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Finance and Housing Stock Options Appraisal

Prepared for: Southwark Council



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1. Executive Summary

1.1. Introduction

The Council has ambitions to improve its services and the quality of its homes beyond current levels. It faces significant challenges with a legacy of housing which is reaching the end of its life and is expensive to repair and costly to maintain and replace.

Following the Housing Commission report in 2012 the Council is conducting an extensive programme of resident engagement to consider the future of council housing in Southwark. At the same time it has commissioned Savills to carry out a finance and housing options appraisal. The scope of Savills work has included a review of the base line position of the housing business plan, and an analysis of options to improve investment in homes and services.

It should be stressed that the findings in this report present an initial view, following a relatively high level assessment. Further work is needed to refine the position and this is set out in the conclusion to the report.

1.2. Developing a robust information base for decisions

A critical element of the housing business plan is the information available on the future investment needs of the stock. Savills has reviewed the information available to the Council held in its asset management data base, alongside information from other sources within the Council in order to prepare a comprehensive assessment of future investment need. This indicates a requirement for an estimated £58k per tenanted property over the next 30 years – a total of some £2.1bn.

More work is required to refine these estimates to ensure that a deliverable programme is established which represents a value for money approach to maintaining existing assets and Savills' review makes recommendations about the steps required to develop this.

Savills has also reviewed the revenue costs in the current business plan. Day to day management and maintenance costs compare favourably with the Department for Communities and Local Government (CLG)'s previous assessment of reasonable costs for Southwark. They reflect significant savings already delivered to prepare for Housing Revenue Account (HRA) self financing.

The review indicates areas where the revenue position could be refined over time, including increases in income from a self funded garage improvement plan as well as potential savings from local management. Additional allowances are included in the plan to manage the impact of welfare reform and these will also need to be refined over time as the impact of these changes materialises.

1.3. Baseline HRA business plan

All income and expenditure and key assumptions that drive the Council's housing landlord business have been brought together into a single comprehensive financial model that can be

used to project the future resources, investment and borrowing requirement over time, and to test different scenarios and future options.

The baseline plan includes the capital expenditure in the current business plan to deliver Warm, Dry, Safe. Under this scenario the plan indicates significant financial capacity, with additional borrowing capacity of £126m before reaching the cap on borrowing allowed by Communities and Local Government (CLG) as well as significant revenue resources building up in the longer term.

The position changes once the full investment needs of the stock are considered, as well as revised estimates for the impact of welfare reform. Under this scenario, borrowing is increased as necessary to meet investment needs. While an increase in borrowing would be required, this is still affordable within the long term plan.

This demonstrates that an increased programme of investment is possible within resources available to the Council subject to:

- Sensitivity analysis to test the impact of risks
- Demonstration of the value for money of investment at this level at a local level
- Deliverability of larger capital programme

In order to test the strength of the plan to withstand future risk the report has explored the impact of reduced income and increased costs that could materialise for a range of different reasons. While the business plan can withstand a level of risk, for example where future capital receipts are less than anticipated, there is a point at which reduced income and increased expenditure mean that the plan is no longer deliverable within the debt cap, and ultimately not affordable in the long term.

This demonstrates the need for the Council to make choices between the level of investment delivered and the amount of income generated from rents and capital receipts. The Council will also need to understand the impact on leaseholders of any increased capital programme and explore options to manage the affordability of service charge bills.

The housing stock is not uniform and in reality the business plan cashflows will vary across the borough, with some assets creating surpluses and others making losses. Given the legacy of housing in Southwark that is now reaching the end of its life, it is important for the borough to understand the cashflows associated with different assets in order to provide an objective basis for future decision making.

The Housing Commission made the point that in Southwark “good money is being wasted on treating the symptoms of building failure, rather than tackling the root causes”. The development of an active policy of managing housing assets which challenges the value for money of each investment decision, based on an analysis of both the value of future cashflows, and the extent to which investment meets the Council's social housing objectives could improve long term business plan capacity and resident satisfaction.

The analysis of the social return on investment needs to include more than a purely financial analysis. The financial results need to be considered alongside an assessment of other sustainability factors linked to the Council's social housing objectives. There will be different strategies for business improvement depending on whether an asset group exhibits weak values, weak sustainability or both.

A high level analysis of rental income and capital expenditure associated with assets across the borough shows that 27% of long term stock has a combination of higher than average capital expenditure and lower than average rents. Medium and high rise flats are over represented in

this group. Geographical concentrations of these properties are found in Borough and Bankside, Camberwell and Walworth. This is based on information currently available to the Council, which represents surveys of close to 30% of the stock. A more detailed analysis to model cashflows at a very local level would identify pockets of poorly performing properties that will exist in these areas and elsewhere and local options appraisals, in consultation with residents, may identify better outcomes for these properties, and for their residents, that could be delivered through alternative strategies.

1.4. Future options

The modelling of the baseline HRA position shows that retention of the existing housing stock is a viable option for the Council to consider, subject to the management of future risks, and effective asset management to tackle the legacy of housing that may require regeneration and renewal.

This report also looks at alternative options for the stock including

- Exploring the Housing Commission scenarios for stock reduction to 20,000 units and stock increase to maintain 39,000 over the life of the plan.
- Whole and partial stock transfer
- Whole scale PFI

Finally this section explores options for maximising opportunities under retention including exploring local management arrangements, for example tenant management organisations, arm's length management organisations and partnerships with external providers.

1.4.1. Stock reduction

The impact of stock reduction is difficult to test with any certainty due to the inability to predict with accuracy the rate at which the Council would be able to reduce costs as stock numbers reduce. In reality it is likely to be a significant challenge to reduce all costs pro rata in line with stock reductions. Therefore any benefits of stock reduction (e.g. from capital receipts) would be needed to manage the financial impact of stock loss, delivering limited additional value, if any, to the overall financial position. In addition a net loss in social housing would leave many in the borough without the affordable home they need, and have financial implications for the Council in terms of the increased cost of homelessness.

These assumptions can only be illustrative at this stage, and in any event, the case for stock reduction on any scale is not evident. In reality the initial view is that the HRA business plan is robust enough to allow for an increased investment programme under retention. Community led initiatives may lead to small scale transfers in future, where there is a clear rationale for the disposal, and where the impact on both the HRA and the General Fund can be managed more effectively. There is no obvious financial case to drive larger scale stock reduction and the financial benefits of this to the HRA business plan are unclear in the short term and may be negative longer term.

Stock reduction will happen, as a result of Right to Buy sales. A strategic approach to managing any further stock reductions based on community led decisions using effective asset management could generate opportunities for additional benefit by replacing stock with new mixed tenure redevelopment which adds value to the business plan.

1.4.2. Stock increase

The alternative scenario explored in the Housing Commission report is that the Council's rented stock is maintained at current levels with a programme of new build which replenishes stock lost from Right to Buy, void disposals and regeneration.

New build at social rent requires a subsidy and without this, HRA borrowing would quickly rise above the debt cap and social rent income would be insufficient to avoid debt escalating each year. In reality the Council would need to construct new build development either on a smaller scale, at a level that could be funded from HRA surpluses, or by providing additional cross subsidy, either from the affordable housing fund, recycled Right to buy receipts, grant and/or mixed tenure.

Delivery and funding of new or replacement housing, conventionally funded in the HRA, would lead to an increase in HRA debt and (depending on the scale) potentially a breach of the HRA debt cap. As the HRA debt cap is primarily in place to prevent increased borrowing on a council's existing HRA housing, rather than to restrict additional borrowing to fund new housing delivery, there are a number of alternative delivery and funding options that other councils are exploring, that do not impact on the debt cap. These options are typically either:

- Funding and delivery within the HRA in a way that does not impact on debt cap
- Funding and delivery outside the HRA

The important point to note is that the debt cap need not be a constraint to the Council engaging in a programme of new development. Constraints still exist however, in particular the availability and cost of funding, the affordability of the development and the Council's own capacity to deliver.

1.4.3. Stock transfer

The implementation of HRA self financing has introduced new issues to be considered as part of a stock options review and in particular relating to the option of stock transfer. Following the introduction of HRA self financing the Council needs to ensure that HRA debt (£451m) can be repaid from the proceeds of transfer or written off by government. CLG's starting point for consent to transfer is that transfer cash flows reflect the assumptions in the HRA self financing debt calculation, which also valued the future anticipated cash flow. Any relative increases in costs or reductions in income assumed in the transfer cash flows, which will reduce the valuation, must be explained and justified through additional outputs, in return for debt write off.

This presents a barrier to stock transfer in that typically councils would want to promise tenants an improved standard under transfer compared with retention, and this would mean a departure from the HRA self financing valuation assumptions which would trigger a requirement for debt write off. While a limited budget may exist in the current spending round to fund debt write off for stock transfer, this would need to be matched by broader economic benefits to HM Treasury which may be difficult to demonstrate based purely on an enhanced programme of investment.

Stock transfer brings additional costs in terms of VAT liability, set up costs and the costs of external funding.

An indicative business plan for a landlord taking transfer of Southwark's stock, based on assumption that the new landlord would pay a purchase price sufficient to cover the Council's existing housing debt, shows a position that is very unlikely to support the ability to raise private finance at the level required to finance the plan.

Residents have consistently stated that they would not support stock transfer in Southwark. Stock transfer can only proceed if the majority of tenants voting in a ballot confirm their support for the proposals and there is no pressing financial case for stock transfer.

Stock transfer introduces additional costs, and critical risks in terms of ballot and funding availability. Without evidence of tenant support for change, and without financial support from government, it is unrealistic to consider whole stock transfer, or large scale partial transfers as a viable option for Southwark.

1.4.4. Private Finance Initiative

There are currently no rounds of funding for PFI credits available and in reality housing PFI was only ever deliverable on an estate based level, due to the limits in both the availability of credits, and the market for the contracts. PFI is therefore not considered further as a route to fund improvements to business plan capacity in Southwark.

1.4.5. Maximising benefits under retention – alternative models for housing management

This initial review indicates that retention could be a viable option for Southwark with the potential to increase investment beyond the current Warm, Dry, Safe programme.

There is potential for the Council to improve its business plan under retention, through effective asset management. This would mean identifying those assets which are a net liability in the plan, and exploring alternative options for those properties, in consultation with residents. While this approach can address the issues associated with assets which are currently a financial liability within the plan, and failing to meet the Council's social housing objectives, there remains a desire to fundamentally improve the management and day to day maintenance service, as well as the quality of homes.

There are several options for alternative models of housing management which the Council may wish to explore in order to provide the step change in performance improvement which both the Council and its residents are seeking. Examples of these are set out in the report.

These models include

- Tenant led management initiatives through a tenant management organisation or community led mutual
- The establishment of a public/private or public/public cost sharing or shared services vehicle
- Local delivery vehicles
- The establishment of one or more Arm's Length Management Organisations
- Outsourced management

It is clear from resident feedback captured in the Housing Commission report, and from discussions with Council officers, that the Council is keen to deliver a step change in performance improvement and the catalyst for this change needs to be established. In the past councils have used whole stock transfer, PFI or Arm's Length Management as this catalyst for change, linked to the potential for additional funding. Additional funding is no longer available through these routes, and this has created barriers, at least in the case of PFI and whole stock transfer, where the level and cost of change cannot be justified by benefits delivered.

Arm's length management continues to be an option that is explored to provide a local focus for improvement in landlord services, and some councils have explored joint ventures with private sector providers to provide either housing management or development services. With the introduction of self financing, and the freedoms and flexibilities available for Councils to engage in new development again, many are looking at arm's length arrangements through Council owned companies, or partnerships with the private sector, to provide a locally focussed business approach to improve services and provide new homes, with residents at the heart, at board level, driving improvement in line with their priorities.

At Southwark it has been identified that the size of the housing stock in itself presents barriers to performance improvement and there is a clearly expressed desire for the development of locally focussed service delivery structures. These may be through small scale local management structures wholly owned by the Council, local partnerships with other providers, or tenant led management organisations. This would create the internal market of competition through comparisons, in order to drive service improvement. There is no immediate financial crisis in the HRA and therefore the Council has time to enable these proposals to develop at a pace which residents are comfortable with but which could deliver significant long term benefits once in place.

Key next steps to develop local delivery structures would include

- The establishment of an overarching framework of governance to ensure the development of local decisions while managing the impact on the overall HRA.
- A policy framework for decisions on how a local management area is defined. These areas must make sense to residents on the ground, and must be of a scale and with a balance of properties which enable viable proposals to develop. The area based asset analysis work identified above may be one way of ensuring that viable property portfolios are established, alongside appropriate levels of debt and funding to sustain long term improvement. This needs to sit alongside resident engagement to ensure these areas reflect existing communities and will enable the establishment of a clear local focus which balances the views of tenants and leaseholders..
- Resident engagement which allows each area to explore options for the management model that suits their appetite for involvement and partnership, drawing up local service standards to inform any contractual arrangements required.
- A programme of soft market testing, visits to other providers, and in the case of external partners, procurement, with resident involvement .
- The establishment of a service structure, with local delivery alongside shared support services, enabling the financial strength of the HRA to be maintained, while devolving delivery to a local level.

1.5. Conclusions and next steps

HRA self financing introduces new opportunities for a viable long term business plan with the potential to increase levels of investment beyond Warm, Dry, Safe. Initial modelling indicates that additional investment is affordable with significant long term surpluses forecast. Choices may need to be made between timing and level of investment due to short term business plan pressures.

Local asset analysis is needed to determine value for money of investment and alternative options for redevelopment and renewal.

A reduction in stock to the 20,000 unit scenario explored in the Housing Commission would lead to a significant loss of future HRA revenue which could not be matched at the same time by a corresponding reduction in costs. This means that in revenue terms the HRA would be worse off as a result of stock reduction and capital receipts from disposals would need to be used to balance the revenue position, reducing the amount of capital available for any additional benefits.

There is no overriding financial case for whole scale stock transfer, or any significant stock reduction at estate level. Instead any stock reductions can be on an asset management basis, and community led.

Local management options may facilitate service improvement and locally focussed asset management to improve business plan capacity and resident satisfaction

There are a range of funding options available to deliver Council led estate renewal and new build where this makes strategic sense, allowing the Council to access the funding required without impacting on the cap on borrowing currently in place in the HRA. This could provide opportunities for new mixed tenure redevelopment.

In order to develop the capacity of a retained HRA business plan to deliver Council and resident objectives for the future the following next steps are recommended

- A detailed evaluation of the financial performance of the Council's housing assets, alongside an assessment of the extent to which assets meet the Council's overall social housing objectives
- Exploration of the Council's appetite to lead regeneration and renewal and the development of funding strategies to deliver these within the existing HRA debt cap or through alternative financing arrangements
- A programme of resident engagement to communicate the ambitions for the retained housing stock and to explore the appetite for local management arrangements and TMO development, balancing the objectives of both tenants and leaseholders.
- The development of local management solutions needs to be planned alongside a detailed understanding of the HRA overhead recovery and its relationship with General Fund costs in order to ensure the Council and residents continue to benefit from the financial strength of the HRA but have the freedom to determine local solutions to deliver performance improvements.
- Investment planning and asset management strategy to deliver an enhanced capital programme to meet the full investment needs of the stock, where this represents value for money and developed in consultation with tenants and home owners.

2. Introduction

2.1. Background

The Council has ambitions to improve housing services and the housing stock beyond the minimum standard to a standard desired by residents and to regenerate some of its estates over the next 30 years. Despite an unprecedented £326 million five year investment programme in making every council home warm, dry and safe by 2015/2016 there remains a legacy of poorly designed and built housing that is nearing the end of its life, is expensive to repair and costly to maintain and replace. The Council wishes to examine the options that are available to it to lever the maximum investment into its homes to renew, regenerate and repair for current and future generations of Council tenants. At the same time, despite recent improvements in housing management performance, the Council is keen to do more to improve levels of resident satisfaction and to continue to improve efficiency and effectiveness.

The council established an independent housing commission ‘to explore options for the future financing, ownership and operation of Southwark’s housing stock beyond 2015/16’ which reported in October 2012. The Housing Commission report highlighted the challenges and opportunities the council faces in terms of meeting the housing needs of the borough in the long term. “The council has a chance to break from the past and under the new HRA system can do things differently. It has the opportunity to become a beacon of excellence. But to do this the council will need to change the way it invests in and manages its council housing. It will need to run council housing more as a social business...”

Following the publication of the independent Housing Commission’s report the Council is embarking on a comprehensive engagement process with residents. The engagement is asking residents to consider three fundamental questions that will shape the future of housing in Southwark over the next years:

- Who should council housing be for (and for how long)
- How much council housing should there be (and of what quality)
- Who should manage our housing stock

At the same time the Council has commissioned Savills to take forward the findings and options presented by the Housing Commission and to test them as part of a finance and housing stock options appraisal, with a view to establishing viable future options for housing management and investment to inform future business planning and consultation with residents.

2.2. Review scope and methodology

The key stages of our review are as follows:

- Assessing the base position of the housing business plan
- Understanding how the Council can use its housing assets to improve business plan capacity

- Exploring a range of future options to improve business plan capacity to deliver better homes and services

As part of our review we have considered the information available to the Council and the extent to which it is fit for purpose to provide a robust information base for decisions. This has involved a review of a wide range of information currently held by the Council, and interviews with key officers to ensure as far as possible that all relevant factors are considered.

Information considered as part of this review includes

- Housing Commission report October 2012
- Stock condition information held in the Council's Apex asset management system
- Other information on investment requirements including Fire Risk and Mechanical and Electrical estimates prepared by Council officers
- The existing HRA business plan
- Existing regeneration plans at Heygate, Aylesbury and High Investment Needs Estates (HINE) and existing initiatives such as the 1,000 new homes strategy and the Leathermarket TMO self financing arrangements.
- Housing performance reports
- Existing strategies relevant to future service delivery such as the tenancy strategy and affordable housing policy, Home Ownership management and service charge policies and sheltered housing.

This information has been incorporated into a single business plan model in order to determine the base line financial position for the Council's housing stock. This model has then be used to test future options for the stock including

- Sensitivities and risks to the base position under retention
- Options to improve capacity through effective management of existing assets
- The options for different levels of stock holding set out in the Housing Commission report
- Whole and partial stock transfer
- Whole scale Private Finance Initiative (PFI)
- Local management arrangements, for example tenant management organisations, arm's length management organisations and partnerships with external providers

The review was carried out primarily in May 2013. We would like to thank Southwark staff for their co-operation in assisting in the collection of information required for this review in a very short timescale.

3. Developing a robust information base for decisions

3.1. Review of stock condition information

A critical element of the HRA business plan is the information available on the future investment needs of the stock. Our review of this information has looked at

- A comparison of the data held in the Apex housing management system with the data collected as part of Savills' original survey in 2010
- A healthcheck of this data to identify anomalies and gaps
- An analysis of the data at an estate level to consider variations across the borough by area and archetype
- Compilation of other data on investment requirements from Fire Risk Assessments (FRAs) and relating to Mechanical and Electrical installations (M&E)

Key messages from the comparison and the healthcheck carried out are

- In general changes reflect the programme delivered since 2010
 - The expenditure requirement on programmed repairs is approximately £10m per annum less in years 1 – 5 than projected in 2010
- Data integrity has been maintained and supplemented with in-house surveys
- There are some differences in methodology since our original survey to reflect a local Southwark standard
 - For example window replacements have been deferred where their life can be extended through repair for 6 – 10 years.
- There have been some changes in methodology for cost calculation (for example relating to roof finishes and wall structures) that have not yet consistently applied and a methodology was agreed with officers to recalculate these elements

Additional costs that have been included for other elements based on estimates provided by Southwark officers or (where indicated) information from Savills original survey

- FRA works £93.6m in years 1 – 10 with an ongoing requirement of £2m p.a.
- Asbestos £1m p.a. based on historic spend
- District heating £82m over 30 years with 50% of this requirement in the first five years
- Electrical works to lateral mains in blocks £133m over 30 years based on Southwark estimates included in Savills' 2010 survey

- Scaffolding £66.4m over 30 years based on Southwark estimates included in Savills' 2010 survey
- Lifts £5m p.a. based on historic spend.

Further refinement of this information is recommended including

- Moving to a planned replacement programme for major M&E work
- Refining work programmes arising from FRAs to provide a response that is both effective and value for money
- Identifying a programme of a scale that is deliverable, including a phased increase within affordability constraints.
- Accessing additional funding for energy efficiency and reduction of carbon emissions, in particular in relation to district heating.

No increases in charges from home owners have been assumed at this stage for prudence.

At this stage no judgement is made as to the business case for investment at a local level. In reality, as part of an asset management strategy, the Council would consider the viability of investment in individual blocks. This is considered later in the report.

When transferring Apex data into the business plan costs have been uplifted by 30% in line with historic practice in Southwark to reflect the cost of preliminary works, professional fees and management of the capital programme.

A full 30 year cost profile is included at Appendix One.

The total investment requirement is estimated at £58k per tenanted property over a 30 year period. This represents a significant allowance when compared with other local authorities and reflects the nature of the stock, much of which is beginning to reach the end of its life and has suffered from a lack of investment in the past due to historic low levels of funding available for investment in Council housing nationally.

A comparison of the 30 year stock condition estimates with the allowances currently in the business plan for the delivery of the Warm, Dry, Safe programme and HINE shows that the assessed investment requirement is significantly higher than current allowances in the first five years but broadly similar over the long term of the business plan with a lower requirement in years 26 – 30 than currently included in business plan estimates. This is illustrated below.

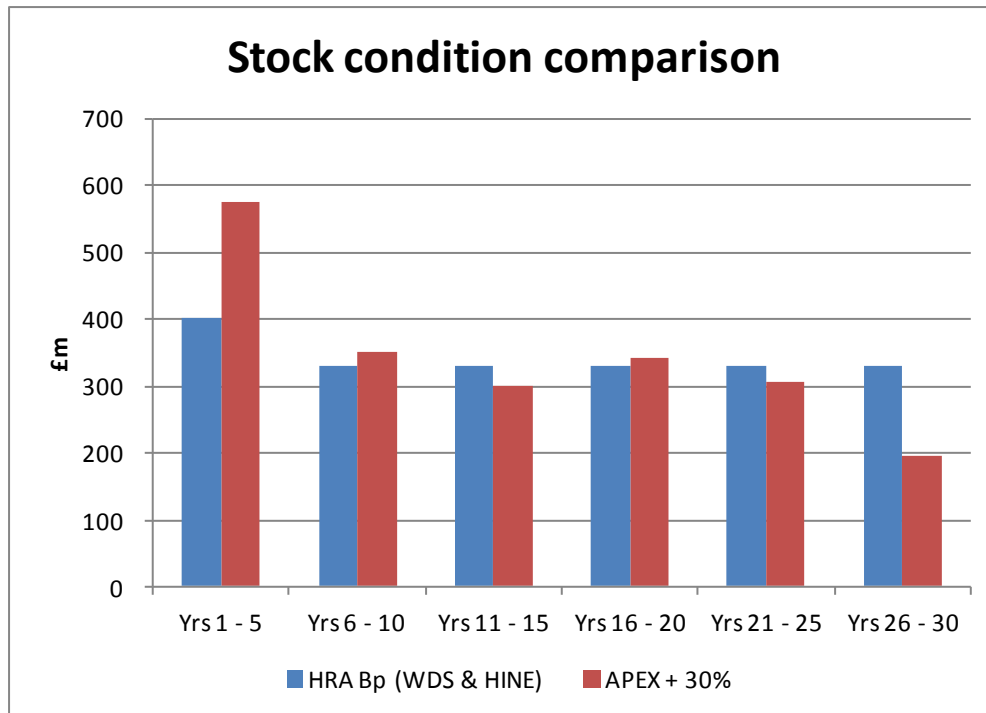


Fig 1: Comparison of 30 year estimates for stock condition and existing business plan allowances

3.2. HRA net revenue

Other elements considered to build up a comprehensive understanding of the income and expenditure available to Southwark's housing business plan include

- Income from rents and service charges,
- Day to day management and maintenance costs,
- Other sources of income such as backlog funding for decent homes from CLG, capital receipts from void sales and land disposals
- Stock loss as a result of regeneration, void disposals and Right to Buy
- Income from garages and commercial property
- Interest costs

Income from rents and service charges has been included in line with the existing HRA business plan reflecting Southwark's existing rent policy.

Day to day management and maintenance costs in the current business plan represent annual expenditure of £2,855 per unit in 2013/14. This compares favourably with the allowance in CLG's HRA self financing debt calculation which allowed £3,066 per unit in 2012/13. This reflected CLG's assessment of what is a reasonable requirement for Southwark given the nature of its stock, and the needs of its population. This reflects what we understand were significant efficiency savings introduced by the Council to prepare for HRA self financing prior to April 2013.

No further savings have been included in the current plan. The potential for savings is explored later in this report.

Other sources of income from backlog funding and capital receipts have been included:

- Agreed backlog grant funding of £65m
- Capital recoveries from leaseholders, estimated at £4m pa increasing by inflation
- Other capital receipts from existing regeneration programmes and future sales of voids and surplus land

The plan reflects current assumptions on stock numbers reducing from current levels of c39,000 to c32,000 over 30 years as a result of existing regeneration plans, principally at Aylesbury and Heygate, small scale void disposals and Right to Buy.

Income from garages and commercial properties is included at a rate, net of costs, of £8.7m in 2013/14, which is assumed to broadly rise in line with inflation.

Interest costs on current housing debt of £451m reflect a blended rate from a mix of different loans, many of which mature during the 30 year life of the plan. On average, the interest cost in the short term is some 6.56%, and this is then projected to reduce to 4.8% over time, as higher rate historic housing debt is refinanced.

The existing business plan included an allowance for the impact of welfare reform on rental income of £3mpa. As a result of the uncertain impact of the reforms on the Council's financial position, a further £4m pa allowance has been included for the 5 year period from 2014 and then an ongoing allowance of £2m pa.

Further refinement of this information is recommended including:

- Incorporating additional income from garages as a result of plans being developed for a self funded programme of improvements to bring empty garages back into use
- Variations in stock numbers that will arise based on community led change and strategic asset management, dealt with later in this report
- Potential savings from local management arrangements, dealt with later in this report, balanced by the impact on fixed overheads in both the HRA and General Fund (GF).
- Refining allowances for the impact of welfare reform as these materialise over time.

4. Baseline HRA business plan

The various factors set out in section 3 have been brought together into a single comprehensive financial model that can be used to project the estimated future resources, investment and borrowing requirement over time, and to test different scenarios and future options. Detail of the key inputs and assumptions in the plan are set out in Appendix 2. Key messages from the outputs and sensitivities are set out below.

4.1. Baseline plan - Warm, Dry, Safe

The baseline plan includes the capital expenditure in the current business plan to deliver Warm, Dry, Safe. The chart below compares forecast HRA debt with the cap on HRA debt imposed by CLG under HRA self financing and then shows the way in which surplus reserves would build up.

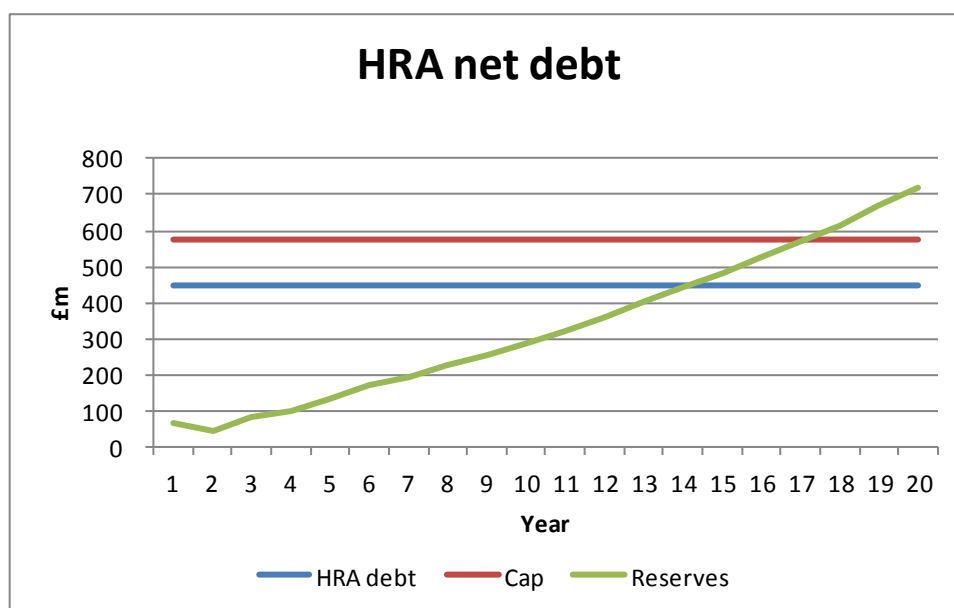


Fig 2: Baseline HRA - Warm Dry Safe

The overall financial capacity in the plan is shown by the gap between current HRA debt and the debt cap (£126m) as well as revenue surpluses that arise over time. Increasing reserves show significant financial capacity in the longer term, with reserves reaching the level of current forecast debt within 15 years.

4.2. Baseline HRA - fuller investment need

In reality, although the Warm, Dry, Safe programme represents a higher level of expenditure than has been the case in the past, in order to bring the properties up the decent homes standard by 2015/16, expenditure would need to increase further in order to meet the full investment needs of the stock.

The chart below replaces the Warm, Dry, Safe costs with the estimates of fuller investment need set out in section 3. This includes significant programmes for Fire Risk and Mechanical and Electrical as well as a full programme of planned major works in order to maintain the stock at the decent homes standard in the long term.

This revised plan maintains a minimum £20m in reserves and assumes that borrowing is increased as necessary to meet investment needs. It includes the estimated additional costs of welfare reform. For prudence it assumes no increase in leaseholder charges beyond those assumed under Warm, Dry, Safe.

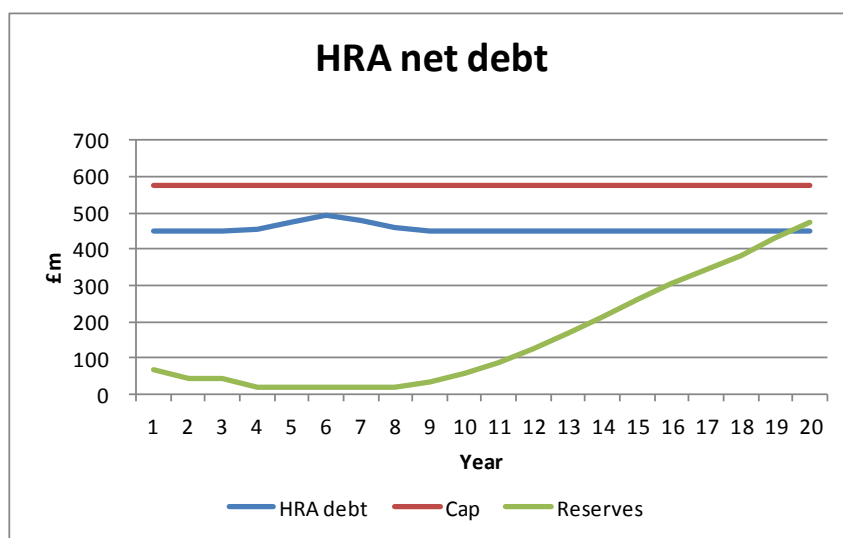


Fig 3: Baseline HRA - including fuller investment requirement

The chart shows an increase in borrowing required in years 4 to 10 of some £40m, but that this is affordable long term, and does not breach the debt cap. There would still be capacity to increase borrowing by a further £85m before the cap is breached.

This demonstrates that an increased programme of investment is possible within resources available to the Council subject to

- Sensitivity analysis to test the impact of risks
- Demonstration of the value for money of investment at this level at a local level
- Deliverability of capital programme of which in early years is some £120m pa

4.2.1. Impact on home owners of increased capital expenditure

Any increase in the capital programme is likely to impact on leaseholders through increased recharges for works to common areas. The financial model shows the full costs of works to common parts charged to the HRA with the costs of the management of the programme increasing as a fixed % against overall spend. At this stage no assumption has been made for financial modelling purposes about increased recovery from leaseholders of these costs although in reality this is likely to be required. This raises questions in relation to affordability to leaseholders.

The Council currently recovers capital costs from leaseholders on a lump sum basis as costs are incurred, providing a range of options to pay over time. If the Council does implement a long term structured capital programme this may provide the basis for the Council to move to setting up sinking fund type arrangements where capital costs to leaseholders are spread over a long period. This would smooth the costs to leaseholders but clearly would result in annual charges being higher for a long period.

4.3. Treasury management illustrations

The HRA has a range of different debt portfolios which mature at different times which places some restrictions on options about the balance between repayment of debt and the building up of reserves. The Council will also need to consider its approach to treasury management which is outside the scope of an appraisal of options for future ownership and management of the stock.

The Council's current HRA business plan assumes that debt is maintained at £451m by refinancing loans that mature. This is reflected in the illustrations above. At the same time, using these assumptions, surplus reserves would start to escalate from year 10.

In practice an active treasury management policy may not result in additional loans being taken on at the same times as surpluses are building up. An alternative illustration using surpluses to reduce debt over time is shown below, by combining the debt and reserves lines. This is provided for illustrative purposes to demonstrate the affordability of the HRA cashflows and does not take into account the specific timing of when actual loans mature which would form part of a more detailed treasury strategy.

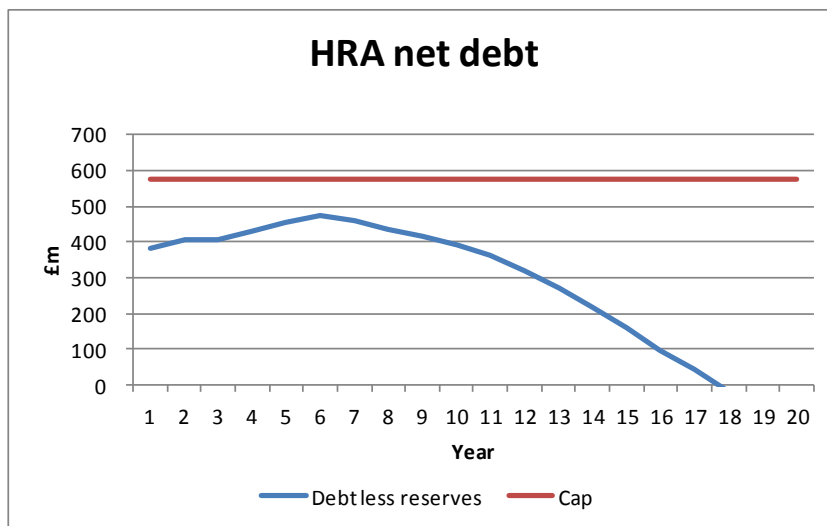


Fig 4: Baseline HRA - including fuller investment requirement with debt repayment

As an alternative to maintaining HRA debt constant at the opening level of £451m, or the above illustration which shows maximum use of reserves to repay debt, an alternative illustration shows the option of reducing debt by 2% of the opening debt (£9m) each year. Under this option the interest charge in the HRA would reduce, and lead to an escalation in reserves.

The chart below projects the HRA debt and reserves position for the baseline HRA – Warm Dry Safe (Fig 2) on the assumption that £9m of reserves are used each year to reduce debt.

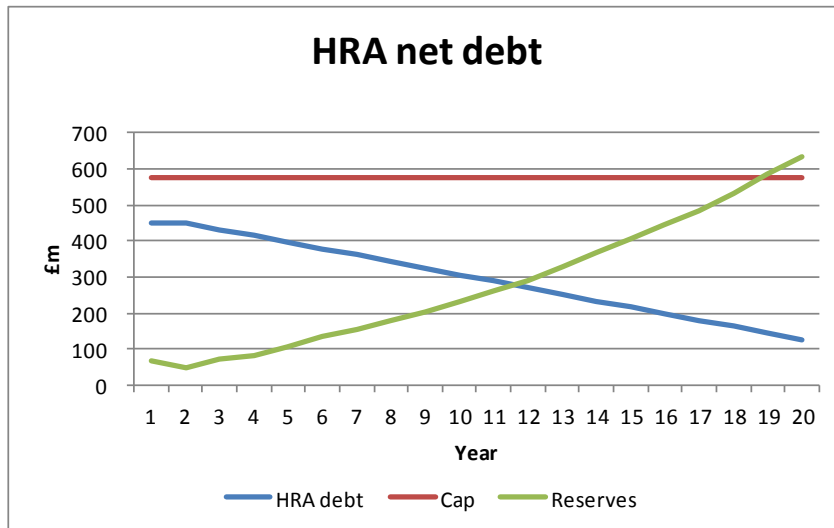


Fig 4a: Baseline HRA - Warm Dry Safe with debt repayment

On subsequent revisions of the business plan, with higher investment levels, there is limited availability of reserves to make debt repayments in the early years. For example including a fuller investment requirement (fig 3), surplus reserves do not arise until year 9. The chart below projects the HRA debt and reserves position for the baseline HRA – including fuller investment requirement (Fig 3) on the assumption that £9m of reserves are used each year to reduce debt from year 9.

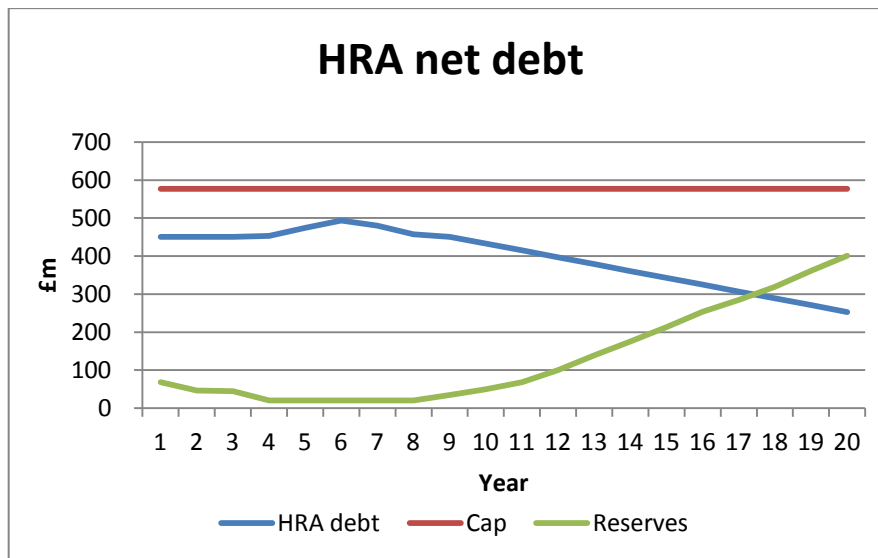


Fig 4b: Baseline HRA - including fuller investment requirement with debt repayment

These two charts illustrate how debt repayment in place of the accumulation of reserves would reduce the overall interest cost and bring forward the point at which debt was matched by reserves.

4.4. Sensitivities and risk

In order to test the strength of the plan to withstand future risk we have explored the impact of reduced income and increased costs that could materialise for a range of different reasons.

The first sensitivity introduces an additional £7.5m pa expenditure in order to reintroduce a cyclical decorations programme. Whilst the base HRA business plan does have an allowance of some £1m pa towards such a programme, the inclusion of an additional £7.5m pa, based on estimates provided by the Council, would allow a full and regular programme to be carried out addressing each property on a 7 year cycle.

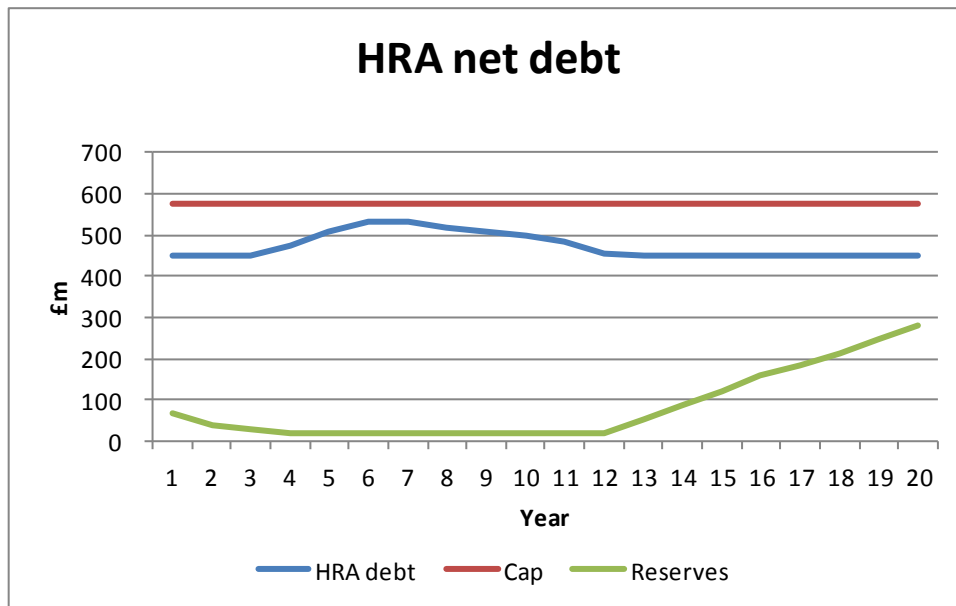


Fig 5: Baseline HRA - including fuller investment requirement and cyclical decorations programme

This shows that a cyclical decorations programme of this scale would also be affordable, though it would lead to increased borrowing for a longer period, to a level that peaked some £40m below the debt cap.

The second sensitivity looks at the impact of reduced income from capital receipts. The current plan relies on capital receipts from void and land disposals of £18m p.a. While these can be relatively certain in the short term (from existing regeneration schemes) the level of receipts in the medium to longer term is far less easy to predict. The next sensitivity shows (in addition to the cyclical decorations programme) the impact of no receipts from land sales beyond year 5, representing a £10m p.a. reduction in income from year 6 from the assumption in the base plan.

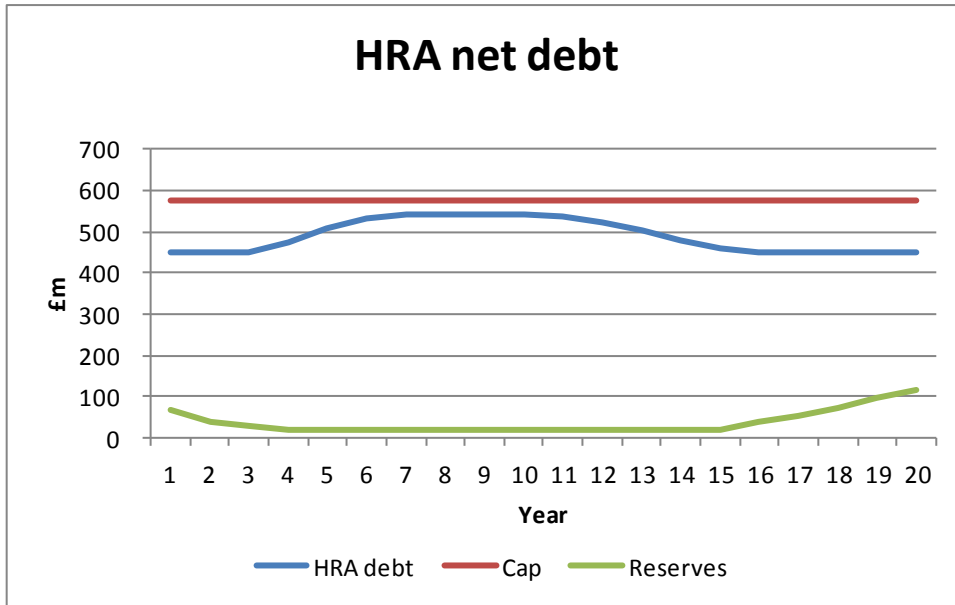


Fig 6: Baseline HRA - including fuller investment requirement, reduced capital receipts and cyclical decorations programme

This prolongs the period over which increased borrowing would be required and debt peaks at a slightly higher level, some £35m below the cap. Over time the plan is still affordable, but it takes longer for reserves to build up again.

The third sensitivity builds on the previous position, but also introduces an additional £60m over the first 5 years, to cover the estimated costs of additional FRA work to fit sprinkler systems in all high rise blocks. .

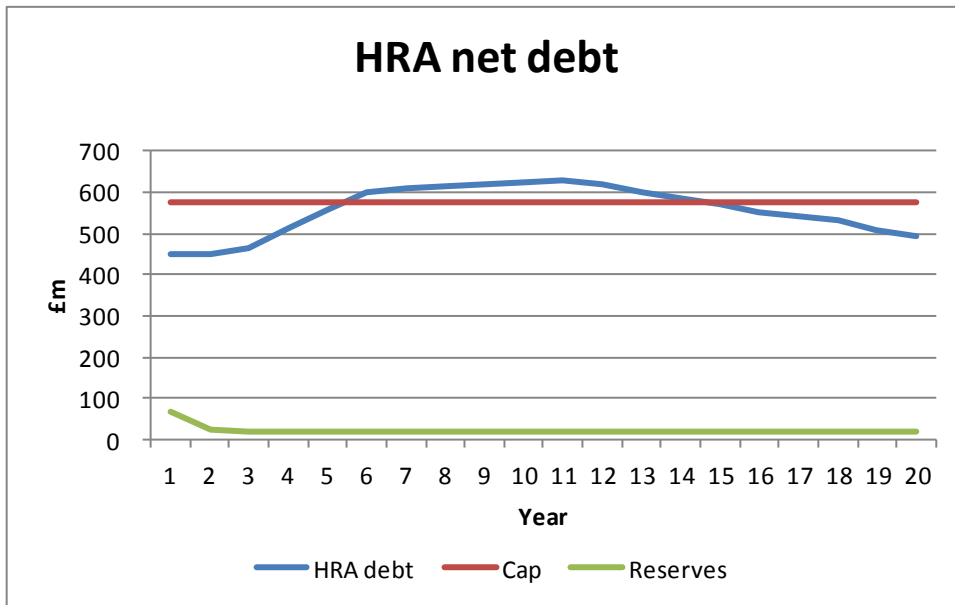


Fig 7: Baseline HRA - including fuller investment requirement, reduced capital receipts and all increased expenditure

Whilst expenditure at this level is shown as being affordable in the long term, with debt requirement reducing after year 12 and surpluses beginning to build up again after year 21, there

would be a need to increase borrowing by some £50m above the HRA debt cap, which is not permissible under current Government policy.

Rental income assumptions

The base HRA financial forecasts assume that the Council follows Government policy on future rent increases, which would result in actual rents converging to formula in 2015/16 (subject to limits on individual property rent rises). This reflects the assumptions used by CLG in calculating the Council's debt settlement. Based on the assumption that inflation is 2.5%, this leads to rent increases in the next 4 years of:

- 2014 – 4.64%
- 2015 – 4.57%
- 2016 – 3.94%
- 2017 – 3.74%

Thereafter, annual rent increases would gradually reduce to 3%.

The baseline business plan with full investment need does not include any assumptions about cost reflective rent increases following a programme of capital improvement works as this is currently not part of the Council's rent policy. Under the government's rent restructuring policy landlords have the option to increase target rents to reflect any uplift in value generated as a result of the improvements.

It is open to the Council to adopt a policy with higher or lower rent increases. However any change in rent policy would have a direct impact on HRA resources available for revenue and capital costs and its ability to service housing debt.

The chart below illustrates the impact on the previous sensitivity (figure 7) of reducing rent increases in the next 4 years by 1% and then reverting to the previously planned rent increases.

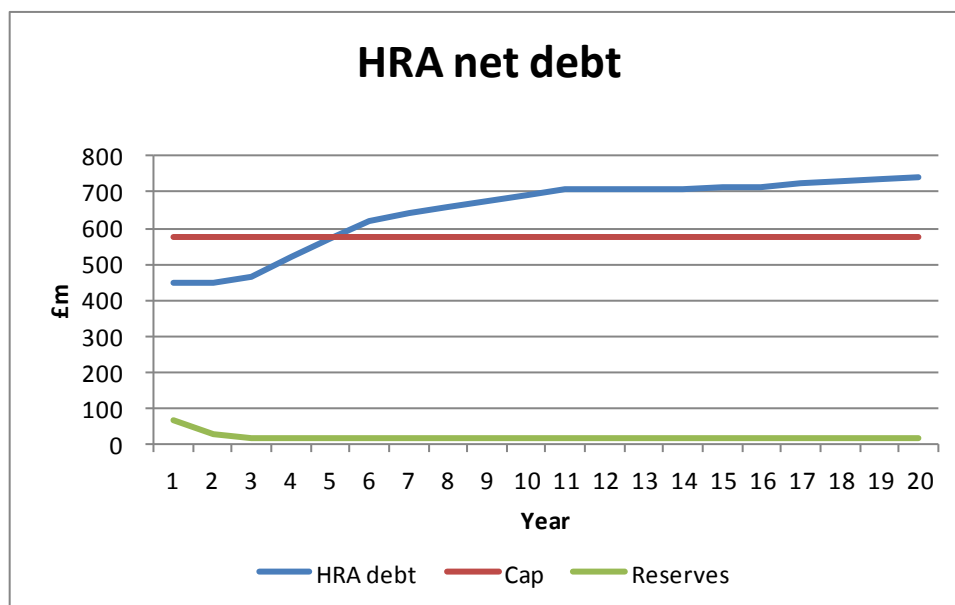


Fig 8: Impact of a 1% reduction in rent increases in the first 4 years on previous sensitivity (fig 7) Baseline HRA - including fuller investment requirement, reduced capital receipts and all increased expenditure

This shows a position that is unaffordable and demonstrates the need for the Council to make choices between the level of investment delivered and the amount of income generated. The rent loss in the 4 year period would be some £20m, and unless future increases were escalated to compensate, the overall 30 year loss would amount to some £300m

4.5. HRA business plan summary conclusions

The HRA modelling demonstrates that the existing business plan is relatively robust, showing an ability to increase expenditure above current levels. It stands up reasonably well to future risks, although choices would have to be made between levels of income and investment in the event that combinations of these risks materialise.

4.6. Asset analysis

The housing stock is not uniform and in reality the business plan cashflows will vary across the borough, with some assets creating surpluses and others making losses. Given the legacy of housing in Southwark that is now reaching the end of its life, it is important for the borough to understand the cashflows associated with different assets in order to provide an objective basis for future decision making.

This principle was understood by CLG in the HRA self financing debt calculation where different types of housing stock were allowed different allowances for future major repair expenditure as well as day to day management and maintenance. Combined with a range of different rents this produced a range of valuations in Southwark from an average for high-rise flats of £8.4K per property to over £60K per property in respect some pre 1945 houses. These houses were assumed to generate significant long term surpluses and therefore could afford to support a higher level of debt. This compares to an average debt valuation in Southwark of £15.8K per property.

Actual business plan cashflows will vary in the same way and understanding this can help to identify candidate groups of properties where alternative options need to be explored to improve business plan cashflows before investment decisions are made. The Housing Commission made the point that in Southwark “good money is being wasted on treating the symptoms of building failure, rather than tackling the root causes”. The development of an active policy of managing housing assets which challenges the value for money of each investment decisions, based on an analysis of both the value of future cashflows, and the extent to which investment meets the Council’s social housing objectives would be likely to be of benefit.

A high level analysis of rental income and capital expenditure associated with assets across the borough shows that 27% of long term stock has a combination of higher than average capital expenditure and lower than average rents. Medium and high rise flats are over represented in this group. Geographical concentrations of these properties are found in Borough and Bankside, Camberwell and Walworth. A more detailed analysis to model cashflows at a very local level would identify pockets of poorly performing properties that will exist in these areas and elsewhere. Local options appraisals, in consultation with residents, may identify better outcomes for these properties, and for their residents, that could be delivered through alternative strategies.

An example of how this more detailed analysis could support decision making across the borough’s stock is shown below. In this chart each of the blue horizontal bars represents the net present value of cashflows associated with different groups of assets. A group of asset may be a particular block type on an estate, or a geographical concentration of similarly aged street properties. The bars towards the bottom of the chart represent assets that have a negative worth within the overall business plan.

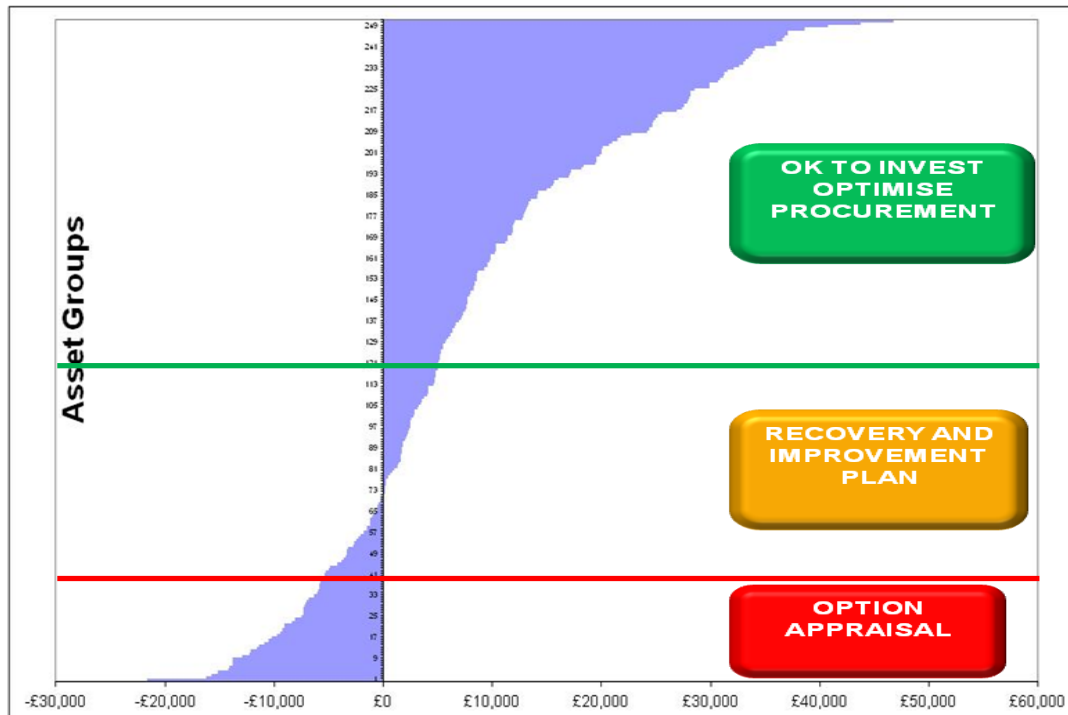


Fig 9: Net present value of operating cashflows of different assets within a large landlord stock (benchmark example – not Southwark specific)

It should be noted that the values in the chart above are not Southwark's as detailed analysis has not been possible within the timescales for this initial review. However the range in value is typical of a large urban social landlord.

The analysis of the social return on investment needs to include more than a purely financial analysis. The financial results need to be considered alongside an assessment of other sustainability factors linked to the Council's social housing objectives. There will be different strategies for business improvement depending on whether an asset group exhibits weak values, weak sustainability or both. The benefits of this approach to evaluating the performance of the Council's assets would help to

- Strengthen the existing business plan
- Make more efficient use of capital resources available, delivering more within the HRA debt cap
- Consider long-term planning for obsolescence
- Obtain a balance between new build, remodelling & stock investment
- Test alternative strategies, enable balanced investment decisions and support difficult decision making
- Communicate reasons to members, staff and residents
- Assist the Council in delivering its social and housing objectives

4.6.1. Asset analysis and HRA debt capacity

Under HRA self financing, CLG used similar methodology to assess the financial performance of Southwark's housing stock, in order to calculate the level of debt that it considered reasonable for the portfolio to support. This provides a strong link between the council's housing debt portfolio, the performance of stock which it has historically supported and the quality of housing product which is delivered through that stock for Southwark residents.

As at figure 9 (the net present value (NPV) model) the council is likely to have a stock portfolio which demonstrates a range of NPVs, some of which are likely to be positive and some of which are likely to demonstrate negative NPVs.

The council's debt portfolio is therefore likely to contain debt which relates to stock which is not delivering any net return and so in practical terms may not deliver the best value for money.

Further analysis is likely to be needed to categorise stock and attribute debt to it so that a detailed financial performance breakdown can be achieved. Doing this could enable the council to make informed decisions about the stock into which it may choose to invest and upgrade, and the stock which it may choose to release to alternative development options.

Better value for money and a more stable investment model is likely to be achievable through investment in stock which is delivering a positive contribution to the business plan, where investment is likely to deliver a genuine financial and social benefit, than in stock where negative NPVs are demonstrated. In this latter case additional debt would effectively seem to be underwriting refurbishment on stock which has a low likelihood of delivering these benefits and so reflect a lower than optimal investment.

5. Future options

The modelling of the baseline HRA position shows that retention of the existing housing stock is a viable option for the Council to consider, subject to the management of future risks, and effective asset management to tackle the legacy of housing that may require regeneration and renewal.

This report also looks at alternative options for the stock including

- Exploring the Housing Commission scenarios for stock reduction to 20,000 units and stock increase to maintain 39,000 over the life of the plan.
- Whole and partial stock transfer
- Whole scale PFI

Finally this section explores options for maximising opportunities under retention including exploring local management arrangements, for example tenant management organisations, arm's length management organisations and partnerships with external providers.

5.1. Stock reduction

The existing business plan assumes that the current stock of 39,000 tenanted units reduces to around 32,000 units over 30 years as a result of demolition, relatively low levels of void sales and Right to Buy.

As a strategic housing authority the Council will need to consider the impact of this stock reduction on the availability of social housing in the borough. This will involve an assessment of RP provision over time and the extent to which any increase in this can off set any reduction in Council owned homes.

The impact of stock number reduction to 32,000 currently assumed in the Council's HRA business plan is:

- Rent and service charge income reduces each year following the disposal largely in line with the average amount (£5,500 per year per property increasing in line with overall rent increases)
- 20% of management costs relating to the properties are assumed to be saved (approximately £300 per year per property)
- 30% of repairs costs are assumed to be saved (approximately £475 per year per property)
- 30% of capital works costs are assumed to be saved (approximately £525 per year per property on average)

The Housing Commission explored an indicative scenario that stock loss increases at a higher rate each year as a result of increased Right to Buy sales and additional void disposals. This would result in a reduction to 20,000 units over this period, representing a significant net loss of social housing in the borough.

The assumptions used in the Housing Commission financial modelling assumed a more favourable financial position as a result of stock loss, with income from rents and other charges

more than covering operational costs and depreciation once stock numbers are reduced. This assumed significant cost reductions as a result of accelerated loss of stock. However these assumptions are inconsistent with the assumptions currently used by Southwark in its HRA business plan in relation to the balance of fixed and variable costs. In reality it would be a significant challenge to reduce all costs pro rata in line with stock reductions. Furthermore the Housing Commission makes the point that the net loss in social housing would leave many in the borough without the affordable home they need.

Based on the income and cost reduction assumptions in the Council's HRA business plan, a reduction to 20,000 units would lead to a significant loss of future HRA revenue which could not be matched at the same time by a corresponding reduction in costs. This means that in revenue terms the HRA would be worse off as a result of stock reduction. The chart below illustrates the impact on the baseline HRA with full investment (figure 3) of a gradual reduction in stock to 20,000. This shows that by year 20 reserves are reduced from £473m to £81m as a reduced income base has to manage existing housing debt and fixed costs.

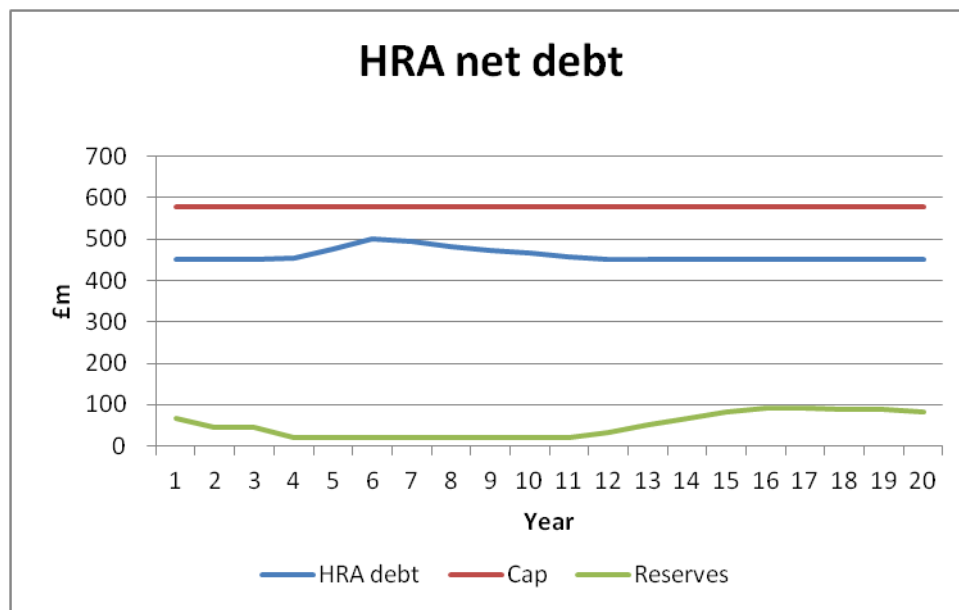


Fig10: Revenue impact of gradual reduction in stock to 20,000 units based on baseline HRA with fuller investment (Fig3)

Whilst this chart models the revenue implications of stock reduction, it is likely that the disposal of HRA stock would generate some additional capital receipts. The level of receipts would depend on the extent to which disposals were through RTB (where retained receipts would be lower) or void disposal. Receipts would need to be applied to reduce attributable housing debt and to manage the fixed cost burden in order maintain a neutral position. This would effectively mean the Council would need to use capital resources to balance the revenue position, reducing the amount of capital available for any additional benefits.

In discussions with the Council it was agreed that further modelling should be carried out to consider the impact of stock reduction to 20,000 achieved without a net loss of social housing, due to the significant negative impact such a net loss would have on the Council's ability to discharge its duties in respect of homelessness and affordable housing provision, and the significant impact on Southwark's residents.

To illustrate the impact of stock reduction to 20,000, including a phased adjustment to the HRA fixed cost base, we have modelled a stock transfer of 16,000 units to independent landlord(s) in 2016/17. Even this position is purely illustrative. In reality the timing will depend on the

development of any community led plans for transfer, or any asset driven disposals as part of a strategic asset management plan. This is likely to present a more phased approach which cannot be identified with certainty at this stage.

Whilst the base assumptions for the treatment of fixed and variable costs in the current business plan may be appropriate for gradual/incremental changes in stock numbers, different assumptions are needed to look at the impact of a major change in stock. Issues to consider include:

- Costs can typically be classed as a mix of fixed, semi-fixed and variable. Whilst variable costs may reduce with each property disposal, semi-fixed may only change on a stepped basis following a number of disposals. Fixed costs would not normally be expected to reduce.
- A very significant reduction in stock could lead to a reduction in the fixed cost base – e.g. upon a subsequent staffing, services or accommodation reorganisation. The timing of such a reduction is difficult to predict.
- A significantly smaller landlord function would be less likely to support the current level of internal council re-charges. Whilst some reduction in charges could be balanced by a reduction in central costs (e.g. less use of accommodation and central services), in other cases there would be limited opportunity to reduce costs (e.g. corporate and democratic costs).
- Stock reduction arising from transfer to a new landlord would provide an opportunity for the Council to transfer a part of its costs base to the new landlord, e.g. through TUPE of staff, the disposal of office accommodation, or service level agreement payments to the Council by the new landlord.
- Capital investment needs by property can be identified and that information used to model the impact of the loss of stock – though there would be a fixed element of the costs likely to remain.

Again due to the illustrative nature of this sort of scenario planning, it can only be assumed at this stage that an “average property” is transferred and retained in terms of rental income and capital investment needs. In reality the actual nature of the stock transferred will have a major impact on assumptions about reductions in rental income and capital investment needs. For example, a strategic asset management approach may lead to the disposal of property with higher than average capital expenditure needs, leaving the residual business plan relatively better off – providing a receiving landlord is prepared to take the stock at a price sufficient to clear attributable housing debt (see below).

Other assumptions to model stock loss to 20,000 units include:

- 75% of the average annual capital investment costs (e.g.£2,500 per home in 2016/17) assumed as immediately saved, with remaining 25% saving achieved 5 years later
- Rent and service charge income is immediately transferred to new landlord(average £5,500 per property per year rising annually)
- 50% of pro rata maintenance costs (£800 per property per year) are assumed to be saved immediately, with the remaining 50% saving achieved 5 years later
- 25% of pro rata management costs (£400 per property per year) are assumed to be saved immediately, with remaining 75% saving achieved 5 years later

The size of stock transferred will influence the Council's ability to reduce its management and maintenance cost base. Typically the larger the transfer, the greater the ability to transfer staff and other costs across to the new landlord. However this will in all cases depend on the nature of the actual disposal.

Finally it is assumed that the capital receipt generated by the disposal is equivalent to the pro rata debt (approximately £12,000 per property). As set out in the previous section, the HRA self financing debt calculation estimated a range of different debt levels which varied by archetype. For example medium and high rise flats were assumed to have higher costs and lower income and therefore attracted a lower level of debt per unit than houses. It will be important for the Council to be able to reduce debt pro rata based on the nature of the actual archetypes transferring but this cannot be identified with certainty at this stage.

The following chart illustrates the impact of these assumptions on the baseline HRA including fuller investment (i.e. as shown in Figure 3).

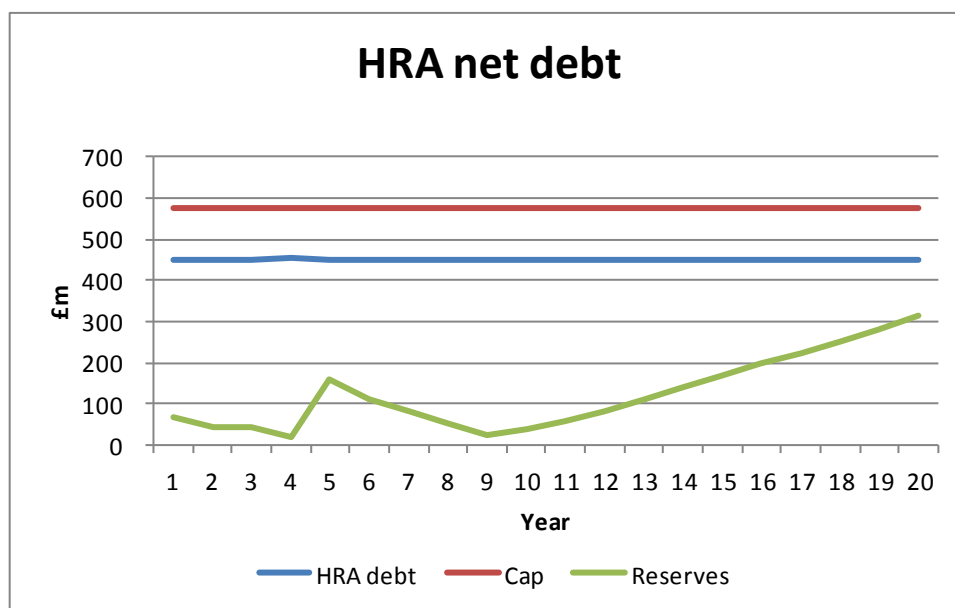


Fig 11 Revenue impact of on off reduction in stock to 20,000 units based on baseline HRA with fuller investment (Fig3)

As can be seen, stock reduction on this scale can only be modelled on a very illustrative basis at this stage. When the assumptions for stock reduction are incorporated within the baseline HRA business plan the short term pressures are reduced, providing the capital receipt is sufficient to cover the attributable housing debt. This is a critical risk and the achievement of a capital receipt at this level is far from guaranteed. The capital receipt is not used to repay debt as it is then required to manage the burden of fixed costs that can only be reduced over a period of 5 years, delivering limited net benefit to the plan over the longer term. With the receipt used in this way, the level of historic housing debt remains the same. This means that longer term the financial position in the HRA is less favourable as a result of lower surpluses generated by a reduced rental income.

These assumptions can only be illustrative at this stage, and in any event, the case for stock reduction on this scale is not evident. In reality the HRA business plan is robust enough to allow for an increased investment programme under retention. Community led initiatives may lead to small scale transfers in future, where there is a clear rationale for the disposal, and where the impact on both the HRA and the General Fund can be managed more effectively. There is no

obvious financial case to drive larger scale stock reduction and the financial benefits of this to the HRA business plan are unclear in the short term and may be negative longer term.

In considering existing projections of a reduction in rented stock to around 32,000 over a 30 year period the Council will need to consider the impact of this on the balance of tenanted/leaseholder properties. Right to Buy sales create a movement from a majority tenanted stock to a more 50/50 tenanted/leaseholder estate. The Council will need to consider the implications of this for the culture of the housing management function and how it responds to leaseholder expectations. This is addressed later in the report in the exploration of future management options.

5.2. Stock increase

The alternative scenario explored in the Housing Commission report is that the Council's rented stock is maintained at current levels with a programme of new build which replenishes stock lost from Right to Buy, void disposals and regeneration.

In order to model the financial impact of this scenario it is assumed that an additional 2,000 new homes are built by 2019 to replenish stock to 39,000 in addition to existing 1,000 new homes strategy that is already included in the base business plan. An ongoing programme of new build of an average of 200 per year is then required for the remaining 30 years of the plan. It is assumed that all new homes are built and let at social rents, and that existing stock reduction is of "average" stock, as set out above.

In reality it may be more likely that high liability stock is replaced with modern new build with reduced long term liabilities. It may also be the case that cross subsidy is available from the affordable housing fund and from cross tenure redevelopment. As neither of these can be predicted with any certainty at this stage the assumptions are not incorporated.

The following chart illustrates the impact of these assumptions on the baseline HRA including fuller investment. This shows the impact of replenishing social housing stock levels over time before the application of any cross subsidy either from the affordable housing fund, recycled Right to buy receipts, grant and/or mixed tenure,

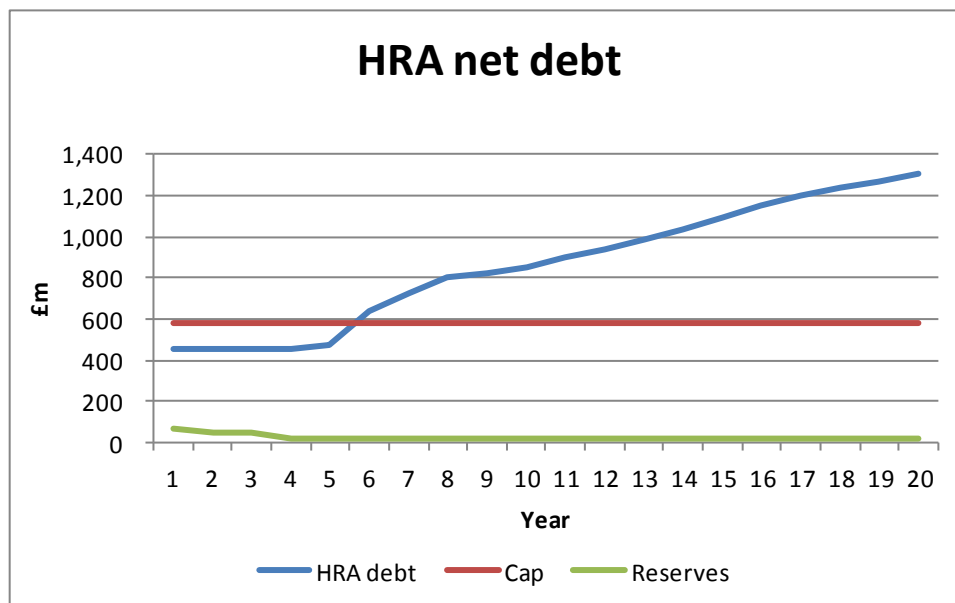


Fig 12: Impact of stock increase back to 39,000 on the baseline HRA including fuller investment (figure 3)

Under the above assumptions, the requirement to fund the replacement of housing and then letting them out at a social rent is unaffordable within the HRA. Subsidised housing requires a subsidy and without this, HRA borrowing quickly rises above the debt cap and social rent income is insufficient to avoid debt escalating each year. In reality the Council would need to construct new build development either on a smaller scale, at a level that could be funded from HRA surpluses, or by providing additional cross subsidy, either from the affordable housing fund, recycled Right to buy receipts, grant and/or mixed tenure.

5.3. Alternative options for stock increases

Delivery and funding of new or replacement housing, conventionally funded in the HRA, would lead to an increase in HRA debt and (depending on the scale) potentially a breach of the HRA debt cap.

As the HRA debt cap is primarily in place to prevent increased borrowing on a council's existing HRA housing, rather than to restrict additional borrowing to fund new housing delivery, there are a number of alternative delivery and funding options that other councils are exploring, that do not impact on the debt cap. These options are typically either:

- Funding and delivery within the HRA in a way that does not impact on debt cap
- Funding and delivery outside the HRA

5.3.1. Funding and delivery within the HRA

The HRA debt cap restricts Council borrowing, by imposing a limit on its HRA Capital Financing Requirement (HRA CFR) at each year end. Conventional borrowing to fund capital investment on HRA assets would lead to an increase in HRA CFR. However, there are some alternative funding structures that could be used within the HRA that would support the delivery of new HRA housing without an increase in HRA CFR.

One such structure which has recently been used to fund housing in the RP sector is a sale and leaseback through an operating lease structure. Under current accounting rules, funding new housing through a lease that is classified as an operating lease (as opposed to a finance lease) would not lead to an increase in borrowing by the lessee. As a result, it is possible to deliver new HRA housing that is leased by the HRA from an investor that has no impact on the debt cap.

Financing costs of sale and leaseback arrangements will typically be higher over the long term, although the profile of payments can provide a better match against resources in the short term.

Whilst there is a precedent in the RP sector, to date, no such HRA operating lease transaction has been undertaken by a local authority. There are also some complexities in ensuring that the lease is classified as an operating lease, that would have an impact on the cost of such a funding arrangement. As a result, local authorities have tended to pursue funding and delivery of housing outside the HRA as the first alternative option.

New housing delivered within the HRA would be let on secure tenancies with the Right to Buy.

5.3.2. Funding and delivery outside the HRA

Whilst housing is typically owned by a council within the HRA, there are alternative options for it to be held within the general fund or in a separate council owned company, where borrowing to fund

investment is not restricted by the HRA debt cap. Of these two alternatives, it is the council owned company option that has been pursued by a number of local authorities recently. The typical arrangement is for a wholly owned council company to be set up, which becomes the owner of new or existing housing. It is then the company that receives the rental income and has landlord responsibilities for management, maintenance and repairs. The company would have surplus rental income (after costs), from which it would have the ability to service any debt. The precise debt capacity of the company would depend on the rent levels and associated costs

It is important to note that (in the absence of a subsidy from the Council or elsewhere) that the company would need to be capable of meeting its debt servicing obligations from the net rental income. If it is structured in this way, then it could borrow from the Council to deliver new housing with no use of the current HRA borrowing headroom. It is possible for a Council to borrow from the Public Works Loan Board (PWLB) and then on lend to a company. This provides a benefit to the company as a result of lower funding costs. State aid issues need to be considered where the benefit is in relation to any market housing, although these will not apply in respect of affordable housing. Government consent may be required under S25 of Local Government Act 1988 where on lending represents financial assistance to the company.

Whilst there are a number of legal and policy issues to address, a number of other councils are using a company in this way to broaden and increase their capacity to deliver new housing.

New housing delivered through a council company would not be let on secure tenancies and therefore Right to Buy would not apply, although the company could offer a contractual preserved Right to Buy where appropriate.

5.3.3. Building a development strategy

The important point to note is that the debt cap need not be a constraint to the Council engaging in a programme of new development. Constraints still exist however, in particular the availability and cost of funding, the affordability of the development and the Council's own capacity to deliver.

The key steps to building a development strategy would need to include

- Identifying opportunities through
 - Review of current assets
 - Review of land capacity across the HRA estate
 - Widen scope to general fund assets
- Option appraisals – to consider the quality and quantity of housing that can be delivered
- Exploring investment opportunities to generate revenue
- Considering a range of options from private sale to market rent as well as affordable
- Buy in from members
- Consultation with existing tenants
- Wider benefits of unlocking stalled sites, increased economic activity, new homes bonus, access to new funding opportunities

5.3.4. New build and the comprehensive spending review

There is the potential that the spending review announcement at the end of June 2013 may provide a mechanism for local authorities to have their debt cap lifted, in return, perhaps for increased economic activity (e.g. new build) leading to broader economic benefits.

It is also publicised that the review may include a restrictions on rent increases for non developing social landlords.

Both these measures would increase the business case for Southwark to engage in new build development within the capacity of its business plan, either within the limits on HRA borrowing or through alternative mechanisms as set out above.

5.4. Whole and partial stock transfer

The implementation of HRA self financing has introduced new issues to be considered as part of a stock options review and in particular relating to the option of stock transfer.

One key issue is the valuation of the stock and the price the new landlord pays the Council. The stock is valued on the basis of tenanted market value, which values the ongoing cashflows for the properties as social housing. As the income is largely set by the Government's social (formula) rent policy, the higher the level of expenditure in the valuation, and therefore in the new landlord's business plan, the lower the value of cashflows and the lower the price paid to the Council for the stock. This ensures that the new landlord can afford to fund promises which are costed into the valuation.

Following the introduction of HRA self financing the Council needs to ensure that HRA debt (£451m) can be repaid from the proceeds of transfer or written off by government.

CLG's starting point for consent to transfer is that transfer cash flows reflect the assumptions in the HRA self financing debt calculation, which also valued the future anticipated cash flow. Any increases in costs or reductions in income assumed in the transfer cash flows, which will reduce the valuation, must be explained and justified through additional outputs, in return for debt write off.

This presents a barrier to stock transfer in that typically councils would want to promise tenants an improved standard under transfer compared with retention, and this would mean a departure from the HRA self financing valuation which would trigger a requirement for debt write off.

The HCA has issued a series of discussion papers which set out the development of new guidance for stock transfer including how authorities need to justify the case for transfer and debt write off. The discussion papers indicate that there will be a requirement for a full business case in line with HM Treasury Green Book guidance. It is worth noting that this requirement goes beyond that of any other social housing project. The business case will need to set out the strategic, economic, commercial, financial and management case for transfer. Where debt write off is required, the case must be agreed with both CLG and HM Treasury and it will be necessary to demonstrate through cost benefit analysis that the transfer proposals offer a net benefit to government over the long term.

Stock transfer brings additional costs in terms of VAT liability, as Registered Providers have a different VAT status to local authorities. As a result, the new landlord would not be able to reclaim automatically any VAT it incurs on revenue or capital costs. In view of the scale of the proposed capital programme, the potential VAT liability arising through transfer would be sizeable. To address this additional cost, transfers have typically included "VAT shelter" arrangements whereby some of the investment in homes post-transfer is undertaken under the shelter of the

Council's VAT status. However this would not eliminate the entire additional VAT liability. The additional VAT cost would reduce the valuation and potentially trigger a requirement for debt write off. Whilst this is recognised as a justification for departure from the HRA self financing cashflows, the draft guidance appears to still require the economic case for the resulting need for debt write off to be able to demonstrate long term benefits to government. The additional VAT liability would also be reflected in any recharges to leaseholders for major works.

Stock transfer brings additional set up costs for both the Council and the new landlord. The new landlord would need to absorb these costs within its business plan. The Council would need to be able to fund its own set up costs in a way that does not add to the debt write off requirement.

Following stock transfer, the new landlord would require funding from the private sector to produce a viable long term business plan. In the current economic climate the availability of long term funding may be challenging. The cost of funds is likely to be higher than the cost of current HRA debt via the Public Works Loan Board.

Some authorities have explored a financing model for stock transfer where the existing housing debt remains with the authority, reducing both the cost of funds and the amount of additional private sector funding needed. This model (referred to as "Council and Community owned" or "CoCo") is currently not acceptable to HM Treasury. Its concerns have focussed on the level of control that the Council exerts through the funding mechanism, and the resulting risk that the entire debt of the new organisation counts as public sector borrowing.

5.4.1. The implication of stock transfer in Southwark

In order to consider the implications of stock transfer in Southwark we have considered an indicative business plan for the receiving landlord in the context of a whole stock transfer. The chart below shows the indicative debt of the new landlord, starting at the level required to pay the Council enough to redeem existing housing debt.

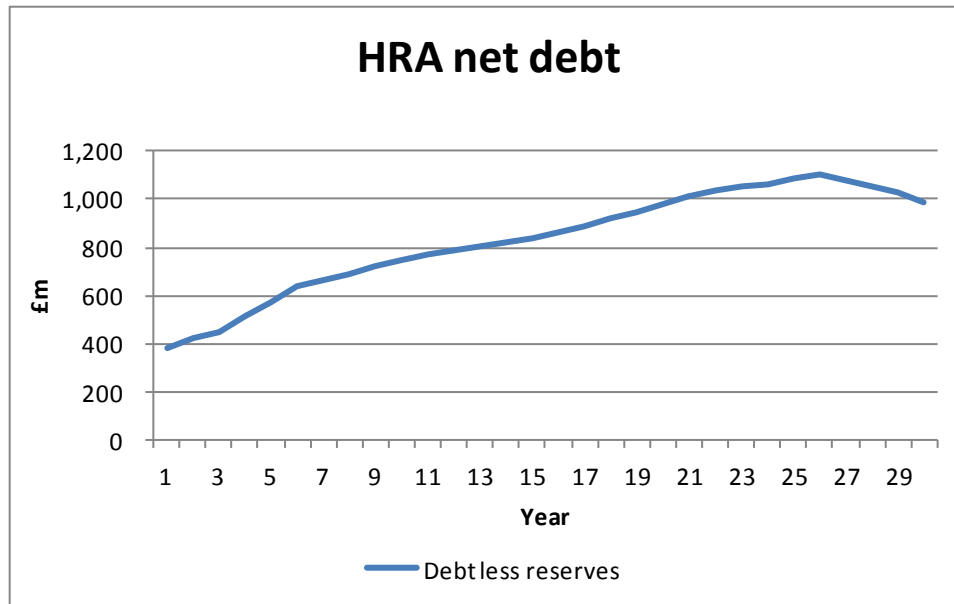


Fig 13: Indicative new landlord business plan - whole stock transfer.

Whilst the projections show debt starting to reduce by the end of 30 years, this position is very unlikely to support the ability to raise private finance at the level required to finance the plan.

Government support for transfer is uncertain, with gap funding available to support the transfer of high liability stock and limited debt write off, available only in return for wider economic benefits. This means that it would be difficult to promise tenants a higher standard of investment following stock transfer as this would not be affordable. If a higher standard of investment was reflected in the valuation, this would reduce the capital receipt, meaning that receipt would not be sufficient to meet the costs of existing housing debt. If a higher standard of investment was reflected in the new landlord's business plan, but not in the valuation, the new landlord would face a requirement for a higher level of funding, which could not be supported by the business plan cashflows, due to the high price paid initially for the stock. Affordability could be supported by debt write off by CLG, but this would mean the Council would need to demonstrate that the delivery of a higher standard of investment would generate economic benefits to central government to match or exceed the cost of debt write off. The case for these economic benefits is unclear at this stage.

Residents have consistently stated that they would not support stock transfer in Southwark. Stock transfer can only proceed if the majority of tenants voting in a ballot confirm their support for the proposals.

The business plan shows that under retention the Council can afford to deliver a higher standard of investment than current programmes, and address many of the disrepair issues identified as required. There is therefore no pressing financial case for stock transfer. Stock transfer introduces additional costs, and critical risks in terms of ballot and funding availability. Without evidence of tenant support for change, and without financial support from government, it is unrealistic to consider whole stock transfer as a viable option for Southwark.

The position with regard to large scale partial transfers is considered above in the exploration of the impact of a reduction in stock to 20,000. In the case of partial stock transfer the same issues arise in terms of the need for the Council to receive a receipt sufficient to the attributable housing debt of the properties transferring, and the extent to which this limits the receiving landlord's ability to deliver a significantly enhanced capital programme, beyond that which could be afforded under retention. In addition with partial stock transfer the Council faces the challenge of reducing its costs to reflect the reduction in rental income. It is likely that some costs will take time to manage out of the businesses, leaving the Council with critical pressures in its business plan.

The position is slightly different with small scale transfers to existing landlords. In these circumstances it may be possible for a receiving landlord to develop a business plan for the Southwark stock which reflects only a marginal additional cost of management, compared with the existing landlord's cost base. This enables the receiving landlord to pay a receipt to the Council sufficient to redeem debt and manage fixed cost reduction over time. Due to the marginal management costs, the new landlord can develop a fundable business plan. Where very small scale transfers are considered it may be possible to access existing funding facilities, removing the uncertainty of the availability of additional private finance in the current economic climate. However, the fact remains that small scale transfers can only proceed with tenant support and therefore it is only likely to be a viable option where proposals are developed which are community led. The Council's existing business plan is robust enough to allow time for these proposals to develop where they are wanted by the local community, without any pressing financial requirement to introduce the idea of transfer where it has not been developed on a community basis.

5.5. Private Finance Initiative

Traditionally another option considered by Councils was the Private Finance Initiative (PFI). Under this option the Council would let a long term contract for the management, maintenance and investment in Council housing to a private sector provider. The private sector provider would borrow to fund early years investment in the stock, in return for a long term payment commitment from the Council. The cost of these payments was supported by PFI credits paid by central government. There are currently no rounds of funding for PFI credits available and in reality

housing PFI was only ever deliverable on a small estate based level, due to the limits in both the availability of credits, and the market for the contracts. PFI is therefore not considered further as a route to fund improvements to business plan capacity in Southwark.

5.6. Maximising benefits under retention – alternative models of housing management

This review has already demonstrated that retention is a viable option for Southwark with the potential to increase investment beyond the current Warm, Dry, Safe programme.

There is potential for the Council to improve its business plan under retention. One example is the use of effective asset management to ensure investment is targeted where there is maximum return against the Council's social housing objectives. The exploration of alternative options for stock that is currently a liability in the business plan can help to identify opportunities for regeneration and renewal that would result in an improved quality of homes for residents, and improved value within the Council's business plan.

There is a limit on borrowing within the HRA, but this need not be a constraint to the delivery of regeneration and renewal as set out above. The key issues are the affordability of the scheme and the Council's capacity to lead regeneration schemes at scale, in consultation with residents.

While this approach to active asset management can address the issues associated with assets which are currently a financial liability within the plan, and failing to meet the Council's social housing objectives, there remains a desire to fundamentally improve the management and day to day maintenance service, as well as the quality of homes.

The evidence received by the Housing Commission indicated that "housing services for tenants and leaseholders have often been poor or unsatisfactory for some time". The Commission also made the point that the size of the housing stock in Southwark means that the service is "like a giant oil tanker" with a change in direction requiring time and consistency of purpose. There is evidence of recent improvements in performance demonstrated both in the Council's own monitoring against key performance indicators, and by the efficiency savings delivered to prepare for HRA self financing.

These improvements have been delivered with the existing service structure. As can be demonstrated by the HRA business plan model, the size of the existing service structure provides a financial strength which can deliver significant benefit to residents, delivering an enhanced programme of investment over time. However the size can also act as a barrier to improvement, without adequate internal competition to drive change, and making local engagement in service challenge more difficult. Additional improvements in service delivery could contribute to further revenue efficiencies, increasing the resources available for investment in homes. It could also have a significant impact on resident satisfaction.

There are several options for alternative models of housing management which the Council may wish to explore in order to provide the step change in performance improvement which both the Council and its residents are seeking.

These models include

- Tenant led management initiatives through a tenant management organisation or community led mutual
- The establishment of a public/private or public/public cost sharing or shared services vehicle

- Local delivery vehicles
- The establishment of an Arm's Length Management Organisation
- Outsourced management

5.6.1. Tenant led management

One alternative which can present a proactive approach to developing local management solutions is to follow the model adopted by the Leathermarket TMO. This has involved a “self financing” model of TMO devolved management where communities take responsibility not just for the day to day management and maintenance of the properties, but also the long term capital financing of the stock. This means that the TMO can benefit from opportunities of long term effective asset management, and the Council can manage the impact on the residual HRA more effectively due to the reduction in its liabilities for debt servicing.

This may represent an effective and viable model for Southwark subject to there being community interest in this approach. In addition to community interest it is important to ensure that the calculation of attributable housing debts reflects the specific archetypes within the TMO area. This ensures that the TMO has a fundable business plan, and that the Council is not left with a level of HRA debt which represents an additional financial burden for the rest of the borough's residents.

Further work would be required to refine these proposals but it is possible that partnership arrangements for local management, and the development of further self financing TMOs could enable Southwark to start to deliver significant improvements in housing management and maintenance services based on local needs and aspirations, while continuing to benefit from the overall financial strength of the Council's HRA.

In time residents may wish to take proposals further beyond management to take on ownership of the housing, perhaps through the establishment of community mutuals (as at Rochdale) or community gateway organisations (as at Phoenix in Lewisham). In March 2012 CLG published consultation on proposals to give tenants greater control through Right to Transfer regulations. The regulations would be designed to make it easier for tenants to take the lead locally to explore options for transfer from their Local Authority, by placing a new duty on the Local Authority to co-operate. The regulations aim to ensure that change of ownership can only take place if

- The tenants group proposing the transfer is independently assessed as being credible
- Their proposals are supported by the tenants whose homes would be affected.

Additional safeguards are considered to enable a Local Authority to halt the Right to Transfer process where it would have wider negative impact.

The consultation recognises that the regulations would impose a new cost on Local Authorities to support tenants to develop proposals and propose to fund this through “New Burdens”. Under certain circumstances the Local Authority would be required to consult tenants on the proposals and to ballot affected tenants on the disposal of their homes. These costs would not be funded through “New Burdens”. These regulations provide no other financial assistance to support stock transfer.

5.6.2. Cost sharing/shared services vehicles

One option Councils have explored historically is the creation of one or more Arm's Length Management Organisations which are wholly owned council companies, established for the management of all or part of the stock. This is explored later in this section. An alternative that

can provide less of a separation from the Council, and therefore may result in reduced set up costs is the establishment of a cost sharing vehicle where elements of the service are shared with other providers in order to provide economies of scale and benefit from shared best practice. These vehicles have often focussed on shared support services, such as procurement, finance, HR and IT and senior management.

The sharing of management services is a model seen in London with bi and tri borough agreements, for example between Hammersmith & Fulham, Kensington & Chelsea and Westminster which share a range of senior officers and services, but maintain their own individual democratic autonomies. To date this arrangement has not involved any housing services.

It is more commonly found in housing associations where the benefits from cost savings from VAT (not relevant in a local authority context) add to the business case for the establishment of the cost sharing structures.

5.6.3. Local Delivery Vehicles

The concept of a local delivery vehicle received government support in the 2007 green paper "Homes for the future – more affordable more sustainable". This is a broad term to include joint venture local housing companies (LHCs) which would act as master developer for new communities within an area, working in public/private partnership between the local authority and private sector. It is a model that can attract both additional funding and management expertise in order to improve performance.

Under a joint venture model the Council would still be a major shareholder in a specially established company and could use its assets to attract long term funding, supported by a management agreement to improve core services, increase investment in council owned homes and deliver new sources of housing supply.

The private sector partner would have a stake in the new vehicle, giving it a key incentive to improve performance. The private sector partner would bring additional expertise to the management of the organisation.

Subject to the attractiveness of the arrangement to the private sector partner (e.g. the scale and length of the management agreement, and the arrangements for the sharing of equity and development funding and risk) the new vehicle could deliver increased investment for residents, and could be structured to ensure that the value of future development is captured for the benefit of all residents. In this way the new vehicle would fit with Southwark's current position of having significant housing assets and would enable these assets to be used to the benefit of residents.

There are many examples of joint ventures established purely for development purposes, for example most recently Oxford City Council have been exploring a joint venture with Grosvenor to deliver 1,000 new homes on council owned land, with the Council to retain some or all of the affordable housing element of the development.

However it is fair to say that LHCs have not taken off in the way envisaged in the Government's Green Paper. The challenges in the external housing market were a large factor, impacting on development potential. But the cost of setting up LHCs was also seen as a barrier by many, particularly for smaller scale developments.

A variation of the Local Housing Company approach was proposed by the Housing Commission. This is the potential for partnership working with other local providers to share services and best practice to deliver locally focussed management. This approach may fall short of the establishment of a full joint venture company and therefore provide a more cost effective change that can be implemented at a very local scale.

Typically soft market testing for this type of approach will indicate significant interest from local registered providers (RPs) who can get advantages from economies of scale by expanding their local management service to include relatively small pockets of Southwark stock. This approach can also be attractive to local residents by providing a service focussed on the specific needs of their area.

Other providers may be able to offer to provide a management service on a marginal cost basis, reflecting the fact that their fixed overheads do not need to increase as a result of managing a larger number of properties. Therefore their proposals may reflect only the direct costs of housing management. This may seem attractive to the Council when compared with their current costs. However these proposals need to be considered in the context of how the Council would manage reductions in its own overheads.

As an example, an analysis of Housemark benchmarking costs for local authorities shows that the proportion of expenditure on "Support Services" (recharges from other council departments) is approximately 20% of total management expenditure. Where a council is considering a partnership model of devolved service delivery, it would still need to fund the support services recharge and therefore only 80% of its current cost base is available to fund management through a different provider. Therefore only bids for less than 80% of current costs would represent a significant cost saving to the Council.

These figures are purely illustrative and a detailed analysis of Southwark's HRA support service costs would be needed before assessing the value for money of any partnership management proposals. However the fact remains that reductions in management costs delivered in this way would need to be balanced against the impact on fixed overheads.

Some partnership approaches may include proposals for trickle transfer of void properties to the registered provider. This gives them an increasing asset base, which they can use to secure additional funding for investment, which does not impact on the Council's borrowing limits. This would be in addition to any void disposals to generate capital receipts. For the Council it remains important to ensure that each trickle transfer disposal at least generates a receipt sufficient to clear attributable housing debt. The Council's direct management and maintenance costs could transfer to the new provider, as they will already have done under the partnership arrangement. Therefore the only remaining issue is the reduction in fixed overheads. In considering the benefits of trickle transfer of voids to a registered provider who is already carrying out the management function in the area, compared with open market disposal of voids the Council will need to consider the balance between the ongoing ability to access the unit as social housing compared with the capital receipt available from open market disposal.

In reality trickle transfers can be difficult to manage as they represent a reactive approach to asset management and disposals, based on void occurrences which cannot be controlled or predicted with any certainty. The costs of such an approach for the Council can be difficult to manage due to the impact on the residual HRA of fixed overhead costs. The transfer of voids can only happen in relation to rented properties and may do nothing to improve services to leaseholders within the blocks.

5.6.4. Arms Length Management

An alternative to the establishment of a local delivery vehicle in partnership with other providers is the establishment of one or more Arm's Length Management Organisations which are wholly owned council companies, established for the management of all or part of the stock. In the past the establishment of an ALMO created the potential to bid for additional funding to deliver decent homes. This additional funding is no longer linked to the establishment of an ALMO and the Council has already been able to access this funding directly.

While many councils have taken steps to end their ALMOs, bringing the management function back in house, others are maintaining their ALMOs and some are considering setting them up for

the first time. One example of a newly established ALMO is at Welwyn Hatfield Community Housing Trust established in 2010 as a management organisation for the management of the council's housing and most housing services. One example of a Council that has decided to maintain its ALMO is London Borough of Barnet where decisions have been made not only to extend the life of the ALMO, but also to extend the range of services that it delivers, to include homelessness and elements of adult services, improving both HRA and General Fund services.

One disadvantage of some ALMOs established purely for housing management on a relatively short term agreement has been in the inability to attract and retain independent board members with the skills required to ensure strong governance. An ALMO's role has been relatively limited and this limits the attractiveness of ALMO board membership when compared with that of a Housing Association with a broader role, for example with housing development and wider community development functions – neither of which have been historically part of an ALMOs' core functions. This is changing with the establishment of longer term management agreements and the increased freedoms in local authority housing finance to engage in new build development again.

The drivers for maintaining or establishing an ALMO now focus not on access to decent homes funding but on the potential for service improvement from an organisation focussed solely on landlord services with the operational freedom to deliver, governed by a board with strong resident representation. ALMOs are now also being explored as a useful vehicle for new development.

This is an option that Southwark may wish to explore for all or part of its stock, although with the lack of a link to additional funding, the Council would need to be convinced that the cost of establishment and separation of services from the Council was outweighed by the performance benefits that could be delivered.

5.6.5. Outsourced management

Another option is the letting of a management agreement, typically with a private sector provider to deliver a defined range of housing services often over a 5 – 10 year time frame.

These arrangements have been common at a local estate level. For example Lewisham Council outsourced several small scale management agreements to Housing Associations and private sector providers, as did Westminster which then used its Arm's Length Management Organisation to manage the outsourced management arrangements. Lewisham Council has since taken steps not to renew its management agreements and the service is now wholly managed by its Arm's Length Management Organisation, Lewisham Homes. Westminster has chosen not to renew some of its management contracts, but others remain.

More recently Hammersmith and Fulham has announced plans to outsource housing management in the south of the borough, and caretaking and cleaning across the entire borough for a period of 10 years, with an option to extend for a further 5 years. The Council will continue management of the north of the borough in house, providing a mechanism for competition between providers intended to drive performance improvement across the whole borough.

Modern housing management outsourced contracts have very different characteristics to the old style "command and control" type contracts used under Compulsive Competitive Tendering in the 1980s and in the very prescriptive housing PFI type contracts with highly specified and detailed contracts, often taking several years to get into place. More recently, partnering style contracts, focused on outcome, rather than a detailed specification of inputs and outputs, have not only been cheaper and more straightforward to establish, but are also intended to give the provider the operational freedom required to improve services.

5.6.6. Local determination of management models

It is clear from resident feedback captured in the Housing Commission report, and from discussions with Council officers, that the Council is keen to deliver a step change in performance improvement and the catalyst for this change needs to be established. In the past councils have used whole stock transfer, PFI or Arm's Length Management as this catalyst for change, linked to the potential for additional funding. Additional funding is no longer available through these routes, and this has created barriers, at least in the case of PFI and whole stock transfer, where the level and cost of change cannot be justified by benefits delivered.

Arm's length management continues to be an option that is explored to provide a local focus for improvement in landlord services, and some councils have explored joint ventures with private sector providers to provide either housing management or development services. With the introduction of self financing, and the freedoms and flexibilities available for Councils to engage in new development again, many are looking at arm's length arrangements through Council owned companies, or partnerships with the private sector, to provide a locally focussed business approach to improve services and provide new homes, with residents at the heart, at board level, driving improvement in line with their priorities.

At Southwark it has been identified that the size of the housing stock in itself presents barriers to performance improvement and there is a clearly expressed desire for the development of locally focussed service delivery structures. These may be through small scale local management structures wholly owned by the Council, local partnerships with other providers, or tenant led management organisations. This will create the internal market of competition through comparisons, in order to drive service improvement. There is no immediate financial crisis in the HRA and therefore the Council has time to enable these proposals to develop at a pace which residents are comfortable with but which could deliver significant long term benefits once in place.

The Council's rented housing stock is projected to reduce to 32,000 over the long term. Right to Buy sales create a movement from a majority tenanted stock to a more 50/50 tenanted/leaseholder estate. In moving to devolved management solutions the balance of tenanted to leasehold stock may vary significantly by local area. In areas where there is a leaseholder majority the operational style may be very different to where there is a tenant majority. The Council will need to consider the implications of this for the culture of the housing management function and how it responds to leaseholder expectations. This may present opportunities to develop the leaseholder focus of its management service but may also raise questions about how the Council enables a balance of tenanted and leaseholder views as local solutions are developed.

Key next steps to develop local delivery structures would include

- The establishment of an overarching framework of governance to ensure the development of local decisions while managing the impact on the overall HRA.
- A policy framework for decisions on how a local management area is defined. These areas must make sense to residents on the ground, and must be of a scale and with a balance of properties which enable viable proposals to develop. The area based asset analysis work identified above may be one way of ensuring that viable property portfolios are established, alongside appropriate levels of debt and funding to sustain long term improvement. This needs to sit alongside resident engagement to ensure these areas reflect existing communities and will enable the establishment of a clear local focus which balances the views of tenants and leaseholders.
- Resident engagement which allows each area to explore options for the management model that suits their appetite for involvement and partnership, drawing up local service standards to inform any contractual arrangements required. The balance of leaseholder

and tenanted stock in each local area will influence the culture of the management service developed.

- A programme of soft market testing, visits to other providers, and in the case of external partners, procurement, with resident involvement .
- The establishment of a service structure, with local delivery alongside shared support services, enabling the financial strength of the HRA to be maintained, while devolving delivery to a local level.

6. Conclusions and next steps

6.1. Conclusions

The financial modelling carried out for this review has combined a range of inputs which impact on the business plan including levels of income, day to day costs and future capital investment. In addition the impact of existing planned regeneration schemes, and future changes in welfare reform is considered. Taking these factors into account it is clear that HRA self financing introduces new opportunities for a viable long term business plan with the potential to increase levels of investment beyond the current Warm, Dry, Safe programme.

That additional investment is affordable with significant long term surpluses forecast. There are potential risks which need to be managed, including a refinement of the information used to scope the investment programme required, and the deliverability and value for money of investment at this scale. Choices may need to be made between timing and level of investment due to short term business plan pressures.

Local asset analysis has already identified the potential to improve business plan capacity by considering alternative options of estate renewal and regeneration rather than direct investment in some stock. Further work is needed to determine the value for money of investment and alternative options for redevelopment and renewal at a local level.

There exist a range of funding options available to deliver estate renewal and new build where this makes strategic sense and is affordable. The cap on borrowing within the HRA need not be a constraint.

A reduction in stock to the 20,000 unit scenario explored in the Housing Commission would lead to a significant loss of future HRA revenue which could not be matched at the same time by a corresponding reduction in costs. This means that in revenue terms the HRA would be worse off as a result of stock reduction and capital receipts from disposals would need to be used to balance the revenue position, reducing the amount of capital available for any additional benefits.

There is no overriding financial case for whole scale stock transfer and in any event, the financial framework for stock transfer has changed with reduced financial support from government, and challenges to the availability and cost of external funding.

Small scale stock reductions, either as a result of community led transfers, or active asset management to deal with high liability stock, could be managed within the overall HRA. However larger scale partial stock transfers would be financially challenging for the HRA, and there is no evidence of resident support for such an approach.

The Council will need to consider overall social housing levels in the borough and the balance between RP and Council provision as Council rented stock reduces naturally over time as a result of Right to Buy and existing planned regeneration schemes.

Local management options, either in partnership with other providers, or by the development of further self financing TMOs may facilitate service improvement and locally focussed asset management to improve business plan capacity and resident satisfaction.

6.2. Next steps

In order to develop the capacity of a retained HRA business plan to deliver Council and resident objectives for the future the following next steps are recommended

- A detailed evaluation of the financial performance of the Council's housing assets, alongside an assessment of the extent to which assets meet the Council's overall social housing objectives
- Exploration of the Council's appetite to lead regeneration and renewal and the development of funding strategies to deliver these within the existing HRA debt cap or through alternative financing arrangements
- A programme of resident engagement to communicate the ambitions for the retained housing stock and to explore the appetite for local management arrangements and TMO development, balancing the objectives of both tenants and leaseholders.
- The development of local management solutions needs to be planned alongside a detailed understanding of the HRA overhead recovery and its relationship with General Fund costs in order to ensure the Council and residents continue to benefit from the financial strength of the HRA but have the freedom to determine local solutions to deliver performance improvements.
- Investment planning and asset management strategy to deliver an enhanced capital programme to meet the full investment needs of the stock, where this represents value for money and developed in consultation with tenants and home owners.

7. Appendix One: 30 year stock condition estimates

Revised Capital £m	2013-17	2018-22	2023-27	2028-32	2033-27	2038-42	Total
APEX + 30%	401.7	203.8	202.6	254.7	230.9	128.8	1,422.4
Fire risk	48.6	45.0	10.0	10.0	10.0	10.0	133.6
Lifts	25.0	25.0	25.0	25.0	25.0	25.0	150.0
Lateral Mains	20.0	37.1	30.7	21.1	12.1	12.1	133.1
Asbestos	5.0	5.0	5.0	5.0	5.0	5.0	30.0
Scaffolding	11.4	9.0	14.0	15.0	11.0	6.0	66.4
Heating - District	40.0	21.0	8.0	5.0	4.0	4.0	82.0
Contingency	24.1	6.1	6.1	7.6	6.9	3.9	54.7
	575.8	352.0	301.3	343.4	305.0	194.8	2,072.2
Regen	70.0	2.5	2.5	2.5	2.5	2.5	82.5
Other	42.0	43.3	43.3	43.3	43.3	43.3	258.2
	687.8	397.7	347.0	389.1	350.8	240.5	2,413.0

Per tenanted unit £ 15,730 9,874 8,541 9,648 8,639 5,737 58,169
Exc regen

HRA base Capital £m	2013-17	2018-22	2023-27	2028-32	2033-27	2038-42	Total
Warm dry safe	360.8	330.0	330.0	330.0	330.0	330.0	2,010.8
HINE	41.4						41.4
	402.3	330.0	330.0	330.0	330.0	330.0	2,052.3
Regen	70.0	2.5	2.5	2.5	2.5	2.5	82.5
Other	42.0	43.3	43.3	43.3	43.3	43.3	258.2
	514.2	375.8	375.8	375.8	375.8	375.8	2,393.0

Per tenanted unit £ 11,164 9,296 9,296 9,296 9,296 9,296 57,644
Exc regen

8. Appendix two: HRA business plan key assumptions

	Assumption	Comment
Tenanted stock numbers	38,787 reducing to 32,422 over 30 years, reflecting: <ul style="list-style-type: none"> • Regeneration schemes • 150 pa right to buy • 30 pa void sales • 900 new builds over first 7 years 	
New build and disposal costs and proceeds	Costs of new build not included – assumed to be funded from other sources outside HRA (except for partial use of RTB receipts) Void sales proceeds not directly recorded in HRA model – included separately as other capital resources (see below) RTB proceeds are available for the HRA to the extent that Government rules require them to be used to fund new build.	
Inflation	General level of inflation of 2.5% pa used for 30 years Some specific real inflation adjustments	
Rent increases	In line with Government policy on rent restructuring, including cap on annual increases.	Councils have the option to increase at higher or lower levels, but there are financial implications.
Bad debts	HRA forecasts factor in an additional £3m pa bad debts for 2013/14 reflecting welfare reform changes. This increase is assumed in all subsequent years.	
Welfare reform costs	In addition to the £3m pa bad debt increase referred to above, a further amount of £4m pa from 2014 for 5 years, reducing to £2m pa thereafter has been included	
Garage and commercial income	Based on current year budget as adjusted for general inflation, with some additional above inflation increases in initial years	

	Assumption	Comment
Other revenue costs (management and maintenance less service charge and other related income)	<p>Current year costs used as basis for future years – adjustments for:</p> <ul style="list-style-type: none"> • Inflation at general level of 2.5% • Tenanted service charge income rising at 3.0% pa varying directly with stock number changes – majority of related costs also increase by 3% • Leasehold service charge income rising at 2.5% pa varying directly with stock number changes • Maintenance costs 30% variable with changes in stock numbers • Management costs 10% - 20% variable with stock number changes <p>Assumed that £4m of 2013 leasehold income relates to capital works</p>	<p>Whilst management & maintenance variability assumptions are reasonable for relatively small changes, larger stock number reductions would allow step reduction in cost base.</p>
Interest and debt	<p>HRA business plan has opening HRA debt of £451m preserved for 30 year period</p> <ul style="list-style-type: none"> • Repayment of current fixed term loans balanced by assumption of new 30 year fixed term loans • Assumed interest for replacement loans 4.5% up to end of 2015 then 5.0% <p>Impact of this assumption is to reduce average cost of interest from 6.5% to 4.8% in long run</p> <p>Interest on surplus balances included at 0.4%</p>	<p>Assumptions are sensible basis for initial business planning.</p> <p>Option to look at debt repayment assumptions and options in more depth in conjunction with capital spend options</p> <p>In particular there would be little advantage in taking out new loans whilst there are substantial reserves earning only 0.4% interest</p>
Capital expenditure	<p>HRA business plan model includes amounts for:</p> <ul style="list-style-type: none"> • Warm dry safe • High investment needs estates (HINE) • Regeneration • Other <p>Modelling of alternative investment assumptions replaces Warm, Dry, Safe, and HINE with information from APEX and other sources</p>	
Leaseholder capital receipts	<p>£4m pa assumed for 2013 increased in line with inflation and no variation for changes in capital programme assumptions</p>	

	Assumption	Comment
Capital resources	<p>In addition to the capital resources generated from the HRA each year, there are:</p> <ul style="list-style-type: none"> • Balances at the start of the year – both MRR and other unspent capital reserves • Receipts from identified sources – regen schemes and asset disposals • Ongoing assumed asset disposals – voids £8m and land £10m 	Sensitivity has been run assuming the £10m land disposal receipt stops after 5 years
Minimum reserves	In modelling of alternative investment scenarios, it has been assumed that a minimum balance of £20m is retained and that debt is increased if necessary to fund additional expenditure	