increase in certain areas as more homes are made decent. This stock loss creates problems for ALMOs as they lose potential economies of scale. Turnover drives operating costs. Properties lost through RTB are the most popular, easier and cheapest to manage. Unless RTBs are replaced with properties that meet local needs the ALMO ends up with less desirable stock, a higher concentration of vulnerable and economically disadvantaged tenants and with fewer opportunities to manage the stock in the most effective and efficient way.
2. While local housing authorities suffer the same adverse effects on their rental income stream the subsidy system does provide some degree of protection although a number of authorities are now projecting HRA deficits in future years. RSLs are not directly affected by RTB except for preserved RTB which diminishes over time. Nevertheless, some LSVTs are finding that unanticipated rates of preserved RTB in their stock are having a detrimental effect on their business plans. The RSL equivalent of RTB, the right to acquire, is only applicable to certain properties and is much more limited in scale but a major bonus is that all the receipts accrued from the right to acquire must be reinvested back into housing within the locality of the disposal. In comparison 75% of RTB receipts are pooled and only the remaining 25% can be spent by the local authority, but in general only some of this is reinvested in replacement housing.
3. ALMOs are dependent on a management fee which is usually based upon the stock size and is constrained by the position of the HRA (which itself is subject to fluctuations due to other factors such as changes to management and maintenance allowances) while rent restructuring limits the ability to make up any income shortfall. However, even where the HRA is healthy the ALMO may still face a cut in the fee due to stock reductions. In some cases the fee is a flat rate based on the number of units without reference to condition or occupancy, although some local authorities do make allowances for this. However, there is only limited guidance from ODPM to authorities on what should be taken into account when determining the ALMO fee.
4. The local authority retains ownership of the HRA and the ALMO is therefore much more exposed to stock fluctuations because it has limited options in terms of other income. Furthermore, unlike RSLs and housing authorities, ALMOs are the only social housing organisations whose additional capital funding is dependent upon maintaining, and continually improving, its standard of service. RSLs and housing authorities that drop below 2* are not automatically in danger of their funding being suspended in the same way.
5. Stock losses affect ALMOs differently in the first five years compared to the remainder of the 30-year business plan period. Losses above those assumed in the BCM calculations may result in a net gain in terms of funding for improvements for properties that no longer need to be improved. However, this has to be put into the context of the ongoing loss of rental income over the 30-year business plan period and the 'Gershon' factor i.e. the ALMOs' ability to manage a reducing stock efficiently without implications for staffing levels in the future. The bottom line is a reduction in income to the council and the ALMO.

6. Stock losses have a number of management issues for ALMOs but also impact on the ability of councils to deliver some of their key strategies, particularly in terms of sustainable communities and neighbourhoods. Bolton At Home is currently losing the equivalent of three-quarters of a housing officer's patch each year to RTB, impacting on higher management costs. Yet at the same time it is experiencing increased demands for services, for example significant growth in anti-social behaviour and tenancy management demands.
7. Demographic trends, wages, unemployment and deprivation have remained fairly constant. In essence the higher demand, desirable stock is being lost to RTB and ALMOs are increasingly left with a residual stock, where those who have no choice must remain. This has a further impact on the delivery of a choice-based lettings system with high demand properties no longer available to applicants. Higher management costs and choice based lettings are two examples of performance measures contained against which ALMOs are judged if they wish to become three star organisations. At what point does this aspiration to three stars become no longer financially viable?
8. For local housing authorities there is also a problem for the strategic housing role. RTB take up is affected by other housing market pressures. There is a relationship between increased RTB and increased rates of homelessness. Rises in house prices make it more difficult for low income households to find their own accommodation while rises in RTB reduce the numbers of properties available to house homeless and other priority need households. Oldham, for example, is now using B&B for the first time. Although authorities do have greater borrowing freedom under the prudential regime the HRA subsidy system limits the attractiveness of using these freedoms to provide replacement affordable housing. Recent changes to PFI may make re-provision an option for some authorities but this remains an investment route that has limited applicability.
9. An emerging issue is the number of RTBs in some areas that are subsequently let to inappropriate tenants or, in the worst cases, abandoned and allowed to fall into disrepair which then become a blight to the street scene. A general concern is also that whilst a lot of owners invest in their RTB property a significant number do not and as the standards of estates improve due to delivery of decent homes, a number of RTB properties stand out because of inadequate maintenance – thereby affecting the sustainability of the neighbourhood. The Housing Bill, when enacted, will increase the duty on the local authority to warn RTB applicants about the costs of maintaining their properties but there is no repairing obligation on the former tenant.
10. The valuation process for RTB exacerbates the problem. For valuation purposes RTB properties are valued within their own discreet group and the valuation is very judgement-based. RTB properties are almost invariably valued at levels below those of similar properties, including ex-RTB dwellings, and appeals against the valuation are usually found in favour of the tenant. If valuations are lower than the cost floor (because of recent investment in the property) the valuation is all the purchaser pays. This does not represent value-for-money to the public purse. The below market valuations of council properties encourages some tenants to take up RTB not because they want to own their home but because they want to make a substantial profit. Added to this is the impact of speculative investors who buy up both council and privately owned properties in areas subject to major regeneration or housing market renewal. This also serves to contribute to overheating of the market.
11. The net result of these various pressures is a mismatch in supply, primarily of certain properties. In Stockton, for example, 72% of RTBs are 3 bedroom houses which make up only 42% of the overall housing stock and this is a common picture. Even in low demand areas there may be a shortage of particular sizes and types while first time buyers may find it difficult to access the market. Since it is generally those tenants who are economically more stable that take up RTB the ALMO is left with a higher proportion of vulnerable tenants and properties that are either unpopular or fail to meet current housing demand. It becomes more difficult to find alternative accommodation for those in properties not suitable for their need. Without the ability to replace stock loss where appropriate the sustainable management of the stock becomes more problematic and more resource intensive.

12. RTB takeup varies at both regional and local level. The attached Appendix (NB not included in this report) shows RTB sales in Rounds 1 and 2 ALMOs between 1999 and 2003. Overall the ALMO stock has reduced by between 9% and 12% in only five years. Because RTB fluctuations are generally caused by a range of underlying factors it is very difficult to accurately predict them in the business planning process. Economic upturn, low interest rates, rent restructuring and local regeneration and market renewal initiatives all have an influence. Many ALMOs have found their RTB rates have doubled or trebled in recent years but distinguishing real long-term trends is not easy. Sudden unanticipated surges in RTB can cause major problems with the budget. Furthermore, management overheads cannot be reduced in direct proportion to stock loss. Costs can be driven up by the need to improve services in order to access ALMO funding and service users' expectations are rising as a result. However, it is not easy to translate reduced income into efficiency savings where services are dispersed and there is a relatively fixed cost base.
13. Many organisations have lobbied for changes to RTB. It does not represent value-for-money in terms of public expenditure although genuine RTB (i.e. the purchase of their own homes by tenants who wish to live in them as owner occupiers) has had social benefits through introducing diversification of tenure and maintaining stability on estates. However, speculative RTB (especially where companies have encouraged tenants to sell in order to relet the properties) has the opposite effect.
14. The Housing Bill, when enacted, will help to reduce speculation and abuse of RTB but the NFA considers that the changes to the discount level to bring RTB in line with the right to acquire only in certain areas has been a missed opportunity. The family silver is being sold off too cheap and a fairer price/discount regime is needed. The government has estimated that in the 41 authorities where the RTB discount entitlement has been reduced to RTA levels 9000 fewer RTB sales will take place over the next 10 years. Complete alignment across the country is both fairer and in tune with the government's broader objective of aligning tenants' rights in the social housing sector. Furthermore, the current system, if it is to maintain a semblance of logic, depends on regular reassessment of both homelessness and RTB activity in all authorities and it is unclear whether or not this is, in fact, taking place.
15. Stock loss through demolition also brings its own problems. While the use of decent homes funding to help pay demolition costs is welcome there are also revenue consequences. Stock that is being cleared consumes considerable extra resources in terms of negotiating acceptable rehousing solutions for residents displaced and for securing estates until all the properties have been emptied and demolished. Deciding whether or not to demolish properties can be a vexed and time consuming process necessitating weighing the economic and social benefits and disadvantages against residents' wishes and an assessment of long-term housing needs and sustainable outcomes. All this is staff intensive and places increasing pressure on ALMO overheads.
16. While none of the issues surrounding RTB and demolition are unique to ALMOs the nature of ALMOs' dependency on a fee system and the restrictions on their ability to raise alternative income makes them more vulnerable to the impact of stock loss. ALMOs, unlike the local authority, have no control over the HRA or over how retained RTB receipts are used and, unlike RSLs, do not yet have access to Social Housing Grant (SHG) or the ability to raise private finance outside public sector borrowing constraints. Reducing management costs through redundancy is expensive in the short term while the alternative (natural wastage) may result in an imbalance in skills and expertise. As the concentration of vulnerable tenants and the demand for improved services increases it becomes more difficult to balance these requirements with efficiency savings. Allowing ALMOs access to SHG and the power to trade and offer other services would help cushion the problem and enable them to continue to make the most efficient use of economies of scale in order to deliver excellent services and better plan for the future.

Recommendations

- a) ODPM should, in consultation with the local authority associations and NFA, produce guidance on factors to be taken into consideration when agreeing a management fee.
- b) ODPM should bring RTB discounts in line with the right to acquire across the country.
- c) ODPM should review the guidance on RTB valuations to ensure they represent the real value of the stock.
- d) ODPM should consider incentives to encourage local authorities, where there is evidence of need, to make greater use of their housing capital receipts or prudential borrowing powers for replacement housing or to utilise windfall capital receipts by using council owned land to defray land costs (as announced in October).
- e) ALMOs should be given access to social housing grant to enable them to replace the stock where there is evidence of need, although the effective use of SHG would depend on being able to retain the rental income from the new development to the extent needed to finance borrowing for the balance of the development cost.
- f) ALMOs should be given broader powers to trade in order to maximise their income stream.
- g) Consideration should be given to some form of leasehold/equity insurance arrangement where RTB applicants are assisted to create sinking funds and provide for future maintenance obligations. ALMOs with their ongoing capital programmes are well placed to help meet this need.
- h) ODPM should pursue the Home Ownership Task Force recommendation to develop a form of equity loan as an alternative to RTB.

9 November 2004

Appendix 2

ALMOs: The Wellbeing Power and the Power to Trade

1. LEGAL FRAMEWORK

Part 1 of the Local Government Act 2000 (“the 2000 Act”), and more specifically section 2 of this Act, significantly widens the powers of local authorities to do anything which is likely to promote the economic, social or environmental wellbeing of their area. This recent power is part of the Government’s move towards the modernisation of local government by encouraging innovative action.

Below is a framework, based on the accompanying guidance to the legislation issued by the ODPM and entitled *Power to Promote or Improve Economic, Social or Environmental Wellbeing* (modified June 2003) (“the Guidance”). This outlines what local authorities need to consider before using the new wellbeing power.

1.1 *Is the proposed action likely to promote or improve the wellbeing in the area?*

It is for the local authority itself to decide whether any particular action would promote or improve wellbeing. It is a discretionary power to do anything which in its view would promote or improve the wellbeing in the area.

Local authorities are required by section 4 of the 2000 Act to work together with other bodies to establish a strategy for promoting the wellbeing of their local communities. Such strategies will establish common priorities and determine action which needs to be taken to improve wellbeing.

1.2 *Is the primary purpose of the action to raise money?*

Section 3(2) of the 2000 Act prevents local authorities from exercising the power to raise money. This ensures that where a local authority has to obtain funds before putting its strategy into effect, it can only do so using existing sources of income. The power does not confer new powers to borrow, introduce new taxes or to charge for services provided in furtherance of wellbeing. This principle is subject to some legal debate but the intention of parliament is clear.

1.3 *Is it explicitly prohibited on the face of other legislation?*

Section 3(1) provides that local authorities are only able to do what they are empowered to do by statute. The new wellbeing power does not change this, but it does significantly extend the limits of the local authority’s powers.

Any prohibition, limitation or restriction must be explicit. Any limits to local authority powers which might be implied or inferred from the way in which those powers have been drafted do not prevent the wellbeing power being used.

1.4 *Are there any explicit limitations or restrictions on the face of other legislation?*

Some legislation contains general restrictions or limitations which mean that local authorities may only undertake activity in respect of certain matters or if particular conditions are complied with. The Guidance provides that before using the wellbeing power local authorities will need to take into account the requirements of Part V of the Local Government and Housing Act 1989, the Local Authority Companies Order 1995 (as far as still extant after 1 April 2004) and other such provisions. Limitations may also arise from broader statutory requirements such as the requirement to achieve best value.

2. DIVERGENCE OF LEGAL OPINION

Some lawyers disagree with the interpretation outlined above and have adopted a narrower approach to construing section 2. They prefer to advise that the power should be limited to areas where local authorities are already empowered to act under existing statutes. This would not, however, accord with the guiding principle behind the legislation that local authorities

should be given a wide general power to do any thing that it deems to be for the wellbeing of the community. The limited amount of case law on the subject leans towards a wider interpretation, but none of the cases so far has been concerned with community leadership or innovation.

3. THE WELLBEING POWER AND ALMOs

3.1 *Charging for Services and Trading*

It is clear from the Guidance that section 2 can be used for the formation of an ALMO (paragraphs 42 and 43). This is confirmed by ODPM guidance on *Arms Length Management of Local Authority Housing* at paragraph 2.16. Furthermore, paragraph 70 of the Guidance states that where the wellbeing power is used to set up a company (such as an ALMO), “that company is not subject to the restrictions provided by section 3(2). In practice, this means that an ALMO can charge for any services it provides.”

3.2 *Charging for Services and the Relationship between Section 2 of the Local Government Act 2000 and Section 93 of the Local Government 2003 Act*

Section 93 of the Local Government Act 2003 (‘the 2003 Act’) provides for local authorities to charge for the provision of discretionary services, provided that the income from charges does not exceed the costs of provision. Discretionary services are those services which a local authority has the power but not a duty to provide, and an authority may charge where the recipient has agreed to its provision.

In order to charge, authorities must already have the power to provide the service and we believe that section 93(2)(a) means that this power can be derived from the wellbeing power in the 2000 Act. This is supported by the ODPM’s guidance entitled *General Power for Best Value Authorities to Charge for Discretionary Services – Guidance on the Power in the Local Government Act 2003* dated November 2003.

It is important to note that the power to charge under this provision does not apply where the power to provide the service in question already benefits from a charging power (93(2)(a)) or is subject to an express prohibition from charging (93(2)(b)). Section 93(7) of the 2003 Act, however, expressly provides that the prohibition on raising money in the 2000 Act is to be disregarded.

3.3 *Trading and the Relationship between Section 2 of the Local Government Act 2000 and Section 95 of the Local Government 2003 Act*

Section 95(1) of the 2003 Act confers on the Secretary of State the power to make an order enabling local authorities which have been judged as ‘fair’, ‘good’ and ‘excellent’ in their CPA (Comprehensive Performance Assessment) to trade. The Local Government (Best Value Authorities) (Power to Trade) (England) Order 2004 (the “Trading Order”) was subsequently made under Section 95 and came into force on 29th July 2004. This Trading Order provides powers to trade in function-related activities through a company.

For the purposes of the legislation ‘trade’ means to do something for the main purpose of making a profit and extends to the provision of services, the supply of goods and carrying out works. This power can only be exercised through a local authority company and it only enables the local authority to trade in its ‘ordinary functions’. This means that the local authority must already have the power to carry out the proposed activity (albeit in a non-commercial sense). Section 95 can then be used to enable the local authority to exercise the existing power through a separate vehicle to make profits.

Guidance entitled *General Power for Local Authorities to Trade in Function Related Activities Through a Company*, which has been produced by the ODPM pursuant to the Trading Order, confirms that the section 95 power can be used in conjunction with the wellbeing power. Activities which have been undertaken to promote wellbeing can, therefore, be regarded as ‘something which local authorities are authorised to do for the purpose of carrying out their ordinary functions.’ The guidance emphasises the point that the power to trade in wellbeing function-related activities is a primary power specifically conferred by the Trading Order. An authority exercising this power does not contravene section 3(2) of the 2000 Act and the

restriction on raising money because it is not trading under the wellbeing powers. Before a local authority exercises the power to trade, the Trading Order requires that a local authority must prepare and approve a business case in support of the proposed trading enterprise. It is important for ALMOs intending to use the power to note that their existing business plan will not be suitable for this purpose. The preparation of a business case for trading would be a separate exercise and would involve assessing the risk involved in the proposed trading activities.

4. CONCLUSION

ALMOs formed under the wellbeing power will be able to charge for services provided to third parties. ALMOs will only be able to trade, however, if the wholly-owning local authority qualifies to do so under section 95 of the 2003 Act and the Trading Order. If an ALMO does qualify and can utilise this power to trade, it can trade in wellbeing function-related activities.

Appendix 3

Merger with another ALMO: Some preliminary issues for consideration

Tenant consultation

Any merger between ALMOs would require tenant consultation under section 105 of the Housing Act 1985. Tenants need to be informed of the merger proposals and have the opportunity to make representations to the ALMO. This could be through a ballot or test of opinion. In particular, where the ballot process was previously used by the local authority in establishing its ALMO then this may raise a legitimate expectation of a further ballot.

Clearly there will need to be wider tenant representation in the newly merged organisation and the opportunity to review and restructure existing tenant and resident groups may produce mixed reactions. Differences between tenant compacts may also need resolving.

Company structure

If, as is currently the case, each ALMO is 100% owned by its parent authority then the likelihood is for a 50% share of each local authority in the newly-merged organisation. This may create the potential for deadlock. For example, the amendment to the memorandum and articles of association requires a 75% special resolution. Therefore one local authority could 'block' the other and prevent an amendment. This would remain the case under option 3 if (as might be the case) the council retained more than 25% of the voting rights.

An alternative would be to create a group structure with relevant functions being delegated to each local authority area.

This raises the question of whether an RSL could be included as part of a formal group structure. This would not currently be permitted. It is a basic requirement of the Housing Corporation's registration that an RSL is not permitted to be a subsidiary of an unregistered body (e.g. an ALMO) to avoid control being exercised by a body which is neither subject to Housing Corporation regulation nor to the various statutory requirements which result from registration.

Although RSL group structures frequently include unregistered subsidiaries, an ALMO would also be prevented from joining an RSL group as an unregistered subsidiary since this would require the RSL parent (rather than the local authority) to have control over such a subsidiary ALMO.

It may be more appropriate for ALMOs and RSLs to operate less formal arrangements, i.e. without entering into constitutional partnerships or group structures. For example, informal agreements could be put in place to allow an RSL and an ALMO to join together to help each other, share experiences and pool specialist expertise. There could also be contractual arrangements where the organisations could work together to bid for joint development programmes.

Board structure

A 'parent' or 'strategic board' could be formed with a mix of local authority tenants and council nominees from each ALMO board. Independent board members could then be added and the ALMOs would need to determine how candidates were to be chosen and what connection would be needed with either or all geographical areas. The size of the board would also need to be determined (e.g. fifteen board members comprising five tenants, five council and five independent board members). Agreement would also be needed as to how any deadlocks would be resolved.

Audit Commission Assessment

A procedure would be required to assess and determine the relevance of previous 'scores' awarded by the Audit Commission in previous assessments. This may be important in terms of how future assessments are scored. Given the current necessity of a minimum two star rating, there is the obvious risk that one local authority's ALMO could have a negative impact on the quality and standards of services of another (with the risk that both lose their access to decent homes funding).

Staffing Issues

The possibility of a TUPE transfer needs to be considered and the implications that arise from this. In particular unions and employees will have concerns and the identity of the new employer or employers will need addressing. Agreement will also be needed as to which local authority staff will 'TUPE back' on the winding up or termination of the newly merged organisation. There may also be issues surrounding pension contributions and under funding – particularly if there is under-funding at one local authority and not the other.

Contract Monitoring

There is the potential for disagreement where one local authority is satisfied with the performance of the newly-merged ALMO but the other is not. There will need to be contract monitoring arrangements in place to ensure that any disagreements or deadlocks can be resolved. The role for the various scrutiny committees of each local authority also needs to be clarified. The involvement and monitoring by these and other external bodies suggests the potential for significant time and resource commitments by the ALMO and therefore close collaboration is desirable.

Management Fee

The basis on which the management fee is calculated will need to be determined and procedures agreed for future adjustments. This is particularly the case where one local authority experiences a higher level of right to buy sales than the other. Agreement is also needed as to how any surpluses are to be distributed and used.

Powers

The areas where the ALMO is permitted to operate will need to be set out in the constitution. Certainly the 'wellbeing' power is available for each ALMO and its parent authority but cross-boundary working could be problematic.

In particular, each local authority will have a Community Strategy which will need to be considered and possibly re-evaluated.

The District Auditor for each local authority will need to be reassured. In particular the prudential borrowing limits of each local authority will be affected and suitable controls will need to be in place to ensure that each local authority is compliant.

VAT

Contractual arrangements (as opposed to formal groups) raise the possibility of VAT inefficiency. This should not be a difficulty for an ALMO/ALMO relationship but for an ALMO/RSL relationship the RSL would be unlikely to be able to recover the VAT it pays.

Appendix 4

ALMOs and New Build: Some technical issues

There are some technical issues to be addressed if ALMOs, particularly under option 3, carry out new build – whether market rental, key worker accommodation or affordable housing.

Some of these technical issues are currently being analysed in specific contexts and this appendix seeks only to identify some of the major issues which need to be addressed.

- **Form of Tenancy** – this turns on whether the local authority or the ALMO itself is to be the landlord. As far as market renting is concerned, all local authority tenancies are ‘secure’ unless caught by the exceptions in the Housing Act 1985, none of which apply to market renting. For a local authority to grant market rental tenancies there would need to be legislative and policy change to exclude the tenancy from security and from rent convergence. Whether key worker accommodation needs the same relaxation/exception would depend on the nature of the scheme. There would be no need for a relaxation/exception for affordable housing.

If the ALMO is to grant the tenancy it would need an interest in the property, created by the grant of a lease from the council and as section 4.7 explains this would require Secretary of State consent under section 32 of the Housing Act 1985. Any tenancy granted by an ALMO at market rent would be an assured shorthold and not subject to the residents’ charter or the local authority secure tenancy regime. It might be appropriate for the ALMO to ‘accept’ contractual limitations which ‘mimic’ the residents’ charter and the local authority secure tenancy regime in the case of key worker accommodation and it might very well be appropriate in the case of affordable housing.
- **Management** – even if the ALMO does not own the property and therefore becomes the landlord it might well be appropriate for it to be the manager of that accommodation. Management responsibilities can be delegated to the ALMO under section 27 of the Housing Act 1985 with the Secretary of State’s consent.
- **Use of a subsidiary** – there seems little obvious merit in an ALMO creating a subsidiary for new build purposes. If the ALMO itself (under option 2) is still wholly-owned by the local authority then the assets and liabilities of the ALMO are still ‘on balance sheet’ for the local authority; while if the ALMO is no longer wholly-owned by the local authority (i.e. under option 3) then there is no need to create a subsidiary to achieve that effect.
- **Right to buy** – any property held under an assured tenancy is not subject to the right to buy (unless that assured tenancy was created following a transfer of a tenanted property from the local authority). Instead the right to acquire would apply.

Appendix 5

ALMO FINANCIAL FREEDOMS REVIEW

CASE STUDY ANALYSIS

FINAL REPORT

AUGUST 2005

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ANNEXES

ANNEX 5A Assumptions used for Self Contained HRA / ALMO Business Plan

1. Introduction

1.1 Background

1.1.1 Tribal HCH (formerly HACAS Chapman Hendy) was appointed by the six case study ALMOs and their sponsoring authorities to provide an assessment of the impact of the different options being used for the CIH / NFA / HouseMark Review of Financial Freedoms for ALMOs.

1.1.2 This report has been prepared to show the illustrative impact of the authority / ALMO withdrawing from the current subsidy regime based on five different options as follows:

- Option 1A Based on Decent Homes Investment programme only
- Option 1B Based on A Full Reinvestment & Environmental Works Programme
- Option 2 Based on 1B with the ALMO taking full control of the HRA
- Option 3 Based on 2 but utilising private sector funding
- Option 4 Based on the ALMO becoming a landlord / leaseholder

1.1.3 The principle behind the approach is to make the HRA more or less self-sustaining and to give the ALMO a key role in managing it. Option 4 is included for illustrative purposes only as this would involve a stock transfer under existing legislation.

1.2 Case Studies

1.2.1 The six case studies volunteered to be part of the CIH / NFA Project and provided information on their current HRA business plans, budgets and the building cost models where available. All six were included in the first two rounds of the ALMO programme.

1.2.2 At this stage we have preserved the anonymity of the Case Studies although we provide below a brief profile of the different organisations.

Case Study	Region	Opening Stock
A	London	12,600
B	South West	3,700
C	London	9,900
D	East Midlands	14,500
E	North West	20,000
F	North East	12,300

- 1.2.3 Meetings and / or telephone conferences were arranged to discuss the approach being taken and the format of the likely output. Feedback has also been sought via combined meetings with the CIH, ALG, LGA, HouseMark, Trowers and Hamlins, the NFA and the ODPM. Following initial discussions on 19 January a separate meeting was arranged with the ODPM on 27 January to discuss the subsidy assumptions and the impact on the Exchequer. This paper follows an initial draft circulated on 31 January and a subsequent update produced on 3 March and discussed with representatives of the ODPM, CIH and NFA on 4 March and 21 March. Further discussions with ODPM also took place in June and August 2005 and this revised final version was produced in August 2005.
- 1.2.4 Our thanks to all those who provided information and advice on the data and on the broad approach being adopted.

2. Modelling Assumptions

2.1 Development of Model

2.1.1 In order to assess the impact of each of the case studies we first had to examine the current HRA business plans for the relevant authorities / ALMOs and update them as necessary. Most of the business plans had been prepared on the current ODPM model but in two cases other models had been used and some further adaptation work was required.

2.1.2 We then adapted each model by integrating a common sheet which enabled us to examine the key data and consider the impact on each of the outputs for each of the given options.

2.1.3 All figures are based on 2004/2005 budgets and business plans (with the exception of Case Study C which originally used 2003/04 as a base but has been brought forward for comparison purposes).

2.2 Key Outputs

2.2.1 The main outputs which have been drawn from the modelling are as follows:

- (i) The financial impact on central government – this takes into account the up front value of future subsidy payments based on a given set of subsidy assumptions. We also consider the impact of RTB sales and taxation (e.g. VAT).
- (ii) The level of debt that the authority / ALMO could be expected to start with and be sustainable over 30 years based on the given business plan assumptions. This broadly equates to the purchase price ('stock valuation') used for a stock transfer.

2.2.2 The other output will be the impact on the local authority General Fund and the resources available to meet non-HRA capital investment.

3. Key Variables

3.1 Different Assumptions for Each Option

3.1.1 The model has been based substantially around the existing business plan assumptions but where appropriate we have altered these assumptions to reflect differences between the five options as follows:

Option	Major Works	Mgmt Costs	Interest	VAT
1a	Decent Homes Only	Per Business Plan	Set at 6.0% *	Assumed negligible
1b	Enhanced Works Prog'mme	Per Business Plan	Set at 6.0% *	Assumed negligible
2	Enhanced Works Prog'mme	Per B Plan + 5%	Set at 6.0%	Assumed negligible
3	Enhanced Works Prog'mme	Per B Plan + 5%	Set at 7.0%	Assumed negligible
4	Enhanced Works Prog'mme	Per B Plan + 5%	Set at 6.5%	Payable on all works & 10% of mgmt costs

* On new borrowing only

3.1.2 We comment on each of those key assumptions below in the sections which follow. Further detail on all the assumptions can be found at Annex A.

3.2 Major Works

3.2.1 This presented the largest area of difficulty when compiling the data and comparing the business plans. Authorities / ALMOs generally had reliable stock information up to 2010 in order to meet the Decent Homes target. However there was considerable variation in the information beyond 2010.

3.2.2 On stock transfers RSLs would normally be expected to produce a warranted stock condition survey before proceeding. The circumstances here are very similar in that the HRA / ALMO will be expected to be sustainable without direct government subsidy. The authority therefore needs reliable information on its future investment needs.

3.2.3 The difference between option 1a and the others is essentially that option 1a is focussed primarily on decent homes whilst the others focus on the wider stock investment and environmental needs. For example decent homes does not allow for expenditure on lifts or enhanced security / street lighting on estates. There are also different interpretations of what should be included in the decent homes standard (especially criterion 'c' on modern amenities).

3.2.4 In the absence of any better data we have assumed for the purposes of this exercise that the ongoing cost of decent homes represents around 75% of the overall investment needs based on an initial analysis of one case study's costs. This will require further more detailed analysis for each individual authority / ALMO.

3.3 Management Costs

- 3.3.1 We have broadly based our modelling on the current management costs assumed in the business plan for each authority / ALMO.
- 3.3.2 These assumptions vary according to the resources currently available to the authority / ALMO and their expectations on future subsidy – in particular the distribution of M&M allowances. It will also depend to an extent on future stock movements (eg RTB sales, demolitions and transfers).
- 3.3.3 In practice we believe it would probably be necessary to agree a suitable formula for management costs in the model which will form the basis of negotiations between the parties.
- 3.3.4 In the meantime we have assumed existing costs for options 1a and 1b but added a further 5% for options 2, 3 and 4 on the basis that the added independence associated with more ring-fenced arrangements will tend to introduce some extra governance, regulatory and monitoring costs.

3.4 Interest Costs

- 3.4.1 At present the interest charged to local authority HRAs is based on the average rate incurred on the authority's overall loan debt (including General Fund). The rate of interest will depend on the amount of fixed interest borrowing taken on by the authority and the repayment period.
- 3.4.2 The estimated rates across the country for 2004/05 range from around 4% to 12% and the weighted average is around 6.79%. For the six case studies the rates ranged from 4.87% to 6.50%.
- 3.4.3 At present the HRA is largely protected through the subsidy system from changes in interest rates. Consequently authorities tend to pay little attention to interest rate forecasts in the business plan. In the event that the authority / ALMO withdrew from the subsidy system there would need to be some agreement reached on:
- (i) The level of debt to be repaid (including any early redemption penalties) and the extent, if at all, of any refinancing.
 - (ii) The management of any future loan debt and the scope for the ALMO to manage or control this.
 - (iii) The interest allowance for future borrowing in the business plan.
- 3.4.4 The HRA / ALMO will be more exposed to interest rate fluctuations after withdrawing from the subsidy system. Consequently we are currently assuming an average interest rate on borrowing of 6.0% for new public sector borrowing (options 1a, 1b and 2), and slightly higher private sector rates for option 3 (7.0%) and option 4 (6.5%).

3.5 VAT

- 3.5.1 ALMOs currently incur VAT on some of their costs but are able to recover most if not all of this through the fee charged to the council. The council is able to recover VAT as an exempt public body.
- 3.5.2 We are therefore assuming that VAT will not be a significant item so long as the ALMO's income remains as a fee (options 1a, 1b, 2 and 3). However this position changes in the event that the ALMO income is the rent itself as is envisaged under option 4. Under these circumstances the ALMO (or its successor body) would be unable to recover the VAT as rent is not a 'vatable' item.
- 3.5.3 This would place it in a similar position to a RSL in that the VAT costs would need to be reflected in its business plan and therefore in the level of debt that it is able take on at the start of the process (ie equivalent to the price paid for the stock on transfer). The most significant items will be for the major works and repairs (assumed to cover all costs) although this will also apply to some management costs (assumed to be around 10% of costs for this exercise).

4. Other Factors

4.1 Other Assumptions in Stock Valuation

4.1.1 Other assumptions in the model have been held consistent for each of the options. This includes:

Opening Stock	As at April 2004
Right to Buy Sales – Variation 1 (See Section 4.2)	No sales
Right to Buy Sales – Variation 2 (See section 4.2)	1% of opening stock with existing sales growth assumptions
Demolitions / transfers	Per Current Business Plan only
Inflation (RPI)	Assumed to be 2.5% per annum
Target Rents (See section 4.3)	Assumed to increase by 1.5% above RPI until 2011/12 and 0.5% thereafter
Actual Rents (See section 4.3)	Converges with target by 2011/12 and 0.5% thereafter
Bad Debts / Voids	Per Current Business Plan
Other Income (eg service charges /garages etc)	Per Current Business Plan
Responsive & Cyclical Repairs	Per Current Business Plan
Corporation Tax	Assumed to be negligible
Debt repayment (See section 4.4)	Assumes debt repaid by year 30
Accounting changes (See section 4.5)	New arrangements for: <ul style="list-style-type: none"> • Depreciation • Balance Sheet • Surplus on Sales

4.1.2 We discuss our approach on some of the main assumptions in the sections below.

4.2 Right to Buy Sales

- 4.2.1 Under the new regulations introduced in April 2004, all authorities are required to repay 75% of their right to buy sales receipts to the ODPM as part of the pooling arrangements - subject to the transitional rules which are available to authorities who were debt free at that time. None of the 6 case studies were debt free in April 2004.
- 4.2.2 Unlike rent income, capital receipts are not currently ring-fenced and authorities have different policies on the use of the remaining 25%. This is also reflected in the cross section of case studies. Interest on usable capital receipts currently gets credited to the General Fund.
- 4.2.3 Under the current subsidy arrangements authorities are partly protected from the effect of RTB sales. In the event that an authority was to withdraw from the subsidy system it would therefore need to retain more of the capital receipt for spending in the HRA and / or to provide cover for debt repayment.
- 4.2.4 Under current stock transfer arrangements local authorities and social landlords are able to share the receipt. We have consulted with the ODPM about the arrangements that might apply for this research project. Their initial view is that a similar arrangement would apply – ie the authority would share the receipt between the HRA (ALMO) and the General Fund for use on non-HRA capital projects.
- 4.2.5 As right to buy sales are difficult to predict we have modelled each of the five base options on a position without any sales (variation 1). We have then modelled the position to assess the distribution of RTB income based on annual sales of 1% of the stock (variation 2). The amount which would be needed for the HRA will differ according to the authority (and, in practice, according to the property sold).

4.3 Target and Actual Rents

- 4.3.1 Rents for all options have been based on the existing rent restructuring regime for local authorities. We have therefore assumed that target rents will continue to increase by RPI + 1.5% until 2011/12 and actual rents will converge with the target by 2011/12 – subject to the impact of any individual caps and limits.
- 4.3.2 The ODPM recently launched a consultation which looked at making some slight changes to the regime in order that local authorities and RSLs are using the same formula. It also proposed some changes to bedweights in the formula. We have ignored the effect of these changes at this stage.
- 4.3.3 At present authorities are also constrained by the subsidy regime which penalises the authority (by withdrawing benefit subsidy) if its overall average rent is higher than an overall pre-set limit rent. The regime also gives no incentive for the authority to revisit capital values following a major improvements programme as any increase is absorbed into the guideline rent which is paid back to the ODPM. These rules do not apply in the RSL sector.
- 4.3.4 Withdrawing from the subsidy regime would give authorities more incentive to review their rents policy within the confines of the restructuring regime. We believe this would give the authority / ALMO greater flexibility and would aid more proactive

asset management. The overall approach would need to be agreed between the council and the ALMO.

4.4 **Debt Repayment**

4.4.1 Our model assumes that in each of the options the debt will need to be repaid by year 30.

4.4.2 This is consistent with the policy adopted on stock transfer whereby lenders generally require the landlord to demonstrate that it could repay its loan debt over 30 years or less.

4.5 **Accounting Changes**

4.5.1 At present the accounting requirements for the HRA are very different from the way that RSL accounts are presented.

4.5.2 In order to allow ALMOs and their sponsoring authorities more opportunity to utilise the financial freedoms we have assumed that the following key changes will all be addressed (this applies to all of the options):

(i) **Depreciation**

Currently authorities are required to provide depreciation cover in the HRA based on the Major Repairs Allowance (MRA). This effectively prohibits the authority from borrowing against the MRA. RSLs have more flexibility over the calculation of depreciation and over the amount of major works charged to capital / revenue. We believe a similar arrangement will need to be put in place for a truly ring-fenced HRA.

(ii) **Surplus on Sales**

At present there is no credit to the HRA for any accounting surplus on RTB sales (or other disposals). This is unlike the practice in the RSL sector. We believe that it would be necessary to reflect any accounting surplus on sales in the operating account in order to offset the net loss of rent.

(iii) **Balance Sheet**

At present the council's HRA assets are incorporated into an overall corporate balance sheet – thus making it difficult to disaggregate the assets and liabilities in the HRA. We believe that aligned with the above changes it would be necessary to introduce a new HRA Balance Sheet to sit alongside the Operating Account.

4.5.3 The extent and need for these changes may depend, to some extent, on the opening financial position of the authority / ALMO and would need to be assessed further.

5. Subsidy Assumptions

5.1 Developing the baseline position

5.1.1 In order to assess the net impact on the government we first needed to calculate the baseline position – i.e. the resources that the ODPM would have paid to or received from the individual authority had it remained in the existing subsidy system.

5.1.2 In order to do this we have looked carefully at the key variables used in the subsidy calculation.

- (i) Guideline and limit rents
- (ii) Management and maintenance allowances
- (iii) Major repairs allowances
- (iv) Supported capital expenditure (borrowing)

5.1.3 The amount of HRA subsidy paid to / received from authorities over the longer term (30 years) will also depend on the number of properties in the HRA. When a property is disposed of the ODPM compensates the authority for the net loss of income from that property. The amount paid is based on the guideline rent less the management, maintenance and major repairs allowance. In return the ODPM receives a fixed 75% of the disposal price where the property is sold under the right to buy.

5.1.4 The difference between the net loss of rent income and the 75% return on the capital receipt will vary according to the authority.

5.2 Guideline and Limit Rents

5.2.1 We have assumed that guideline rents and limit rents converge with target rents by 2011/12 in line with current policy.

5.2.2 In practice the effect of the individual caps and limits adjustment may mean that, in some cases, convergence will be deferred for a few years. However due to the complexity of modelling this for individual properties and the marginal nature of the likely impact we have not quantified that at this stage. We have assumed that after convergence in 2011/12 all rents continue to increase at RPI + 0.5%.

5.2.3 It is assumed that the provision for void losses remains at 2% throughout.

5.3 Management and Maintenance Allowances

5.3.1 The ODPM introduced a new system for targeting management and maintenance (M&M) allowances in 2004/05. These new 'targets' ('pre transitional allowance') vary from the 'actual' allowances provided to the authority ('post transitional allowances'). The rate of convergence depends on the difference between the old system and the new system.

5.3.2 Following discussions with the ODPM we have assumed at present that the ‘target’ allowances will increase by around 2% over RPI per annum in line with the ODPM’s commitment to redistribute the rebasing of guideline rents. We have assumed that the ‘actual’ allowances will converge with the targets by 2011/12 and that thereafter the allowance will increase by RPI + 0.5%. This can have a significant effect on the Exchequer.

5.4 Major Repairs Allowance

5.4.1 As with the M&M allowances the ODPM has introduced a new targeting system for the Major Repairs Allowance (MRA). This was adjusted in 2004/05 to reflect an increase in the number of property archetypes. However, unlike the M&M allowances these are not being phased in.

5.4.2 The actual allowances can change according to the profile of the properties disposed of during the year but for convenience we are increasing the MRA by RPI only in line with the overall approach adopted by the ODPM.

5.5 Supported Capital Expenditure (Borrowing)

5.5.1 Authorities are provided revenue support towards the interest on their historic debt (based on the Subsidy Capital Financing Requirement or SCFR). The SCFR is increased each year through a Supported Capital Expenditure (or SCE) allocation in line with regional allocation policies. This operates in a similar way to the allocations that have been made to ALMO authorities (although initial ALMO allowances for Round 1 and 2 ALMOs – until 2010 – are being set at a fixed rate of 8% rather than being based on actual interest costs).

5.5.2 Under the present regime authorities have an option whether to use this allowance to support borrowing. Some authorities will use it for borrowing, some may use it as revenue contributions toward capital expenditure and others may use it to support management or maintenance costs. Authorities are also able to use available capital receipts to support their stock investment programme. Some will be able to make additional revenue contributions as a result of generating extra income and / or making savings against the M&M allowances.

5.5.3 This means that the resources provided by government in the baseline position will not necessarily equate to the actual stock investment programme. In some cases it will be higher and in some cases it will be lower.

5.5.4 The interest rate on the SCFR will vary according to the council’s current loan portfolio and the rates it secures on future borrowing. This is set in line with the average loan debt across the authority’s entire loan portfolio (i.e. includes borrowing on non housing services). For the purposes of this analysis we have assumed that borrowing is 6%. In practice the long term loan portfolio would need to be the subject of further examination.

5.5.5 In the absence of any formal guidance on future SCE allocations, we have assumed, following consultation with the ODPM, that authorities will continue to receive a SCE allowance until 2010 based on their current allowance. Thereafter it has been assumed, for the baseline, that the SCE allowance will be equal to the

difference between the forecast investment need (based on the current estimate of decent homes only) and the other resources available.

5.6 **Future assessments**

- 5.6.1 In practice it will be necessary for each authority to carefully assess the resources that it might have received under the current system and compare this with the resources and freedoms under the alternative options.
- 5.6.2 The figures used in this analysis are a guide only and would need to be the subject of further examination should an authority consider any of the options.

6. Impact on Central Government

6.1 Key Items

6.1.1 In order to assess the impact on central government we have broken down the impact into the following components:

- Loss / gain in HRA Subsidy payments received / paid
- Loss of RTB Sales receipts
- VAT & Corporation Tax

6.1.2 The assessment is based on a broad analysis of the economic impact rather than the accounting impact and is therefore different from the approach adopted in the Public Sector Net Borrowing (PSNB) figures used for the Single Transfer Model (STM), as utilised on stock transfers.

6.1.3 This approach means that we have excluded the actual levels of borrowing and have focused instead on the revenue support that the government would have provided under the current model.

6.1.4 We have discounted all costs in order to arrive at a Net Present Value (NPV). The NPV is based on a nominal rate of 6%. The approach assumes that the new borrowing taken on by the HRA to support future stock investment falls under the prudential borrowing regime and is being supported directly by rent and other income.

6.2 Gain / Loss of HRA Subsidy

6.2.1 The main baseline for comparison is the level of HRA subsidy that the ODPM would have paid to or received from the individual authority. This base position varies from one authority to another according to the factors discussed in section 5.

6.2.2 We have assessed the NPV of future revenue payments to / receipts from each authority based on the current stock (i.e. Variation 1 - without sales) and after sales (i.e. Variation 2 including 1% sales per annum). The net baseline position is as follows:

Case Study	No Sales	Sales @ 1%	Net Revenue Loss to ODPM following RTB Sales	No Sales	Sales @ 1%	Net Revenue Loss to ODPM following RTB Sales
	Net Payment to / Receipt from (-) authority	Net Payment to / Receipt from (-) authority		Net Payment to / Receipt from (-) authority	Net Payment to / Receipt from (-) authority	
	Total £'000	Total £'000		Total £'000	Per Unit £	
A	122,660	146,492	23,832	9,713	11,600	1,887
B	-15,221	-10,492	4,729	-4,033	-2,780	1,253
C	280,234	303,180	22,946	27,512	29,764	2,253
D	-2,823	19,273	22,096	-194	1,327	1,521
E	84,877	107,809	22,932	4,228	5,371	1,142
F	-18,771	2,166	20,937	-1,523	176	1,698

6.2.3 This table demonstrates a number of things including:

- (i) That the net payments to / receipts from authorities under the existing regime differ considerably across the six case studies – this reflects the broad position nationally. The authorities receiving the greatest subsidy are those with the highest level of loan debt (including borrowing to support the ALMO programme).
- (ii) That under the existing regime the ODPM will lose revenue from all 6 authorities as a result of RTB sales. This ranges from £1,142 per opening unit to £2,253 per opening unit in the 6 case studies.

6.2.4 The above table gives a broad indication of the amount that would need to be paid to or received from an authority if the net revenue impact on the ODPM was to be broadly neutral (based on the current assumptions). If RTB sales are treated separately then the following case study authorities would be required to pay the following amounts to the ODPM to withdraw from the subsidy system:

Case Study	Total	Per Unit
B	£15.2m	£4,033
D	£2.8m	£194
F	£18.8m	£1,523

6.2.5 For the remaining case study authorities the ODPM would have to pay the following amounts as a capital sum to enable them to withdraw from the current system (and pay off part, or all, of their existing housing debt):

Case Study	Total	Per Unit
A	£122.7m	£9,713
C	£280.2m	£27,512
E	£84.9m	£4,228

6.2.6 If an authority paid less (Case Studies B, D and F) or received more (Case Studies A, C and E) the net revenue impact on the ODPM would be negative.

6.3 Loss of RTB Receipts

6.3.1 As highlighted above the ODPM currently compensates authorities through the subsidy system when it disposes of a property. In return the ODPM receives around 75% of the capital receipt from RTB sales (and occasionally other amounts from other sales).

6.3.2 If an authority withdrew from the existing subsidy regime it would need to retain part of that income in the HRA to offset the net loss of rent income and repay part of the loan debt. As highlighted in section 4.2, we have assumed, following initial consultation with the ODPM, that the capital receipt is shared between the HRA / ALMO and the General Fund. In the event that the ODPM wished to retain a share of the capital receipt this would require further analysis.

6.4 VAT & Corporation Tax

6.4.1 Under the current regime and under options 1 – 3 the VAT paid by the authority / ALMO to outside contractors would mainly be recoverable through the local authority's status as an exempt body.

6.4.2 In the event that the ALMO becomes the new landlord (i.e. equivalent to a Registered Social Landlord under existing legislation) its main income would be the rent, rather than a fee. It would therefore become liable for VAT on all supplies and services provided by outside contractors. We have assumed that the VAT costs would be reflected in full in the ALMO business plan and therefore in the payment made by the ODPM or received from the ALMO. The VAT payments would be received directly by Customs & Excise.

6.4.3 As indicated in section 4.1 we have assumed that Corporation Tax is negligible on the basis that the ALMO would seek to minimise any Corporation Tax liability (e.g. by seeking mutual / charitable status if appropriate). In the event that this becomes more significant this would also need to be reflected in the payment made to / received from the authority / ALMO.

7. Impact on HRA / ALMO / Council

7.1 Opening Debt (Stock Valuations)

7.1.1 The amount of opening debt that an authority / ALMO can afford to take on will depend on the different options and in particular its perceived level of investment need.

7.1.2 The results of our modelling show the impact for each case study and each option based on no sales (variation 1) and the proportion of the RTB receipts that it will be necessary to retain in the HRA based on annual sales of 1% of the opening annual stock (variation 2).

7.1.3 The results of RTB variation 1 (No sales) are summarised below. A positive amount represents the amount of the opening debt per unit that will need to be repaid and a negative amount represents the additional amount of debt per unit that the authority / ALMO could afford to take on.

Case Study	Current HRA Debt per unit	Options (debt to be repaid / added)				
		1A	1B	2	3	4
A	10,294	9,713	17,420	19,954	19,875	35,078
B	-530	-4,033	-795	0	795	6,359
C	23,267	27,512	31,416	32,496	32,888	41,135
D	8,440	-194	2,539	3,294	4,048	8,646
E	5,828	4,228	7,373	8,020	8,568	14,197
F	9,086	-1,523	1,055	1,704	2,920	7,058

7.1.4 This demonstrates that the amount of debt which would need to be repaid by the ODPM increases progressively with each option. Where the debt payment exceeds the current debt the balance is assumed to be made up by way of an up front capital grant. Option 1A reflects the minimum level of investment based on decent homes costs only and broadly reflects the baseline position for the ODPM (see section 6.2).

7.1.5 The actual debt repaid will need to be carefully assessed in order to reflect the average interest rate and the age of the debt portfolio in place at that time (including any early redemption penalties). This would be similar to the usual arrangements for redeeming overhanging debt on stock transfers.

7.2 Peak Debt

7.2.1 After the new arrangements are in place the authority will take on new borrowing to support its investment programme and will repay this from future rent income (in the same way as RSLs). We have calculated the peak new debt per unit for each case study and each option as follows (options 1 – 4 only):

Case Study	Peak Debt Per Unit				
	1A	1B	2	3	4
A	12,115	3,484	1,900	1,584	0
B	12,984	9,804	9,274	8,744	5,829
C	9,621	6,970	6,676	6,381	2,356
D	15,095	11,459	10,635	10,086	6,175
E	11,059	6,924	6,277	5,729	1,494
F	15,332	11,519	10,870	9,816	5,922

7.2.2 This indicates that the level of debt which can be afforded reduces progressively with each option. Case Study A will never be in debt balance in Option 4 as it will require a grant to be sustainable.

7.2.3 The year of the peak debt will also vary according to the case study and option. We have assessed these as follows:

Case Study	Year of Peak Debt				
	1A	1B	2	3	4
A	13	20	22	22	na
B	15	16	16	18	20
C	11	18	20	20	20
D	11	13	13	15	15
E	9	9	9	11	12
F	7	7	7	7	6

7.3 Sensitivity Tests

7.3.1 We have also carried out a couple of key sensitivity tests on the different options / case studies as follows:

- (i) Increase in interest rate of 1% above base assumption
- (ii) A 5% increase in major repairs costs throughout

7.3.2 These sensitivity tests are similar to those recommended by the Housing Corporation for RSLs. The results of the 2 tests are as follows:

Interest Rate at 1% above current rate

Case Study	Year of Debt Repayment				
	1A	1B	2	3	4
A	36	32	29	27	na
B	38	39	39	39	38
C	35	34	34	34	na
D	36	35	35	36	32
E	37	36	36	37	31
F	39	40	41	42	43

Major works costs increase by 5% throughout

Case Study	Year of Debt Repayment				
	1A	1B	2	3	4
A	45	51	never	never	never
B	39	42	43	47	never
C	37	38	39	42	48
D	33	34	34	35	38
E	34	37	37	39	54
F	35	36	37	38	48

7.4 Sharing of RTB sales receipts

7.4.1 Once the HRA is self-contained it will be necessary to retain part of any future RTB receipts to keep it sustainable. We have calculated the appropriate proportion of the receipt that will need to be retained as follows within the HRA :

Case Study	Receipts retained in HRA				
	1A	1B	2	3	4
A	9%	5%	5%	5%	0%
B	24%	22%	22%	19%	13%
C	9%	6%	5%	5%	0%
D	44%	39%	39%	37%	32%
E	85%	70%	69%	65%	51%
F	85%	73%	73%	69%	58%

7.4.2 This shows that the amount that the HRA requires in order to remain sustainable reduces with each option. In case studies A and C the ongoing operational costs under option 4 exceed the rent income and therefore no receipt is required. In practice the ALMO / authority might want to agree a range of figures based on different property sizes. The amounts retained might alternatively be calculated on absolute amounts (linked to inflation) rather than percentages. This would be in line with the usual practice for stock transfer sharing agreements.

7.5 Impact on Non-HRA (General Fund)

7.5.1 The main impact on the council will be on the capital resources it will have available to support non-HRA investment including new affordable housing (although as indicated above any surpluses could, under the new proposals, be directed towards new housing in the HRA).

7.5.2 As authorities currently have different policies on the use of these receipts and these policies can and do change over time – we have simply decided to show the net receipt which would be available for non-HRA spend. This can be summarised as follows (being the maximum which would be retained by the authority)

Case Study	Receipts retained in GF				
	1A	1B	2	3	4
A	91%	95%	95%	95%	100%
B	76%	78%	78%	81%	87%
C	91%	94%	95%	95%	100%
D	56%	61%	61%	63%	68%
E	15%	30%	31%	35%	49%
F	15%	27%	27%	31%	42%

7.5.3 Based on the assumptions in the models this broadly reflects the resources which could be directed to local authority General Funds in each case study. In the event that the ODPM seeks to recoup a proportion of the right to buy receipts this amount would be reduced.

7.5.4 Authorities will also have to consider the impact that repaying debt might have on its overall debt portfolio. As indicated in section 7.1 the debt repaid should also take account of any associated penalty costs on early redemption. In the event that this was not the case there could be a knock on impact on General Fund debt costs.

8. Conclusions

8.1 Key Findings

- 8.1.1 The research has shown the level of debt that will need to be repaid by the ODPM for each case study and under each of the options. We have set out in this report our key assumptions in undertaking this analysis – and the necessary accounting changes which would need to be considered.
- 8.1.2 We have shown in this report the amount that the authority / ALMO would be required to pay or debt to be written off in order to continue meeting the decent homes standard for each authority. We have also shown the position if the authority / ALMO wished to provide an enhanced works programme. In all cases it shows that, based on the given assumptions, there would need to be some additional debt paid off in order to make the HRA sustainable. In some cases, in some options, there would also need to be an up front capital grant.
- 8.1.3 We also assessed the economic impact on central government. If the properties are maintained at the decent homes standard the net revenue effect on the ODPM from withdrawing from the system will be broadly neutral.
- 8.1.4 It has been assumed throughout that the HRA would need to retain a proportion for RTB sales receipts in order to keep the HRA sustainable. The ODPM has indicated that the balance could be available to the council. On this basis the ODPM will make a revenue saving from any RTB sale but would no longer receive a proportion of the capital receipt.
- 8.1.5 A key factor in negotiation of these options with central government could therefore be the RTB sharing agreement. For some case studies RTB receipts could be shared between the ALMO, the local authority and central government. For others all of the receipts would be needed by the ALMO and local authority.

8.2 Next Steps

- 8.2.1 This report has been issued for inclusion as an Appendix to the main NFA / CIH / HouseMark report on the Financial Freedoms. Output from this study has been included in that research. The NFA / CIH / HouseMark report is aimed principally at the review of financial freedoms for ALMOs, being conducted by the ODPM.
- 8.2.2 Subject to the outcome of that review and the subsequent consultation paper we believe that the modelling approach proposed here provides a sound basis from which to calculate and progress the increased financial freedoms proposed by NFA/CIH/HouseMark for ALMOs and their sponsoring authorities.
- 8.2.3 In particular we believe that the model provides a useful starting point for managing financial aspects of the process. It also provides a formula to calculate the level of sustainable debt, the impact of withdrawing from the subsidy system and the share of capital receipts. We would be pleased to discuss how this financial model might be developed further in due course.

David Hall, TribalHCH, August 2005

ANNEX 5A

ASSUMPTIONS USED FOR SELF-CONTAINED HRA / ALMO BUSINESS PLAN

ANNEX A - ASSUMPTIONS USED FOR SELF-CONTAINED HRA / ALMO BUSINESS PLAN

	Option 1A	Option 1B	Option 2	Option 3	Option 4
Opening Stock	As at April 2004				
Sales – Option 1	No sales				
Sales – Option 2	1% of opening stock with existing sales growth assumptions	1% of opening stock with existing sales growth assumptions	1% of opening stock with existing sales growth assumptions	1% of opening stock with existing sales growth assumptions	1% of opening stock with existing sales growth assumptions
Demolitions	Per Current Business Plan only				
Inflation (RPI)	Assumed to be 2.5% per annum				
Target Rents	Assumed to increase by 1.5% above RPI until 2011/12 and 0.5% thereafter	Assumed to increase by 1.5% above RPI until 2011/12 and 0.5% thereafter	Assumed to increase by 1.5% above RPI until 2011/12 and 0.5% thereafter	Assumed to increase by 1.5% above RPI until 2011/12 and 0.5% thereafter	Assumed to increase by 1.5% above RPI until 2011/12 and 0.5% thereafter
Actual Rents	Converges with target by 2011/12 and 0.5% thereafter	Converges with target by 2011/12 and 0.5% thereafter	Converges with target by 2011/12 and 0.5% thereafter	Converges with target by 2011/12 and 0.5% thereafter	Converges with target by 2011/12 and 0.5% thereafter
Bad Debts / Voids	Per current Business Plan				
Other Income (eg service charges /garages etc)	Per current Business Plan				
Management Costs, Growth & Fixed / Variable Split	Per Current Business Plan	Per Current Business Plan	Per Current Business Plan + 5%	Per Current Business Plan + 5%	Per Current Business Plan + 5%
Responsive & Cyclical Repairs	Per Current Business Plan				

	Option 1A	Option 1B	Option 2	Option 3	Option 4
Major Repairs & Improvements	Based on Decent Homes Expenditure only	Based on Enhanced Programme of Works			
VAT	Assumed to be negligible	On 100% of repairs and 10% of Mgmt Costs			
Corporation Tax	Assumed to be negligible	Assumed to be negligible as org'n is converted to Charitable status			
Interest costs	Long term rate of 6.0% assumed	Long term rate of 6.0% assumed	Long term rate of 6.0% assumed	Long term rate of 7.0% assumed	Long term rate of 6.5% assumed
Debt repayment	Assumes debt repaid by year 30				
Accounting changes	New accounting arrangements for: <ul style="list-style-type: none"> • Depreciation • Balance Sheet • Surplus on Sales 	New accounting arrangements for: <ul style="list-style-type: none"> • Depreciation • Balance Sheet • Surplus on Sales 	New accounting arrangements for: <ul style="list-style-type: none"> • Depreciation • Balance Sheet • Surplus on Sales 	New accounting arrangements for: <ul style="list-style-type: none"> • Depreciation • Balance Sheet • Surplus on Sales 	New accounting arrangements for: <ul style="list-style-type: none"> • Depreciation • Balance Sheet • Surplus on Sales

Appendix 6

A risk assessment for the local authority – option 1

Risk	Likelihood [L=likely P=Possible U=Unlikely]	Likely causes	Activities to reduce risk	Effect	Comment
Inadequate capital expenditure to ensure sustainable communities	L in 1a [U in 1b]	Gov't control of expenditure	Raise income; lobby to allow 1b	Expenditure could be wasted	Needs reliable stock condition info and good analysis of wider action needed
Interest rates rise	L	UK economy	Treasury management	LA buffered by loan pooling	Little advantage in short term of fall in rates
Inflation rises	L	UK economy	Restrict wage increases to rent inflation	Rent restructuring allows increases above inflation	Building costs often rise above inflation – see next risk
Building cost inflation	L	Local economy	Procure with other LAs to reduce costs; review size of contracts and phasing of works programmes	May not be possible to deliver commitments to tenants in the original timescale	Good procurement practices essential
RTB sales lead to loss of income	P if RTBs include in HRA remodel U if RTBs in sharing agreement	Local economy	Marketing campaign to increase number of sales	Some capital expenditure will be dependent on RTB income	Most LAs/ALMOs likely to prefer sharing agreement approach
Fall in demand for rented housing	depends on location	Local economy	Assess alternative use; sell vacant poor quality houses and replace with more popular; consider demolition	Can threaten financial viability	Need to spot signs early and prepare action plan
Decline in ALMO performance	P	Could be management or local/ national economy	LA to watch PIs closely and understand changes; work with ALMO board to prepare action plan	Can lead to missing targets and need for more frequent inspections	Important for the LA to ensure the ALMO board responds quickly

Appendix 7

Control arrangements for mhs homes

Control	Frequency	Controlled by	Effect	Comments
mhs homes Rules	On creation Can be amended	FSA	Defines mhs homes as a social housing organisation; profits cannot be distributed.	Changes to fundamental rules need 75% of tenants agreeing
Transfer agreement with council	On transfer	Council	Ensures mhs homes has affordable rents, specifies standard form of tenancy agreement; and includes homelessness agreement	At transfer, consent under s133 of the Housing Act 1988 was given to the future sale of void properties in certain circumstances
Board meetings	Bimonthly	11 directors including 4 non-execs, 2 tenant reps and a staff rep	Responsible for mhs homes business plan and performance	The board would expect to control the organisation from day to day. Having four non-executive directors, one of whom is the chair, is also a control mechanism
Loan agreement	On refinancing	Lenders	Lenders have to agree any significant changes to the business plan	Lenders are a good control mechanism for tenants – they want the organisation to meet its business plan targets and to put a remedial action plan in place if any difficulties arise, to ensure that loan interest payments can be paid on time. If the remedial action plan does not tackle the problem, lenders can insist on other remedies such as bringing in new board members or sales of vacant properties. As last resort they have a step-in right to manage the organisation but they never want to exercise it
Performance monitoring returns to lenders	Quarterly	Lenders	Lenders ask questions if anything not conforming with business plan. Lenders ensuring that mhs homes can meet terms of loan agreement	Returns are signed off by mhs homes' auditors. If mhs homes were to have financial difficulties, the lenders would agree a remedial action plan with mhs homes' board – see above
Tenant satisfaction surveys	Annual	mhs homes board	Confirms (or otherwise) that staff are responsive to tenants' needs and that works are being done to a good standard	They ask for tenants' opinions of general service quality

Appendix 8

Key risks to the ALMO in option 3

Risk	Likelihood [L=likely P=Possible U=Unlikely]	Likely causes	Activities to reduce risk	Effect	Comment
Interest rates rise	L	UK economy	Treasury management	Depends on interest rate assumptions in remodelling of HRA	
Inflation rises	L	UK economy	Restrict wage increases to rent inflation	Rent restructuring allows increases above inflation	Building costs often rise above inflation – see next risk
Building cost inflation	L	Local economy	Procure with other LAs to reduce costs; review size of contracts and phasing of works programmes	May not be possible to deliver commitments to tenants in the original timescale	Good procurement practices essential
RTB sales lead to loss of income	P if RTBs include in HRA remodel U if RTBs in sharing agreement	Local economy	Marketing campaign to increase no of sales	Some capital expenditure will be dependent on RTB income	Most LAs/ALMOs likely to prefer sharing agreement approach
Fall in demand for rented housing - Risk to be shared with LA as with PFI	Depends on location	Local economy	Assess alternative use; sell vacant poor quality houses and replace with more popular; consider demolition	Can threaten financial viability	Need to spot signs early and prepare action plan
Decline in ALMO performance, eg on rent collection	P	Could be management or local/ national economy	Board to watch PIs closely and understand changes; prepare action plan	Can lead to missing targets and problems with lenders	Important for the board to respond quickly

Appendix 9

How will the proposals benefit local authorities with ALMOs?

The proposals set out a funding framework that will ensure long-term financial stability and security for local authorities, independent of decent homes funding. They will enable ALMOs to be effective delivery vehicles that will help achieve central and local government priorities and promote greater tenant involvement and control.

All the proposals depend on decoupling the HRA from the subsidy regime and remodelling the HRA with an affordable level of debt that would be financially self-sufficient based on rental income. A menu of options provides a potential continuum that councils could voluntarily opt into over time. The extent of the council's engagement would depend on local circumstances and on the council's confidence in the ALMO's capacity to deliver the council's objectives and in its own ability to manage the arms length role effectively through the management agreement.

The advantages gained from moving outside the subsidy system are:

- **Certainty** – moves away from an annual subsidy system and provides greater certainty for local authorities and ALMOs thereby enabling long-term business planning based on more predictable rental income stream.
- **Control** – although still subject to the rent restructuring regime local authorities and ALMOs would have greater control over their investment decisions, be able to take a more proactive view of asset management and develop a more commercial approach towards decision-making on capital and revenue.
- **Non-dependency** – moves away from the dependency culture created by the subsidy regime and enhances local accountability. Requires ALMOs and authorities to act in a more business like way. HRA debt would be reduced or increased to a level afforded by the business plan without recourse to subsidy.
- **Flexibility** – provides greater flexibility to switch funding priorities in accordance with local needs, such as retaining operating surpluses to fund new build or regeneration activities.
- **Debt repayment** – the outstanding HRA debt would be repaid at the end of the 30-year business plan period and the cost to the Exchequer would be cheaper than LSVT while delivering many of its advantages.
- **Performance incentive** – maintains link between performance and financial freedoms in line with ODPM's policy on good and excellent authorities and provides an incentive to achieve efficiency savings that can be used for local priorities.