South Derbyshire District Council

Housing Options Appraisal Review

Savills Housing Investment and Consultancy

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Section 1 - Executive summary

1.0 This report has been prepared following a decision by South Derbyshire District Council to undertake an options appraisal of the future of the housing stock within the District.

1.1 The appraisal followed an inclusive, consultative approach, involving tenants, members and staff. For consistency of approach it was agreed that the review should follow the Government guidelines issued previously under which the previous Options Appraisal had been completed.

1.2 The options available were identified as follows:

i) Stock retention
ii) Arms Length Management Organisation
iii) Private Finance Initiative
iv) Stock Transfer

1.3 The options were considered against criteria agreed by the options appraisal group which included officers, members and tenants. From the outset, the Group recognised that it was the financial position of each of the options that would be key to its final recommendations.

1.4 The Group considered each of the options and their financial benefits, against these criteria. They also considered the changes that the Council will be faced with irrespective of the choice that it makes.

1.5 The appraisal process involves a considerable amount of historic and current information. In particular, a key element of the information needs is the condition of the stock and the likely cost of bringing the stock up to a lettable condition and maintaining it as such for at least thirty years. The information used within this appraisal is a combination of a 2002 stock condition survey and assumptions surrounding inflation etc.

1.6 In its final considerations the Group were concerned that their thinking was being compromised by not being able to take into account the potential impacts of the HRA review and the forthcoming stock condition survey. Therefore as part of their final analysis they agreed to consider the position of the Council under the current financial regime and to look forward to what could be the position once the fuller picture is available.

Section 2 - Details of the brief and process

2.0 In October 2008, Savills were commissioned to work with South Derbyshire District Council to consider the options that were available to them, regarding the future of the housing stock.

2.1 The Options Appraisal had previously been carried out in 2004 when the Council's decision had been to retain the stock but with a commitment to revisit the options periodically as Government recommends. It was recognised that this commission was to update the previous appraisal that the Council had carried out in the light of a changing financial position. Regular meetings were held throughout the process. This approach was supported by the Government Office East Midlands who were consulted at the start of the review and kept informed of progress.

2.2 Savills were appointed to support the review process, ensuring that it complied with good practice guidelines produced by the Communities and Local Government office for stock options reviews. In line with that good practice and following the approach taken in 2004 the Council established a stock options appraisal review group (SOARG) made up of 3 tenants, 3 councillors, 3 members of staff and a tenant observer. The observer was given full participative status at the group's first meeting, a decision supported by all members of the Group. The SOARG were given terms of reference by the Council.

2.3 Savills brief was to support Group members to ensure that they were properly informed and able to carry out the review; act as facilitators for that Group throughout the Options Appraisal providing them with information, analysis and support. Members of the Savills team addressed SOARG meetings, with council representatives present, meeting on a regular basis to discuss progress of the options appraised and to agree criteria against which the options should be assessed.

2.4 An Independent Tenant Advisor (ITA) was appointed to the SOARG and that selection was made by the SOARG members. The ITA attended all meetings of the SOARG and conducted the consultation with the wider tenant population at the direction of the SOARG.

2.5 The SOARG met formally nine times over the period between November 2008 and March 2009. The Group considered the financial position of the Housing Revenue Account now and into the medium to long term; the external factors affecting the Housing Revenue Account such as the Government approach to subsidy and specifically negative subsidy; the condition of the housing stock and the possible future expenditure needed. This allows the position of the Authority in the future to be extrapolated, should the status quo apply. In addition the SOARG examined the characteristics of the different options, their applicability to and impact on the Council and the issues facing the housing stock. To assist the Group in better understanding the practical implications of the different options, study visits were made to four other organisations that had similar geographical and stock characteristics to those in South Derbyshire. Visits were made to an ALMO, two stock transfer organisations and a council who have retained their housing stock.

2.6 The SOARG considered the information it had received during the whole of the process and took account of the feedback from the wider consultation when assessing its views on the options to formulate its recommendation to the Council.

Section 3 – Environmental context

3.0 The options appraisal process has been carried out against a background of change within the world of Local Authority Housing finance. The vagaries of the subsidy system and its annual changes makes forecasting on a long term basis normally fraught with difficulties but the latest Government position makes this more so than ever.

3.1 This section seeks to provide some background on the previous position that the Council reached and describe the potential changes to the HRA system

Previous position

3.2 Until around 2001, Local Authorities were not expected to carry out a great deal of planning on the Housing Revenue Account (HRA) apart from the annual budget. The introduction of HRA Business Planning changed that approach, and the movement was towards a 30 year Business Plan. This was to ensure that long term sustainable plans were developed for the investment in, and the management and maintenance of, Council housing stock.

3.3 The Government also introduced Rent Restructuring and the Decent Homes Standard, both with long term dates to be achieved of 2012 and 2010 respectively. At the same time, many were carrying out detailed Stock Condition Surveys for the first time.

3.4 Subsequently, all Local Authorities were required to complete an Option Appraisal, closely involving their tenants, to determine which of the options were most appropriate to achieve Decent Homes.

3.5 In 2004 the Council, working with a review group, considered the options that the guidance suggested, namely:

i) Stock retention
ii) Arms Length Management Organisation
iii) The Private Finance Initiative
iv) Stock Transfer to a Registered Social Landlord

3.6 Following this process, Council Members decided that they wished to retain the ownership and management of the housing stock.

3.7 The challenges that the Council now faces include:

i) An increased loss of rental income back to Government through the HRA subsidy system that has increased from 19p in the £ in 2004 to 30p in the £ in 2008/9;
ii) Whilst the Decent Homes Standard will be met by 2010 and funds should be available to at least meet that standard in the short term, the profile of the housing stock and its investment needs suggests that in the medium term there would be insufficient funds to maintain that standard or to meet the changing aspirations of tenants;
iii) The scope for reducing costs within the Housing Service is very limited as the operation is currently low cost;

iv) Delivering sustainable communities, i.e. delivering more than bricks and mortar investment – creating thriving diverse communities where people choose to live
v) Meeting changing tenant needs and aspirations, i.e. responding to the increasing demand for socially rented property from a diverse range of potential tenants with increasing expectations
vi) Providing the right type and mix of housing, specifically, responding to changing demographics and an aging population
vii) Addressing the problems of affordability and access to the housing market

Future of the HRA system

3.8 In December 2007, Yvette Cooper (Government Minister of the day) announced a review of Housing Finance, to *"examine the case for more radical change to the redistributive subsidy system itself."*

3.9 The principles behind the review are that a sustainable long term system for financing Council housing should:

i) Be fair to both tenants and taxpayers
ii) Give a clear and accurate picture of the balance of support from central and local Government
iii) Enable the delivery of agreed standards of service and accommodation
iv) Provide incentives to landlords to improve the quality and efficiency of services
v) Be affordable

3.10 The scope of the review is wide-ranging and has been looking at:

i) greater devolution to Local Authorities compared to improving the centralised redistributive system we currently have
ii) comparison of the operation of RSLs in relation to LAs
iii) the management of debt in the system
iv) the use of capital receipts
v) rent policy which also impacts on RSLs

3.11 There is also said to be an emphasis on tenant empowerment and giving tenants more choice about how their rents and service charges are used to provide and prioritise services in their locality.

3.12 The review is expected to set out its initial ideas in April 2009 after which there will be a period of consultation. If proposals ultimately lead to a fundamental change in the HRA subsidy system they will require primary legislation which may or may not be able to be achieved before the latest date for the next general election in May 2010.

3.13 Additionally, there have been a series of pilots carried out with six Local Authorities to examine whether self financing of HRAs could be made to work. If implemented, then this would allow a small number of Authorities to "buy" themselves out of the subsidy system. The principles are as follows:

i) A one off settlement would be agreed between the Council and the Government based on a Net Present Value calculation of the Council's entitlement to subsidy over 30 years
ii) The Local Authority still has to ring fence the HRA but it receives no further subsidies and pays no further surpluses
iii) HRA dwellings remain subject to pooling

3.14 The pilots have recently reported back. Although not hugely successful, the findings suggest that it is not the concept of self financing that does not work, rather that the viability fails because of the current levels of subsidy and the assumptions used for the future. This has highlighted problems with the current system.

3.15 In recent years, the Government have also changed the rules on rent restructuring. Prior to this year's subsidy determination, the Government had introduced a cap on rent increases for Local Authorities. This meant that some Authorities lost out in income as the way that the subsidy system works assumed that their rents were higher than they were. This was then addressed using Rent Constraints Allowance, effectively a compensation payment to Authorities, but this was withdrawn.

3.16 Last year, Government recalculated the Guideline rent by extending the convergence date to 2016/17 and allowing Local Authorities to do the same in terms of target rents. However, this was a calculation for one year only.

3.17 The position changed again in this years determination, when Government originally set the guideline rent increase for 2009/10 to 6.2%, driven by the formula that uses the RPI figure in the previous September. In addition, they suggested that the following year would be in the region of 6.1%.

3.18 It also suggested that the first year's increase, because of the high inflation would push the convergence date out further again, although it was expecting lower inflation for September 2009, which would reduce the time to convergence once again.

3.19 This apparent anomaly is because it is the real increase (the difference between the increase and the inflation rate) that matters in terms of delivering convergence. If inflation is low in September 2009 as is expected then the real increase will be substantially higher than the real increase this year.

3.20 Effectively this meant that no one could be sure of when the convergence date would now be. This was complicated further when, on 6th March Government announced this figure would change to 3.1%. At the time of writing no details are available on how this process will work in terms of Government subsidy or recovery of the income lost to the HRA as a result of the reduced rent increase. The situation does however provide a clear and current example of the difficulties of planning local authority housing finances and being able to say with confidence that investment and service needs can be met.

Section 4 – Capital investment requirements

4.0 The Stock Condition Survey was undertaken by Property Tectonics, independent surveyors, with the completed report provided in August 2002, although the survey work was carried out by the end of May 2001. The survey was based on a stock holding of 3,621 properties and a sample of 1,000 properties were inspected internally, approximately a 27.6% sample, and 100% of externals. All costs are as at August 2002 and are exclusive of any fees, preliminaries, management and administration costs and VAT.

4.1 The sample size is seen as more than adequate for an appraisal process, and is significantly higher than we have found elsewhere. However, the time elapsed from the date of the survey is a concern and this is addressed later.

4.2 The report acknowledges that the Council's housing is generally in good condition. Only a small number of properties failed the Decent Homes Standard because of external components. Internally, the majority of dwellings benefited from central heating but generally the kitchens and bathrooms were often old and in poor condition. In respect of Decent Homes, 76% were classed as Decent Homes.

4.3 The headline figures from the survey were as follows:

- Total cost per property £23,600 over 30 years
- Total approximately £4.15m for first five years, therefore the average capital spend is £830k per year for first five years
- Total spend over 30 years - £85.5m

4.4 However, it must be remembered that these figures are some 7 years old and inflation needs to be taken into account to bring the costs up to present day prices. Using August 2002 to December 2008 and the Building Cost Information Service (BCIS) 'all in Tender Price Index' , commonly accepted as the best one for this calculation, the increase would be 43%. For the years between 2002 and 2008 the costs have therefore been increased proportionately.

4.5 Taking the same figures and bringing them up to today's date using the index would make the figures as follows:

- Total cost per property £33,438 per annum
- Average total c.£4.99m for first five years
- Average capital spend £1m per year for first five years
- Total spend over 30 years - £121m

Benchmarking

4.6 The table below shows a comparison between the stock condition results in South Derbyshire and three other similar Local Authorities. The unit numbers are as the date of the survey, for comparison purposes.

Date of survey	LA	Units	Total spend	Spend per unit
May-05	Harborough	2137	£69,835,239	£32,679
Apr-08	Blaby	2180	£82,663,816	£37,919
Feb-05	North Shropshire	2358	£100,718,510	£42,714
Aug-02	SDDC	3621	£85,541,020	£23,624
Inflated to Dec 08	SDDC	3621	£121,082,506	£33,438

4.7 Both Harborough and Blaby were confident of achieving the Decent Homes standards within the timetable and this is reflected within their figures. The table shows that the average unit spend for SDDC is low when compared with the others, even using the inflated levels.

4.8 Once the reduction in stock numbers to 3,100 is made in 2008, the total spend over the whole 30 years at current prices is £104m.

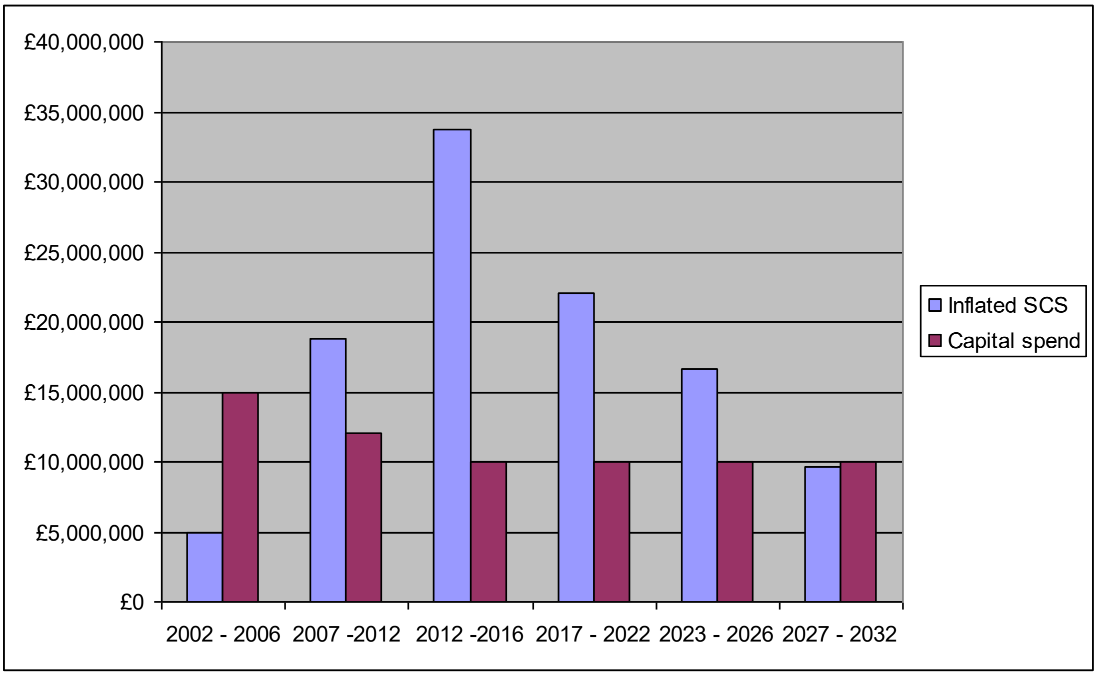
Meeting the costs

4.9 Often the key problem for an Authority is not simply the total costs but is the spread of costs. Most Local Authorities went through patches of building over a considerable amount of time, with the most properties being built when there was financial encouragement from Central Government. This means that the property age is unevenly spread.

4.10 It is sometimes possible to spread the expenditure profile across a number of years. This is particularly the case when dealing with programmed repairs of, for example, roofing. This is extremely important when there are significant expenditure years, when, for a number of factors, it is not desirable to have significant peaks and troughs.

4.11 However, it is not always possible to bring spending forward, particularly when budgets are tight anyway, which normally means expenditure being pushed back, meaning that the number of properties becoming non-decent would increase, unless these works were prioritised. However, to demonstrate how this could work, we have pulled together the investment needs into 5 year bands, based on the inflated figures, to avoid the significant annual peaks that currently exist in the survey.

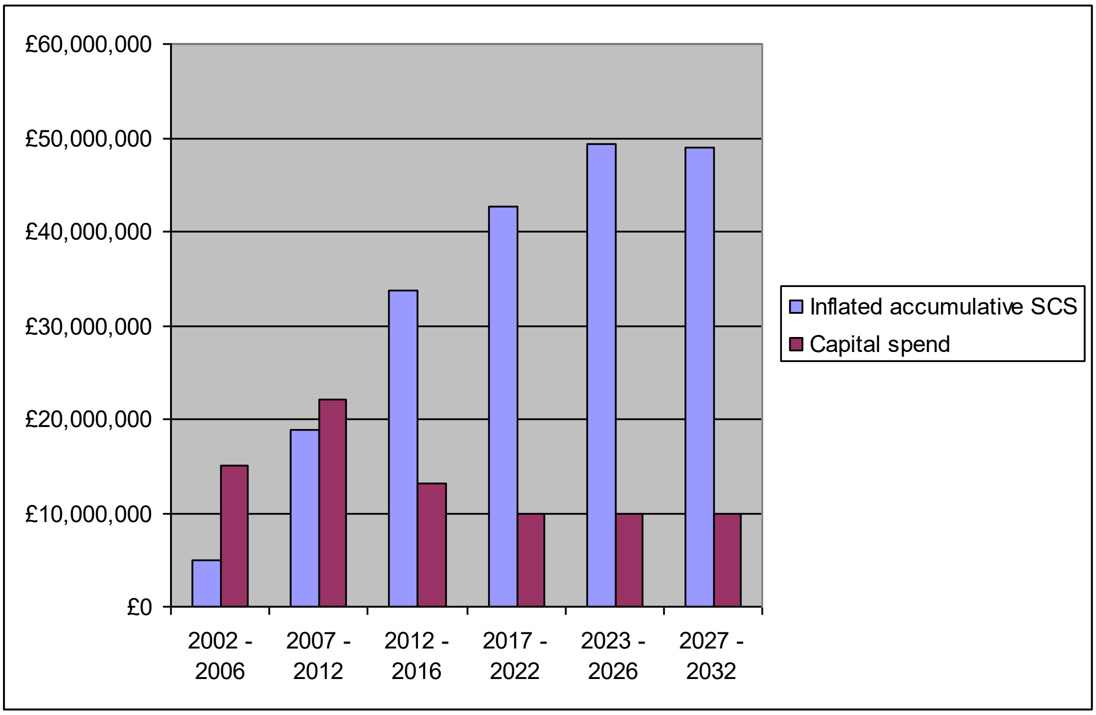
4.12 Alongside the expenditure profiles we have shown the likely capital spend that the Council will have available, based on the Major Repairs Allowance of around £2m per year. However, for the years from 2002 until this year, we have allowed an expenditure of £3m per year as this is more in line with the amounts that the Council has been able to spend, where it has been able to increase its capital expenditure by using revenue contributions.



4.13 The graph shows that 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.

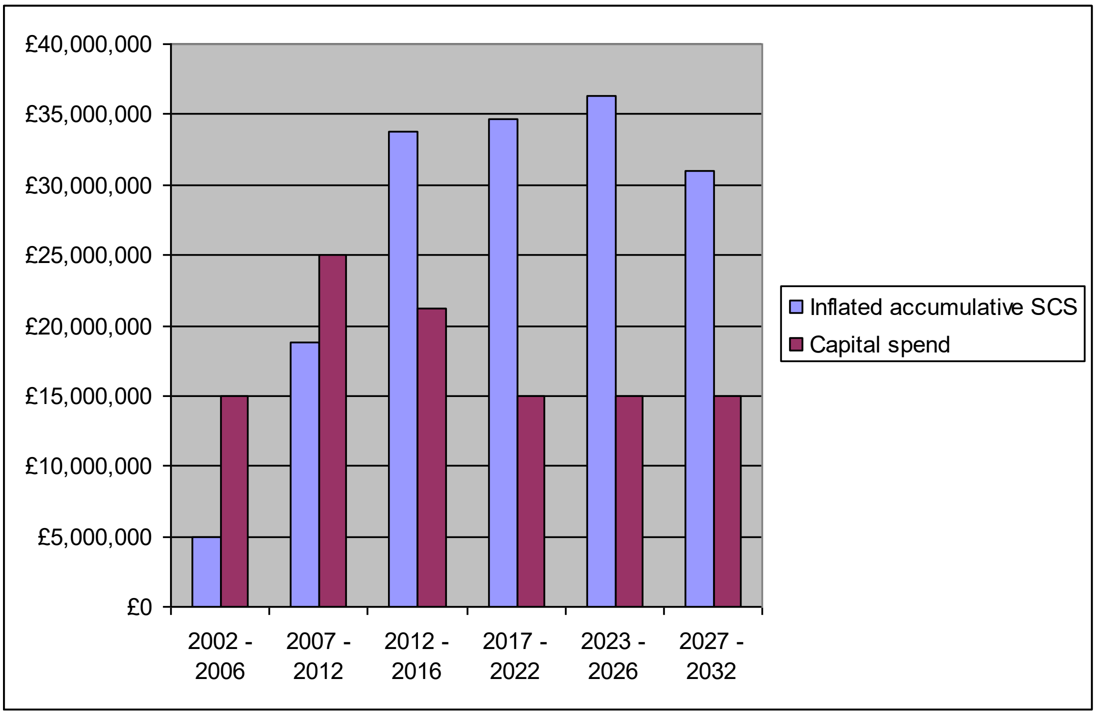
4.14 However, in the current 5 year block, the balance switches the other way and in the future the swing is even more pronounced. All the figures are shown in 2008 prices and assumes that the MRA will increase in line with inflation.

4.15 The graph below shows what the accumulated position would be. Here it takes any surplus from the first five years and adds it in as spend to the next five years. However, it also takes any failure to spend and adds it to the next five years.



4.16 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.

4.17 Even if the Council were able to continue to invest at £3m a year, assuming that MRA continues and they were able to fund the rest from revenue savings, the position is still short of perfect, and is shown below.



4.18 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.

4.19 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.

4.20 It has been suggested that in those years where the available spend is greater than the identified costs that progress could be made towards a higher standard. Our view would be that this would be a poor use of any additional resources available and that this would be better spent in bringing forward key component work that falls in later years and which would prevent properties from not meeting the decency standard in the future.

Section 5 - The Housing Revenue Account

5.0 The previous section concentrated on the capital resources and demands This section deals with the other side of the equation, what is the forecast revenue position going forward. This is important for two reasons:

i) A healthy revenue position could be used to supplement any deficit in capital expenditure

ii) The revenue position has to stay legally in balance and if the income is not at least as great as the expenditure then the expenditure must be reduced, except where there are sufficient reserves to cover the imbalance

5.2 The business of housing is actually quite straightforward. Very few businesses can accurately predict what their long term income would be (rents) and how it will increase (the convergence model). Expenditure tends not to vary considerably year on year. Having said that, given how straightforward it is, forecasting the revenue position in the long term is still difficult to do accurately as the Government adjusts the rules, calculations and assumptions regularly.

The HRA Business Plan

5.3 Long term (30 year) HRA Business Plans have been prepared by Local Authorities since around 2002. SDDC last had a Business Plan prepared in 2005 and signed off by Government in January 2006.

5.4 At that point, the assumptions used for the Business Plan suggested that, without making the necessary changes, that the Council's revenue position would deteriorate to an unsustainable position in year 2014/15, when the reserve balance would be around £500,000, the figure which has been set as a prudent safety position. Auditors expect Local Authorities to have a sufficient enough contingency to be able to manage their key risks and this is a reasonable position for the Authority to adopt given its size.

5.5 There are many assumptions that go into the Business Plan, such as inflation rates, interest rates, levels of expenditure, etc. These are detailed as part of the plan and, having reviewed them, we are satisfied that they accurately reflected the position at the time.

5.6 The Council is no longer expected to have a 30 year Business Plan that has to be signed off by Government Office. Instead, most Council's have moved to a mid-term range for financial planning, concentrating on a 5-10 year plan.

Housing Subsidy

5.7 The core of the housing subsidy system was developed in 1989 for the first year of implementation in 1990/91 as a product of the Local Government and Housing Act. There have been two amendments of the primary legislation - in 1996 and 2003. In addition there have been annual amendments issued in February of each year.

5.8 Under the Housing Revenue Account subsidy regime a local authority's (LA) spending power is primarily determined by the allowances it receives for management and maintenance (M&M), major repairs, and interest cover for borrowing for capital investment. The Major Repairs Allowance (MRA) was introduced in 2001 to increase resources available to local authorities and is based on the estimated long-term average amount of capital spending required to maintain a local authority's housing stock in its current condition.

5.9 The allowances for management and maintenance and major repairs are all determined by formulae which reflect factors such as the different costs associated with different building types, the differential costs associated with levels of deprivation, levels of crime and the geographic difference in building costs.

5.10 The theory is that Government provides subsidy to those who need it. To calculate the level at which subsidy is provided, the Government uses "notional" figures to estimate how much a Council should spend on managing and maintaining its stock. It then takes this figure away from the rental income that it thinks the Authority should be getting.

5.11 There are some other adjustments for such items as interest, leases, other allowances, etc. but the methodology above is primarily how it works. Where a Council is judged to be receiving less rent than it takes to manage and maintain the stock, then the Government provides a subsidy to balance this out.

5.12 However, where the Government calculations suggest that the rents are higher then the notional expenditure then the Council has to pay the balance to the Government, irrespective of its actual spend. This has commonly become known as "negative subsidy" and, it has been argued, can be seen as a "tax" on rents.

5.13 The position in South Derbyshire was that in 2005/06, when the Business Plan was reviewed, the Council paid just over £2m back to Government. In 2007/08 they paid in the region of £2.41m back to Government (around 28% of the rents) and in 08/09 that figure has risen to £2.83m (around 30%). Our calculations suggest that this will be just less than £3m in 2009/10, up to around 31% and this is in line with the Council's calculations.

5.14 It is difficult to forecast forward what will continue to happen to Housing Subsidy levels, in normal circumstances, as the calculation each year depends on changes made to the notional management and maintenance elements of the subsidy calculation. At the present time, this is even more difficult given that there is a review going on.

5.15 The Council's own estimates of their negative subsidy, which we believe are an accurate reflection of the position, given the current uncertainties, indicate that this will continue to increase by 12% in 2010/11, and around 6% in subsequent years, until under the current system, by April 2011, one third of all tenants' rents will be returned to Government through negative subsidy.

The medium term revenue position

5.16 The Council's medium term revenue plan has been examined and the assumptions within it have been tested. As with any predictive model, it is the assumptions that are used for such items as inflation, management costs, future investments etc., which determine the outcomes. These can only be estimated, and the role of the examination is to see whether reasonable assumptions have been made, and then to test them for "sensitivity".

5.17 Sensitivity analysis allows us to say "what if..." so, for example, if Build Cost inflation turned out to be 1% higher than anticipated, what the effect would be. This shows how sensitive the Council's plan might be to certain assumptions changing and demonstrates the risk element of the calculations.

5.18 The current Council projections use assumptions in line with what we would expect to see and take a reasonably prudent view of the foreseeable future. This shows that under these assumptions, which are based on a "more of the same" approach, that the Council's HRA is unlikely to fall into significant deficit until 2012.

5.19 There are two assumptions that we do not altogether agree with. The first assumption is simply on rents where there is a larger than average increase in 2013 and a smaller one in 2014, however smoothing these two, again does not have a significant impact overall, and is after the initial deficit date.

5.20 The second assumption is that the Supporting People grant received by the Council will continue to increase by 2% a year. Our experience elsewhere suggests that this may not be the case and most Landlords are assuming a no growth position for SP grant. This makes the situation slightly worse, enough to put the budget for 2011/12 further into deficit. This forecast however, still leaves the Council with a significant reserve.

5.21 However, simply changing one assumption, the annual increase on housing repairs spend, from 4.5% to 5.5% would put the Council into deficit a year earlier and would wipe out all reserves by 2016.

5.22 The above shows that although the Council's current position indicates a relatively positive outlook in the short term, variations to projections can cause difficulties in both the short and long term.

Financing the capital programme

5.23 The required capital investment, according to the Stock Condition Survey and as demonstrated in the previous section, can be met until 2012, at which point the forward spending that the Council have been able to do, is exhausted, and there will need to be an additional £3m per annum spent on top of that available through the Major Repairs Allowance.

5.24 The current revenue projections show that at 2012, the Council's HRA reserves will be around £3m. This means that there will be insufficient revenue funds to be able to deliver the necessary capital investment from 2012 on. This is the same point at which we believe that without fundamental changes, the revenue stream would go into significant deficit, inhibiting any contribution from the revenue stream to be directed to increasing capital investment.

5.25 This would also mean that any Prudential Borrowing is unlikely as there would not be sufficient revenue resources to be able to meet the necessary annual payments.

Conclusions

5.26 Firstly, it is worth saying that the fact that the forecasts show that the HRA would be in deficit, does not mean that we are saying that the Council's housing account would be bankrupt. The reality for the Council is that they have to balance this budget.

5.27 What it does mean is that the Council would not be able to provide any revenue contribution to the capital investment needed in the way that it has been doing, and it would have to make real reductions to its repairs spending or its management costs.

5.28 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. Similarly, any reduction to the responsive, cyclical and void expenditures would also impact on tenants.

5.29 We would therefore sum up our conclusions as follows:

- 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

Section 6 - Analysing the options

6.0 During the initial stages of the appraisal, the Steering Group took the view that the financial position of the Council and the difference that the options could make, would be the predominant factor in influencing their decision making process.

6.1 Having assessed the difference that ALMO and PFI could make, it was clear that neither would provide any greater investment into the stock than the Council could.

6.2 In the case of the ALMO, it was explained that there was no longer additional resources available for Local Authorities to bid for in the event of wanting to establish an ALMO. Although some of the other potential advantages of the ALMO were discussed, and a visit was undertaken, at its penultimate meeting the Group decided that the ALMO route would not strengthen the financial position and was therefore rejected as a suitable option.

6.3 Similarly, although no visit was undertaken as no Authority has established a whole stock PFI, the Group again could see no real financial advantage from a PFI contract and recognised that there would be considerable risks and costs in achieving this. Therefore it was also agreed approximately halfway through the process that this would be rejected as an option before the final recommendation was reached.

6.4 This left the Council retaining the stock and a stock transfer as the two options available.

Valuing the stock transfer

6.5 As part of any assessment of the stock transfer process, the Council can develop a valuation of its stock using the methodology laid down by the Department for Communities and Local Government, utilising the Single Transfer Model supplied by the DCLG.

6.6 The Single Transfer Model is actually two models, the Cost Generation Model, that sets out what works are required to the properties and the pricing model that incorporates the income figures and other costs. The final valuation figure is calculated within the pricing model. It subtracts the expenditure from the costs for each year of the 30 year model, before discounting the values back to present day prices, and adding them altogether.

6.7 The model is both an art and a science, with the final valuation identified through a series of assumptions, and changes to those assumptions will alter the final valuation.

6.8 Although there are a number of assumptions, the key factors that really make a difference are:

- Rental income
- Capital investment
- Inflation assumptions

- Discount rate
- Management costs

6.9 Given the timing of the appraisal, an accurate picture of the potential transfer value is extremely difficult. This is because:

i) The changes to the rent convergence system are making it impossible to accurately determine what the rental income stream is likely to be
ii) The Stock Condition Survey will not be available until later this year

6.10 Therefore any value given to the stock must be caveated by the fact that the accuracy of two of the key components in the valuation are not as accurate as they should be for an exercise of this type.

6.11 Nevertheless, it is important that the Group are aware of the potential transfer price range that the Council may receive. To be able to calculate what the value would be, the following assumptions have been made to the works costs:

- All of the Stock Condition Survey costs have been included as set out in the survey including the environmental improvements and inflated as set out in the section above
- VAT has been added at 17.5%, except for cyclical, responsive and voids, where some of the work would be carried out by an internal team and this has been set at 8%
- Fees have been added at 8% and Preliminaries at 9%

6.12 Other assumptions have been made as follows:

- Rents to converge in 2016 with average annual increases until then and 0.5% real after
- Management costs at £700 per unit per year with 0.5% annual real increase
- A discount rate of 7.0% has been applied
- No miscellaneous income has been included
- Voids and bad debts are at 2%

6.13 The assumptions as set out above would deliver a positive capital receipt that would be in the range of £20m to £25m. However, these assumptions are fairly broadly based and even within that range there is significant room for movement. The value does not include any additional works required to bring the properties up to any higher standards.

6.14 Any valuation during an options appraisal process should be treated with caution as there still remain a series of decisions that have to be made before a final figure can be reached.

Sensitivities

6.15 The following sensitivities were undertaken using the above assumptions as the baseline. In each case the sensitivity is applied and then reset to the baseline before the next sensitivity is applied. We have used £22.5m as the starting point for these calculations.

Potential change	Change	New valuation
Base start		£22.5m
Reduce fees by 1%	+£0.5m	£23.0m
Reduce management costs to £650 per unit	+£2.0m	£24.5m
Increase management costs by 1.0% real	-£1.5m	£21.0m
Reduce survey costs by 5%	+£2.3m	£24.8m
Increase survey costs by 5%	-2.3m	£20.2m

6.16 The above demonstrates that a positive value viable financial transfer could be demonstrated that would meet both revenue and capital requirements for the Association, but would naturally be subject to a ballot of tenants.

6.17 This should not be seen as simply providing more than a £20m financial boost to the council. From that sum the Council will need to:

i) Meet its set up costs
ii) Pay any pension deficit
iii) Pay off any attributable housing debt
iv) Pay any Government levy that will be due (currently 20% of the net position, taking into account set up costs and attributable debt)

6.18 However, we understand that the Council is in a notional debt free position. Therefore any loans that are repaid would have a beneficial effect on the General Fund. The appropriateness and the timing of any repayment, is, however, outside the scope of this appraisal.

6.19 As set out in the initial stages of the report, the objective of the appraisal was to establish the extent to which each of the analysed options could deliver the aspirations of the Council and its tenants.

6.20 Key to that process was a session with the members of the Steering Group, attended by the Tenant Independent Adviser, where the findings set out above were presented and debated against the analysed options.

6.21 However, it is important that the judgement as to the extent which the different options could deliver the aspirations was not simply a consultant's view and the tenants were asked to contribute in a feedback session, where both options were considered against each criteria.

6.22 This analysis was complicated, however, by the concerns of the Group, who considered that two key factors were not determined at this point in time, namely the outcome of the HRA review and the completion of an updated Stock Condition Survey.

6.23 Therefore it was agreed to discuss firstly, to what extent the different criteria could be achieved under the current position and knowledge and also to explore what might be achieved, depending on the outcome of the review and the stock survey.

6.24 Each of the criteria was "scored" in terms of the extent to which it could be achieved. The following symbols were used in the scoring and the final chart has been replicated at Appendix 1:

Symbol	Explanation
✓+	Potentially could exceed expectations and provide a greater benefit than the Group had originally envisaged
✓	Fully meets expectations and will deliver the key objective set by the Group
✓-	Contributes significantly to expectations but does not fully meet everything that the Group had originally intended
✗+	Will partially meet expectations but at a lower than acceptable level when compared to what the Group's aspirations were
✗	Fails to meet expectations in that it cannot deliver any of the Group's objectives in this criteria

6.25 Appendix 1 shows the findings of the Group. The assumptions regarding both the HRA review and the Stock Condition Survey was that they could both deliver problems and benefits, and it was recognised that there was uncertainty in what they could achieve.

6.26 After considering the options fully, the Group reiterated their concerns over the review and the forthcoming survey and agreed to make the following recommendation:

"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"

6.27 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.

6.28 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.

Appendix 1 – Assessment of the agreed objectives

For the retention position, the first column reflects the current rules, whereas the second column takes into account potential benefits from the results of the HRA review process and assumes that the Stock Condition Survey may show an investment need less than is currently forecast. A similar assessment was made for the Transfer option, but as is seen below these were assumed not to have any impact on the assessment.

Assessment Matrix

		Retention		Transfer	
	Standard to be achieved	**Current rules**	**Post review and survey**	**Current rules**	**Post review and survey**
1	Maintains the financial viability of the Council	✗	✓	✓	✓
2	Provides services that are accountable and responsive to advocacy	✓	✓	✓	✓
3	Protects tenants rights	✓	✓	✓-	✓-
4	Increases the opportunity for tenants to be involved in decision making	✗	✗	✓-	✓-
5	Maintains rents and charges at an acceptable level	✓	✗	✓	✓
6	Increases the provision of new homes for affordable rent	✗	✓-	✓	✓
7	Maximises resources for investment in homes above the decent homes standard and in the environment, security and community services to improve quality of life	✗	✓	✓	✓
8	Provides opportunities to increase the availability of new and existing services, particularly to the elderly and disabled	✗	✓	✓	✓
9	At least maintains the status quo in terms of service quality and provides the best opportunity to increase quality	✓-	✓	✓	✓
10	Provides the best opportunities for staff	✓	✓	✓	✓