
REPORT TO:	Council	AGENDA ITEM: 17
DATE OF MEETING:	9th April 2009	
REPORT FROM:	Director of Community Services	OPEN
MEMBERS' CONTACT POINT:	Bob Ledger (ext 5775)	DOC:
SUBJECT:	Stock Option Appraisal: A review of Housing Revenue Account viability as per Government guidance.	REF:
WARD(S) AFFECTED:	All	TERMS OF REFERENCE: HCS01, FM08

1. Recommendations

- 1.1 To approve the recommendation of the Stock Option and Appraisal Review Group (SOARG) namely that:

“Before taking the options appraisal process any further the SOARG (Stock Options Appraisal and Review Group) strongly urge the Council to consider the outcomes of the Government’s review into the Housing Subsidy system due to report in the Summer 2009 and the Council’s new Stock Condition Survey to be completed November 2009. However it is apparent that under the current financial regime the only option that safeguards the financial future, the service quality and the future welfare of both tenants and staff is to consider transfer to a Registered Social Landlord (RSL)”.

- 1.2 To note and accept the other elements of the report including the detailed work of lead and Independent Tenant Adviser consultants as appended to the report.
- 1.3 To instruct that a report be produced in the autumn of 2009 for Council’s consideration on the implications of the national HRA finance review outcomes and the new stock condition survey, along with any possible next steps in the stock option process.

2. Purposes of the Report

- 2.1 To seek approval for the recommendation produced by the Stock Option Appraisal and Review Group (SOARG) and confirm that further to that recommendation a further report be produced once the outcome of the national HRA finance review and the Council’s own stock condition survey are known.

3. Executive summary

- 3.1 The stock options process entails consideration of the choices available on how to best secure the future viability of the Housing landlord service in terms of finance, property investment and tenant aspirations.
- 3.2 South Derbyshire DC commenced the current stock options process at the October 2008 Housing and Community Services Committee and set up a group (Stock Options Review and Appraisal Group – SOARG) with tenant, staff and member representation to consider the process and make recommendation on any next step back to council. This is the report back.
- 3.3 The process has entailed in-depth tenant consultation through two telephone surveys, two newsletters, a written prepaid post reply survey and eleven drop in sessions. These were carried out by the Independent Tenant Adviser (TPAS – Tenant Participation Advisory Service). Lead consultants (Savills) were also engaged to report in the round on current tenant views, but also tenant aspirations, financial matters, stock investment requirements and future projections of Housing finance locally and nationally.
- 3.4 Having considered all these matters the SOARG makes a recommendation as per 1.1 above.

4. Background

- 4.1 Government has issued guidance that the issues and the viability of the Housing Revenue Account (HRA) should be kept under review.
- 4.2 In the light of this, in the October 2008 Committee cycle the Council decided to review HRA viability and revisit its stock options process. We last carried out a full stock option review in 2004. At that time Government required all stock retaining authorities to complete a stock option review/appraisal by July 2005.
- 4.3 The main driver for undertaking a stock options process at this time was financial. The Housing Service is well regarded by its peers, by its regulators and, most importantly, by its customers. It also provides a very low cost service (verified by the Audit Commission). The national Housing Finance system though requires the South Derbyshire HRA, to contribute 30% of its net rent income to government. It is this contribution which fundamentally affects the future viability of the HRA locally and according to lead consultants, Savills (their report is at appendix 1), on current projections means we will hit fundamental funding and maintenance issues as early as 2012.
- 4.4 To be meaningful and thorough the Stock Options process is involved and time consuming. Government Office and CLG (Communities and Local Government Department) have produced guidance on the approach to stock option appraisals which the group was required to follow.
- 4.5 It is important to emphasise that the decision to re-open the Stock Option Appraisal (SOA) process was not a decision to proceed with stock transfer nor a presumption that transfer was the likely conclusion. The October 2008 Committee report pointed

out that even if the recommendation from the SOARG was to pursue transfer that would then be subject to extensive consultation with tenants, a detailed evaluation of the financial situation including the anticipated net receipt and finally the formulation of a formal 'offer' to tenants. That 'offer' would be balloted on and transfer could not proceed without the majority of the tenants who vote, voting in favour.

- 4.6 As stated, the Stock Options Appraisal and Review Group (SOARG) was created by the October 2008 Housing and Community Services Committee which also established its remit and membership. There was to be equal representation of members, staff and tenants (3 each) with one observer (a tenant). Actual selection of representatives was done in an open way. Staff were asked to volunteer or nominate via meetings and e-mail, the leaders of the two political groups were asked to nominate councillors and South Derbyshire Tenants' Forum were asked to nominate the tenants. At its first meeting the group decided to allow the observer full participative rights in the group.
- 4.7 The Head of Housing in conjunction with the Corporate Management Team appointed Savills as lead consultants to assist in getting the SOARG, and process generally, up and running and then once established SOARG appointed the Independent Tenant Advisers (ITA) as TPAS (Tenant Participation Advisory Service). Each stock options process is required to have an ITA to act as a check and balance to information being given by the Council and its consultants.
- 4.8 The SOARG met formally nine times over the period November to mid-March 2009. It also visited another stock retained authority; two transfer Housing Associations (i.e. previously Council stock) and an ALMO (Arms Length Management Organisation). The process also included reading material in group members' own time. The time commitment was considerable (around 15-20 days per group member). The group also established its own quorate of 7 from 9 and no meetings or events had to be cancelled for lack of attendance. All members of the group contributed to debate.
- 4.9 There were four different models of looking at the future of the HRA business, all of which would be covered in a SOA. These are:
- stock retention;
 - transfer of the stock to a Housing Association;
 - Private Finance Initiative;
 - Arms Length Management Organisation (ALMO).
- 4.10 Whilst the stock retention and transfer options are better understood for the opportunities and constraints they bring the latter two are less well so. In simple terms both are centred around achieving the Government's Decent Homes Standard which is a basic level of property maintenance and condition that all social landlords are required to achieve by 2010. Both are essentially about accessing additional funds one directly from the Government (ALMO) and one from the private sector, via the Government.
- 4.11 For ALMOs the increased funds for investment are provided by government through additional borrowing supported through the subsidy system. There were a series of application rounds from 2002 to 2007 to become an ALMO and seek additional capital resources. In the October 2008 Committee report, it was reported that there was no current bidding round for ALMOs and in the period of the review it has become clear there are no imminent further application opportunities. Indeed a

number of ALMOs are now considering their position having gained and spent initial funding and are assessing through stock options processes whether to rejoin the Council or to move to the transfer model. In short therefore the ALMO option does not currently exist in meaningful terms in the South Derbyshire context. We could establish one outside of the Government process but without additional funding it would essentially be a rebranding and administrative process only. Although this may still be a productive and useful exercise for some authorities, as stated above, our Housing Service is well regarded and there would be no tangible benefit.

- 4.12 In the case of PFI, this provides a vehicle to generate more investment income from the private sector, money which ultimately has to be repaid with interest. The PFI option has been rarely used and where it has been, it has tended to be in large-scale regeneration projects e.g. where large numbers of properties are being knocked down and rebuilt and/or estates are being substantially 'remodelled'. These type of issues are not applicable to the South Derbyshire context as the housing stock is in reasonably good condition and there are no major housing regeneration issues. In the 2004 Stock Option Appraisal process, the PFI option was quickly rejected as not being applicable, as it has been in the recently completed process.
- 4.13 The question could be asked of why did the SOARG consider the ALMO and PFI options when they were assessed in 2004 as not being suitable and, if anything, they are less applicable to the local situation today. The answer is simply that Government guidance requires that we look at all four options but also it could have been that things had changed in the interim.
- 4.14 Therefore the current position with the ALMO and PFI options are that they still appear to offer no long term viable options and, therefore, the SOARG concluded that South Derbyshire's options are limited to retention or transfer to a housing association.
- 4.15 The tenant consultation process was entirely led and undertaken by the ITA, TPAS (Tenant Participation Advisory Service). Their report on the consultation process is attached at appendix 2. TPAS are a long-standing organisation (20+ years) specialising in detailed resident consultation work. They have undertaken the ITA role in stock options processes numerous times.
- 4.16 In coming to a view on what recommendation to make to the Council, i.e. retention or transfer of stock, the SOARG were assisted by the lead consultant, Savills, and the Independent Tenant Adviser, TPAS.

5. Lead consultant's report

- 5.1 Savills' report is attached at appendix 1. As lead consultants their report is a summary of the whole process. The detail of the financial position the Council's HRA faces is critical to the whole process.
- 5.2 The national HRA subsidy system is a way that the Government looks to redistribute money between the remaining stock retained authorities. It basically treats all the individual HRAs as one national account. Of the 206 authorities retaining stock in 2008/9, 50 were in positive subsidy and received money – 156 were in negative subsidy and contributed money. After taking account of the Major Repairs Allowance (a Government assessment of what we need to maintain the key functional

components of the stock) the Government last year (2008/9) took 30% of the South Derbyshire income i.e. 30p in the pound of everyone's Council rent went to Government which amounted to some £2.83m in the year. The contribution we are expected to make to the national pot is scheduled to increase year-on-year. It is this factor that is the most significant in planning for the future viability of our HRA and, even if all other commitments remained the same (with inflationary allowances) and subsidy rises as predicted, the account will go into the red within the next ten years. However our capital spend requirements are unlikely to remain at existing levels and, according to our own stock condition survey information, need to increase in the short-term (this point is drawn out in detail by Savills in charts at section 4.11 to 4.18 of their report at appendix 1).

- 5.3 The national HRA subsidy system has widely been accepted as being in need of reform since the early 1990's. The Audit Commission, a Government body, recommended the system for wholesale change in a 2005 report. A formal Government review was undertaken in 2006 reporting in 2007. The main outcome was the recommendation of a need to undertake a further review which is now underway and is due to report in 2009. There is a fundamental problem in any review that if Councils such as our own are allowed to keep more of their own income where are the replacement resources going to come from for those currently in positive subsidy? This problem is only likely to be further exacerbated by the current economic downturn. Should a revised scheme be proposed that favours Councils such as our own it will almost certainly have a transitional period over a number of years i.e. there is unlikely to be an immediate significant beneficial impact. However, at the time of writing we don't know what the Government is going to propose.
- 5.4 Savills report considers in detail the competing issues of the financial capacity of the Housing Revenue Account and it's ability to invest in the future condition of the stock. Savills identify that there is a fundamental problem with straight projections that assume rolling forward existing budgets in the short and medium term. Savills point out that our stock condition survey of 2002 assumes higher levels of investment will be needed in the next five years simply to standstill in terms of overall property investment. The best way of explaining this is that more components are estimated to fail or come to the end of their useful life in the next five years than in the last five.

5.5 Savills state:

".... in the early years after the survey was carried out the Council was spending more than it needed to maintain the stock and to invest in the future, hence the excellent progress that has been made towards meeting the Decent Homes standards.

However, in the current 5 year block, the balance switches the other way and in the future the swing is even more pronounced.This shows that although the Council can meet its capital requirements until around 2012, that there are substantial problems with meeting the investment needs of the survey after that date.....

The Council's Business Plan written in 2006 recognised that this problem would occur. It also recognised that the Decent Homes Standard, though achievable within the Government's timetable, would not meet the expectations of tenants who were looking for a higher standard.

Together, this illustrates that although the Council can manage to deliver the Decent Homes Standards, it will have difficulties in maintaining the necessary investment to keep the properties at that standard after around 2012 at best, and has no opportunity to deliver higher standards in the future”.

5.6 In terms of projecting the Housing Revenue Account forward therefore there will be a greater pull from property investment needs in the near future. The Council will have to choose whether to ignore this or utilise balances to support investment. If it uses balances it fundamentally brings forward the date when the HRA is projected to be in deficit.

5.7 There are limited opportunities to make savings in services or people in order to fund property investment. As Savills state: “The current position is that the Council has managed to keep its management costs very competitive and it would be very difficult for it to make savings from the current position without it having an effect on services”.

5.8 In terms of projecting the financial health of the housing business forward and building in property investment needs, Savills conclude:

- “Under the current rules, the forecasts demonstrate that the Council can maintain its current service provision until 2012
- This level of expenditure will not permit additional spending over and above that required to meet the investment profile set out in the Stock Condition Survey for meeting the Decent Homes Standards
- To meet the Capital investment for 2012, it would need to reduce its reserves further, because in 2012 there is an estimated additional £3.2m required for Decent Homes and the MRA is forecast to be just over £3m
- That for the 2012 budget, the Council would need to reduce its revenue expenditure
- That beyond 2012, the Council cannot afford its stock condition investment needs and that the revenue budget will not be able to bridge the gap”.

5.9 Savills go on to state:

“Our conclusions are very much in line with that of the SOARG, that to meet their objectives through stock retention under the current financial regime would be impossible, on current forecasts.

However, we are also of the view that the future changes that would be necessary to allow the Council to continue to retain the stock, meet its housing investment needs and continue to provide the service that it currently provides would be immense, and would require a significant shift in the HRA subsidy rules, to a position where the Council retained all its rental income. This would also need to be followed by a Stock Condition Survey that is no more expensive than current forecasts”.

6. Independent Tenant Adviser Report

6.1 The wider consultation with tenants through two telephone surveys, drop-in sessions and newsletters was undertaken by the ITA, TPAS (Tenant Participation Advisory Service), as directed by SOARG.

- 6.2 TPAS are one of the most established organisations fulfilling this role and were selected in a process of tender, shortlisting, presentation by the top three submissions to SOARG and then selection by SOARG.
- 6.3 In our stock options process, two newsletters were sent to all tenants one with a return survey form (prepaid envelopes were provided). 11 drop in sessions were held across the District and a sample of tenants were telephoned after each newsletter.
- 6.4 After newsletter one the telephone sampling was small scale and was focussed on ensuring that people had received the newsletter. 60 tenants were rung and 55 recalled seeing the newsletter. This first newsletter simply reintroduced the stock options concept and outlined the four options and their likely implications.
- 6.5 After newsletter two, 250 tenants were telephoned and were asked the same question as appeared on the hard copy questionnaire contained with newsletter two. Newsletter two indicated that PFI was not really a viable option, explained in detail about the medium and long-term financial problems with the local HRA, recapped on the options, advised of next steps and listed the most common questions arising in the process to that date alongwith the answers.
- 6.6 In response to the survey, included with newsletter two, 477 returns were received by TPAS.
- 6.7 Although there may have been some overlap between respondents to the telephone survey and the written survey, in total 727 (23% of tenancies) responses were received to the question seeking views on tenants' priorities for the future. In TPAS's experience this is a relatively high percentage participation figure for a stock options process. Stock Options processes are meant to be a 'test' of opinion rather than a full ballot i.e. at this stage it's a balance between cost and getting statistically valid results.
- 6.8 TPAS report on the consultation outcomes as follows:

"Consultation outcomes of survey work with around 25% of the wider council tenant and leaseholder population have identified 5 clear priority areas in the following order of importance:

- 1 Council continues to own the housing stock - *(55% stating as their top priority)*
- 2 Rents and service charges to be maintained at affordable levels – *(23% top priority)*
- 3 Council housing staff and trades persons to continue working with us - *(3% top priority)*
- 4 Home improvements to be more frequent and to a higher quality - *(7% top priority)*
- 5 Provide a wider range of services for older people - *(4% top priority)*

This combination of priorities presents a situation of the Council being unable to satisfy collective aspirations as identified by overall views of respondents taking part in the survey consultation elements of the process. However the current housing finance review may have an impact on this position and the planned new stock condition survey may also change current assumptions.

The investment required to meet the aspirations for a wider range and higher quality services and improvements is not achievable within current finance available and in addition to its current legal obligations in respect of other government policy.

TPAS views that this demonstrates need for further work at community level to raise awareness effectively and develop a broad understanding of the potential of different options to deliver across the range of aspirations.

TPAS Views and Recommendations:

TPAS would encourage the Council to consider the outcomes of the Government review in to the housing subsidy system due to report (Summer 2009) and the new stock condition survey to be completed (November 2009) before taking the options appraisal process any further.....”.

7. Impact of retention and transfer on the rest of the Council

- 7.1 Savills take a preliminary view that the net receipt to the Council of a stock transfer with current knowns, i.e. utilising current stock condition and financial data, the likely receipt to the Council of a stock transfer in 2 years time would be in the region of £20-£25m. As the stock options process is not about detailed work on a particular option e.g. stock transfer, but on the options available it is difficult to be more accurate at this time. Any receipt is also significantly affected by the ‘promises’ made to tenants on additional and improved services in any transfer document (i.e. the more promises made to tenants the more this will likely cost the new landlord and therefore the lower the receipt to the Council). The figure would also be significantly affected by the relative health of the HRA at the point of transfer i.e. there are currently £3m in HRA reserves, and the state of the financial markets in terms of the new landlord’s borrowing capacity.
- 7.2 In the event of a transfer of stock those staff working primarily on HRA issues would have TUPE rights and would transfer to the RSL. This is relatively straightforward process for those working wholly or primarily on HRA issues i.e. most Housing staff. However the detailed position for those staff in non-housing departments working partially on HRA issues or indeed those staff in Housing working on general fund issues (homelessness, housing advice, strategic housing) are less clear and again would need to be worked through in detail if the Council were to pursue transfer as a preferred option. Some non-housing staff would also have TUPE/transfer rights.
- 7.3 If the event of a stock transfer, it is likely though that costs currently met by the HRA would fall onto the General Fund. These mainly relate to the costs of central support services (Finance, HR, IT, etc), democratic and corporate costs such as office space, together with the costs of grass cutting. In addition, the General Fund would more than likely incur a further VAT liability. In total, these costs total approximately £850,000 per year. Some of these costs would be transferred and taken on by the RSL, although a proportion of the costs are fixed and will remain. Equally, though transfer could create spare capacity and capacity to work in new areas.
- 7.4 After a transfer has taken place, the HRA is wound-up. Any remaining reserve balance is passed across to the General Fund and can be utilised at the discretion of the Council.

- 7.5 As the Savills report highlights, there are significant implications for the Council in retention of stock. These primarily relate to HRA and landlord activities and focus on when the HRA will be exhausted of reserves and, therefore, no longer viable. However, as stated in section 5 of this report, the issue is more complex than that as current HRA projections assume investment in the stock at current levels for the next 10 years (the period of the current projection).
- 7.6 There will though be substantial shortfalls on the investment needed in the stock in the medium term under the retention option as the stock condition data we currently hold requires additional investment in the medium term just to keep pace with current standards i.e. more units and elements are predicted to reach the end of their working life in the next five years than the last five. Although the effect of this will be a gradual process, the shortfall will start to bite beyond 2012 and from then on tenants are likely to see deterioration in property standards/service. Any tenant disquiet or concern about this though is initially unlikely to be on a widespread scale as it will affect those not getting their kitchen renewal or heating system on schedule, as money will need to be directed more towards health and safety essentials.
- 7.7 As pressure mounts on the HRA to cut costs and direct resources to essentials, so there will be a knock-on pressure on the corporate costs currently charged in to the HRA.

8. SOARG Recommendation

- 8.1 Having considered all of the factors involved in the stock options process through a series of nine meetings, visits to four other organisations to assess their viability and having considered the outcome of the consultation process undertaken by the ITA and the work by the lead consultants on financial viability and investment opportunities, the SOARG make the recommendation at 8.2 below. They came to this view by clear majority.
- 8.2 “Before taking the options appraisal process any further the SOARG (Stock Options Appraisal and Review Group) strongly urge the Council to consider the outcomes of the Government’s review into the Housing Subsidy system due to report in the Summer 2009 and the Council’s new Stock Condition Survey to be completed November 2009. However it is apparent that under the current financial regime the only option that safeguards the financial future, the service quality and the future welfare of both tenants and staff is to consider transfer to a RSL”.

9. Financial Implications

- 9.1 There are no additional financial implications or costs at this time. A full report on the outcome of the national Housing Revenue Finance and the local stock condition survey will be reported in the autumn of 2009.
- 9.2 The findings of the lead consultants re the HRA financial position facing the Council are consistent with monitoring reports into the Committee process produced by the Head of Finance. In his report to the February 2009 cycle of meetings he stated:

“...all of this together continues to provide challenges for managing the HRA. However, unless inflation becomes historically high over a sustained period of years, it is still likely that at some stage the HRA will fall into yearly deficit that can quickly accelerate. If council

house sales at anytime in the future increase back to previous levels, this will also reduce projected income.

Although the short-term position continues to remain fairly sound, the longer-term viability of the HRA is still very much questionable. This is compounded by the uncertainties within the current funding system.

Previous reports to this Committee have highlighted a low cost base compared to other housing authorities, but with limited scope for additional investment. Infact, this current budget assumes a “standstill” position”.

10. Corporate Implications

10.1 Anything that moves from the status quo will have an impact on the Council. Under the current financial regime the status quo is not achievable in the medium to long term.

11. Community Implications

11.1 The report as a whole is essentially about making the best choice for the future management and maintenance of the housing stock based on the needs and aspirations our tenants.

11.2 As part of the option appraisal process, the Head of Housing consulted with other organisations working in the community including the Local Strategic Partnership (LSP), Council for Voluntary Service (CVS), Citizens Advice Bureau (CAB) and the Over 50's group.