

**Cabinet**

**14 December 2011**



**Stock Options Appraisal Project – Update  
and Next Steps**

**Key Decision R&ED/02/11**

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**Report of Corporate Management Team**

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Development;**

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**Purpose of the Report**

1. To advise Cabinet of the outcome of financial analysis and consultation on potential options for the future financing, ownership and management of Durham County Council's housing stock.
2. The report seeks Cabinet approval of the proposed next steps in the appraisal process and in determining the best options or mix of options for the future of the housing stock. The report reflects the findings of the Stock Option Appraisal Steering Group (Annex 1) and the findings of Consult CIH's analysis of financial options for the housing stock (Annex 2).

**Background**

**Housing Stock Option Appraisal – Strategic Context**

3. In 2010 the Council published its Housing Strategy Building Altogether Better Lives. The Housing Strategy includes four objectives:
  - Altogether better housing markets;
  - Altogether better housing standards;
  - Altogether better at housing people; and
  - Altogether better housing services.

The Housing Strategy aims to place housing at the heart of regeneration and growth, improve standards through investment in decent homes and empty homes and providing better customer support services particularly for vulnerable customers.

4. The housing stock option appraisal delivers key elements of the Housing Strategy by exploring the variety of options available to the authority for the future financing, ownership and management of Council housing stock. This report discusses the impact of options on the Council's ability to deliver neighbourhood renewal and regeneration; provide and sustain decent homes for Council housing customers; and deliver high quality affordable housing services to customers.

### **Durham County Council's Housing Services**

5. In April 2009 Durham County Council assumed landlord responsibilities for almost 19,000 homes across County Durham.
6. The Council inherited and currently maintains a variety of management arrangements for its housing stock which relate to three of the former district areas, the others having transferred their housing stock prior to the creation of the unitary Durham County Council.
7. There are two Arms Length Management Organisations (ALMOs) – Dale & Valley Homes (D&VH) operating in the former district of Wear Valley and managing around 4,300 homes; and East Durham Homes (EDH) operating in the former district of Easington and managing around 8,500 homes. An ALMO is a registered company set up by a local authority to manage and improve all or part of its housing stock. The Council pays D&VH and EDH for carrying out services on its behalf, by way of a management fee.
8. The Council has direct responsibility for 6,100 homes in the former Durham City area that are managed by Durham City Homes (DCH), an "in house management organisation" that has put in place independent governance arrangements to drive service improvement. This includes a non executive board to contribute to the strategic management of housing in Durham City. The arrangement is intended to reflect the governance structures of the Council's ALMOs.
9. The issues that the Council inherited and its housing management organisations face are numerous and very complicated:
  - The Council has a combination of ALMOs and an in house provider. There is no standardised service offer across the providers with customers in each of the three areas receiving different standards and quality of service provision;
  - EDH has a significant unmet backlog of decent homes works. In February 2011 the Government allocated £70M of decent homes backlog funding to improve Council owned homes to the decent homes standard in County Durham. £65M of this funding was allocated to EDH with the remainder being allocated to DVH to complete the decent homes programme in Wear Valley. The backlog funding was £37M less than the original funding application submitted by EDH, DVH and the Council.

- DVH has almost completed decent homes works to properties in Wear Valley and has started to look ahead to tackling wider issues of neighbourhood sustainability.
  - DCH has made significant progress in achieving decent homes requirements.
  - Different standards of refurbishment and decent homes improvement works have applied in each of the three former district areas. This has led to variation in the quality of Council owned homes across the county.
  - There are also significant issues with stock design and property types, particularly across some areas of the Council's housing stock.
  - Relatively low values of land and dwellings in many parts of the county are also limiting opportunities for regeneration and redevelopment.
  - There is a huge demand for social housing across the county.
10. Despite these issues, the Council's housing management arrangements are established and performing well. There has been a steady increase in customer satisfaction with housing services particularly since the establishment of the first ALMO in 2004. This can be attributed to the ability of the ALMOs in particular to focus exclusively on the delivery of housing services that meet customer needs; invest in homes and neighbourhoods using the funding provided by the Government to achieve decent homes; and actively involve customers in service design, delivery and development.
11. The overall costs of the Council's housing management arrangements compare well with national averages. However, preliminary analysis of the total costs of management, support and back office services undertaken by Consult CIH in May 2011 suggest that:
- There is a variety of experiences of support, management and central cost structures between the three provider organisations, with EDH having a full infrastructure, D&VH partially sharing services with the Council and the Council supporting both DCH as well as central costs within the HRA;
  - Some service sharing between the three providers is already underway (i.e. income collection).
  - The total of support, management and central costs is not insignificant and may offer some potential for further detailed exploration of opportunities to meet the £3m of efficiency targets set in the Council's Medium Term Financial Plan (MTFP). In 2012/13 savings of £1.5m are identified to be achieved by the Council and its three housing management organisations.

## **HRA: Self Financing**

12. At its meeting on the 27 October 2011, Cabinet considered a report that set out the details of the Government's proposal to dismantle the existing Housing Revenue Account Subsidy System (HRASS) and introduce a system of self financing for council housing. The report also provided forecast impacts on the council's 30 year HRA business plan and MTFP.
13. Members will recall that the Government has committed to introducing the change in the housing subsidy system from 1 April 2012. Once out of the system Councils will be able to keep all of their rental income to subsidise improvements to their stock and housing regeneration programmes. The authority must also service the portion of debt allocated to them by the government but cannot borrow privately above the debt cap. In April 2011 the Government proposed a debt settlement figure of £216m for Durham County Council.
14. The introduction of a self financing system signals a move to devolve control of the management and maintenance of housing assets to a local level. In the future, the Council will no longer be subject to annual funding decisions by central Government and will therefore be able to plan investment and the delivery of services on a longer term basis. However, the HRA will also be more exposed to changes in interest rates, high inflation and the financial impact of falling stock numbers. This will mean that the Council will have a greater responsibility to focus on risk management including sustaining income levels and controlling costs.
15. The self financing system will allow the Council to generate and retain significantly more resources than if the current HRA subsidy system were to continue. The Council expects to receive revised determinations and debt settlement figures by the end of November 2011. At that stage the Council will need to refresh the forecasts included in the 30 year HRA business plan considered by Cabinet in October 2011. A final debt settlement figure will be confirmed in January 2012 and a report will be presented to Cabinet in the New Year updating HRA and MTFP forecasts. Based on increases in inflation, the Council should expect its debt settlement figure to be increased to somewhere in the region of £230M - £235M.

## **Stock Investment Requirements**

16. Investment in the housing stock is the single largest area of expenditure in the Council's HRA business plan. Accurate, up to date data on stock composition, condition and costs of renovation and improvement work is essential to complete an informed stock option appraisal.
17. In December 2010 the Council appointed external consultants (Savills Commercial Ltd) to undertake a condition survey of a representative sample of the housing stock. Savills were also asked to provide the Council with the necessary warranties in the event that a stock transfer is chosen as the preferred option.

18. The Council and EDH judged that because EDH already holds a substantial amount of stock condition data, and was beginning to deliver a substantial investment programme, it was not value for money to produce new survey data for EDH. Savills validated the stock information already held by EDH. However, once further investment work is complete a warrantable stock condition survey may still be required for stock in East Durham. This is particularly important if the council decides to undertake a transfer of its housing stock.
19. The stock condition survey identified the level of expenditure required to bring all of the council's properties up to and to maintain the decent homes standard. The survey also included the expenditure required to meet the obligations of the council that go beyond decent homes. This includes cyclical replacement of key components, energy efficiency tests and measures and the improvements required to communal areas in shared accommodation. The stock condition survey did not include full costs for the refurbishment, redevelopment and improvement required to non traditional properties or to the significant number of one bedroom bungalows.
20. The completion of the survey was complicated by the operation of three different investment standards across the council's housing stock. This meant that each area had a unique investment plan and contracts for the delivery of repairs and maintenance and decent homes works. Consequently each area also operates a different set of costs for the replacement and improvement of key building elements.
21. Savills worked with the Council and the asset managers of DCH, DVH and EDH to review costs, lifecycles of components and specifications. Commonality in costs and approaches were identified, agreed and benchmarked against national and local costs. By testing each of these factors Savills were then able to produce a set of average costs for Durham County Council.
22. The stock condition survey found that the housing stock requires around £797m of investment over the next thirty years. This is roughly equivalent to £40,000 per property.
23. The financial profiles derived from the stock condition survey indicate that once decent homes backlog funding is invested in East Durham and Wear Valley the need for renewals and maintenance becomes broadly consistent across the three provider areas.
24. The profiles also indicate that the need for investment arises at different times in the thirty year business plan for each provider. For EDH, the most pressure to spend is within the first five years, as a decent homes programme is delivered. For DVH and DCH the most pressure to invest arises between years six and ten of the business plan. This is due to the current profile of key components in homes that will reach

the end of their lifecycle and require replacement or significant maintenance.

25. In summary up to £388M of investment is required by the Council's housing stock in the first ten years of the thirty year business plan. This equates to around 49% of the total investment. A report presented to Cabinet in July 2011 indicated that only £333M is available to the authority over the same period. This leaves a shortfall of £55M rising to £63M with inflation. It should be noted that the council can manage HRA investment requirements in the first three years of the business plan.
26. This deficit across the first ten years, coupled with a cap on the authority's ability to borrow has significant implications for Durham. The Council must understand how and where it can access the necessary resources to deliver its business plan or to supplement it. This requires analysis of the Council's rental income, an examination of spending on management arrangements and a full exploration of whether capital resources are being invested efficiently in sustainable housing stock.

### **HRA Business Plan and Potential Options**

27. In April 2011 the Council appointed external advisers (Consult CIH and their partners Savills) to provide specialist financial advice to identify options for the future financing, ownership and management of the housing stock and to assist in the development of a thirty year business plan. Consult CIH's final report on financial options for the housing stock is set out at Annex 2. The report focuses on:
  - Self financing arrangements. The Council is required to implement arrangements to deliver the new system of self financing for Council housing from April 2012. The Council must assume that it will continue to own the housing stock for at least the next five years if it is to develop a deliverable and affordable medium term HRA business plan. Therefore it must explore the affordability and sustainability of existing housing management arrangements;
  - How existing housing management arrangements may need to change financially, in order to deliver a more sustainable business plan; and
  - The financial issues and implications of a traditional stock transfer to housing associations created out of the existing providers;
  - The financial implications of an unconventional transfer of the housing stock to a Council Owned Community Owned (CoCo) model, involving the transfer of providers with the retention of a reduced HRA debt settlement.

28. Effectively there are two options for the future financing, ownership and management of the Council's housing stock. Stock retention: which factors in the impacts of self financing and potential restructuring of existing housing management arrangements; and stock transfer to a newly created or existing Registered Provider (housing association) or to a Council owned community owned organisation (CoCo). An overview of these options and an exploration of their associated models are provided below.

### **Stock Retention and Self Financing Arrangements**

29. As noted above, the Council must implement a balanced and affordable self financing business plan from April 2012 that enables investment when it is required, while allowing the Council to repay HRA debt.
30. Notwithstanding the outcome of the final determinations on self financing, which may change the financial landscape, the current forecasts, assuming full component replacement in line with the financial profiles derived from the stock condition survey, indicate that in the first 10 years of the business plan the Council may need to consider deferring up to £63M of investment in its stock under the stock retention model.
31. In considering this option, the Council must be cautious when deferring works as it can mean departures from industry standards, resulting in potentially increased component failure, higher maintenance costs and reductions in customer satisfaction.
32. The deferral of works may prevent the Council from clearing the £216M of debt it has been allocated by the Government. Consult CIH's financial projections suggest that the deferral of works may mean that the Council remains in nearly £100M of debt at the end of the thirty year period. These projections will be updated once the final determinations on Self financing are received.
33. Having reviewed the likely impact of self financing, financial modelling shows that the Council must make efficiency savings in existing housing management arrangements and central costs recharged to the HRA.
34. Additional efficiency savings of c£2M per annum are required, which must be sustained in each year until the end of the business plan period. This saving is in addition to the £3M of efficiencies already identified in the Council's HRA MTFP and discussions are ongoing to achieve these targets through a specially convened Self Financing Task Group.
35. The Council must also ensure that capital investment is made only in homes and neighbourhoods that are sustainable, to ensure that the

Council directs its limited resources efficiently and effectively. This will enable the Council to target funding on the assets that deliver the best value for money from investment. It should also assist the Council in developing an affordable and comparable investment standard across all areas (following consultation with stakeholders).

36. If stock retention was to be more financially viable, the Council would need to consider a restructuring of the current management arrangements to make the required efficiencies to reinvest into the business plan. This could include reabsorbing housing services back into the Council, to establish a large inhouse housing service, or creating a rationalised ALMO structure, creating a single Arms Length Management Organisation (ALMO) or a combination of ALMOs. Under this scenario the Council would remain the legal landlord; customers would remain secure tenants of the authority and their rights would be unaffected.
37. Efficiency savings could be achieved through reductions in management costs and organisational structures. The Council could then reinvest these efficiency savings into improving the housing stock and service provision to standardise Council housing services to a consistent level across County Durham.
38. To implement a restructuring of the existing arrangements the Council would need to undertake a “test of opinion” with its customers. Consultation undertaken during the stock options review process has demonstrated a strong preference from tenants and loyalty to the existing ALMO’s in particular. The perception being that if the full service was inhouse then there could be a loss of focus, with Housing Services simply becoming part of the Council’s wider service base, and therefore this could have an impact on customer satisfaction levels.
39. In implementing a restructuring of the existing management arrangements the Council would also need permission of the Secretary of State. As part of this the Government would need demonstrable evidence that the restructured arrangements will benefit its customers.
40. Whilst in a restructured “ALMO” scenario the Council would continue to face a cap on its ability to borrow, there are a number of advantages to this approach, in addition to rationalised management and back office savings. The ALMO model represents flexibility in adapting to local regeneration priorities as well as an ability to deliver generally high performing housing services.
41. The Council could consider an expansion of ALMO responsibilities as part of this process, extending the management agreement period and encouraging its ALMO (or ALMOs) to create new revenue streams. Some authorities are also using their ALMOs to do more to tackle housing need in their communities. This includes the development of new homes and neighbourhood regeneration. Perhaps most importantly, the ALMO model is also recognised as a potential useful



stock transfer vehicle, with a number of stock transfers to ALMOs recently taking place (i.e Bolton at Home). This is strategically very important if the Council is to consider a transfer of its housing stock to an external provider in the future.

### **Transfer of the Housing Stock**

42. Large Scale Voluntary Transfer (LSVT): LSVT is a term used to describe the transfer of the whole or a substantial part of a Council's housing stock to a new or existing social landlord (also known as a Registered Provider – RP). Traditionally transfers enable increased investment in improvements to the housing stock and to living environments without calling on public sector housing budgets or putting pressure on the public sector borrowing requirement.
43. Stock transfers have been undertaken since the 1990's. Four whole stock transfers have taken place in County Durham since 2004. Transfer organisations have been able to deliver the decent homes standard and sustain the standard over the long term whilst regenerating neighbourhoods and delivering programmes of new build.
44. A transfer represents a change in landlord and so a positive ballot of all tenants would be required before the transfer could take place.
45. The costs of a transfer can be significant. The Council has a statutory duty to consult with its customers under section 106A of schedule 3A to the Housing Act 1985. Consequently the Council will incur expenditure that can be broken down into pre-ballot costs; consultation costs and post ballot costs. These costs include:
  - consultant fees (particularly financial advice) and legal fees;
  - additional staff costs;
  - Issuing a formal consultation document;
  - Statutory notice to customers and a ballot of all customers;
  - Arranging and implementing a transfer and associated warranties.

At this point in the option appraisal process no final costs have been identified specifically for Council to pursue a transfer of all of its housing stock. However, estimates based on the transfer of similar size and make up of housing stock elsewhere suggest that it may cost up to £7m. The Council is able to debit all consultation costs incurred as part of its pursuit of a stock transfer to the HRA.

46. The transfer of housing stock takes place on the basis of a price (based on the Tenanted Market Value - TMV) offered to the authority for the housing stock. The valuation becomes a receipt to the Council, but must be used to reduce or clear outstanding HRA debt. Since 2003 any "overhanging" debt was cleared by the Government, however with the introduction of self financing, the Government has announced its

intention to subject stock transfer proposals to rigorous value for money assessments. At this stage there is no indication as to whether or not the Government will support the levels of debt write off it has in the past. The Government's position on stock transfer and its view on dealing with HRA debt will be made clear when it reissues the Housing Transfer Manual in Autumn 2011.

47. Valuations of the whole of the Council's housing stock equate to £5.6M. This includes the £70M of backlog funding and reflects high levels of investment need in parts of the stock and relatively low levels of income. If the Council was to try to transfer the stock using this valuation (on the basis of other stock transfers that have taken place in the County) it would require the Government to "write off" (or clear) almost all of the £216M it has allocated in debt to the authority. It is unlikely that the Government would support such a proposal.
48. Recent stock transfers have indicated that the Government is keen to reflect an increasing benefit from VAT shelters back into the business plan. This increases the valuation of the Council's housing stock. If the Council is assured that a fifteen year VAT shelter on capital works can be worked back into the business plan the revised valuations for the whole of the housing stock equates to £55.9M.
49. An increased valuation also has implications for the treatment of housing debt in a self financing context. The Council may be able to negotiate VAT as an allowable expense which could also lead to a reduction in the HRA debt settlement figure. Consult CIH estimate that this could be a reduction of £66M leaving £150M of HRA debt to be cleared upon transfer.
50. If the Council was to ask the Government to reduce HRA debt to £150M to enable stock transfer, potential funders (Registered Provider funders) might reasonably be expected to finance a valuation of £56M. However, this would leave a gap of £94M between the valuation of the housing stock and the revised HRA debt settlement. In the absence of a revised Housing Transfer Manual it is unclear if the Government would write off all of this debt. Therefore the Council would be required to consider the variety of ways it could reduce this gap. This may include; the encouragement of a contribution from a purchasing housing association; or by making arrangements with lenders to make funding available, possibly at a higher price. There is also the possibility that the Government may consider offsetting the £37 million shortfall required to fully complete the decent homes programme in East Durham. However, it is unlikely that these sources will be able to bridge the whole gap. Therefore to make a transfer proposal work the Council would need to make a robust proposition to the Government for further overhanging debt write off, strictly on the basis of value for money.

51. At a provider level a transfer of stock in East Durham would require dowry funding. For Durham City and Dale & Valley, although valued positively, transfer may leave the remaining HRA with too high a debt to sustain unless the Government agrees to further debt write off.
52. It is important to note that the Government is due to update its transfer guidance in the autumn of 2011 which should set out the basis upon which it will consider a transfer proposal post the introduction of self financing. The guidance should include the criteria that the Government will use to test value for money in transfer proposals, particularly in relation to debt reductions.
53. On the basis that a traditional LSVT may not offer the Council a whole stock solution, Consult CIH have also considered an alternative stock transfer model as a potential option for the authority. This would require the transfer of the housing stock to a charitable organisation (likely to be one or all three of the existing providers) that is one third owned by the Council and two thirds owned by tenants and the local community – a CoCo.
54. The CoCo model is a new and innovative model for stock transfer designed by the National Federation of ALMOs to enable access to private sector borrowing whilst preserving community focus and customer involvement. At this stage the CoCo model has not been implemented anywhere else, largely because the Government's views on the model are unknown. However, the Government is expected to take a view on the model as a concept in the revised Housing Transfer Manual and so there are other authorities that have expressed an interest in exploring the model further.
55. Under the CoCo model the HRA debt would remain with the Council and would be serviced by the CoCo. The CoCo would covenant to meet the Council's interest and repayment obligations on its HRA loans (most of which are likely to be from the Public Works Loan Board).
56. The CoCo would be able to take advantage of the Council's borrowing rates, enabling it to raise additional finance in a more cost effective way. Unlike Council borrowing all CoCo borrowing is off balance sheet, so it is not subject to the public sector borrowing restrictions imposed by the treasury under the self financing settlement.
57. As with a traditional LSVT of the housing stock transfer to a CoCo represents a change in landlord, therefore the Council has a statutory duty to consult with customers. This includes a ballot of all customers. The process of consultation will run in exactly the same way as a traditional stock transfer and will be funded from the HRA. Therefore it is reasonable to assume that the costs for consultation on transfer to a CoCo will be broadly similar. However, because the CoCo model is untried it is also reasonable to assume that legal fees will inevitably be higher.

58. A transfer to a CoCo is effectively “cost neutral” to the treasury, as HRA debt is retained by the Council after transfer. Again, the Council would require the Government to reduce the debt settlement on the basis that the CoCo is subject to irrecoverable VAT. This would result in a reduction of £66M and an opening debt of £150M. Again, this would depend on negotiation with the Government. The Council would also need to negotiate a VAT shelter with the Treasury (to allow recovery of VAT on capital works up to fifteen years).
59. Successful delivery of the CoCo business plan is dependent on the same level of efficiencies as required in the self financing option. However efficiencies will achieve even greater benefits to the CoCo’s HRA business plan.
60. The CoCo model may have merit in County Durham as the financial pressures in the HRA business plan are in part caused by constraints of the HRA borrowing cap. The CoCo model could allow private finance borrowing to meet the needs above the debt cap, which could then be repaid throughout the life time of the business plan.
61. At a provider level and from a financial perspective, the CoCo model can apply to all of the housing management organisations, but it may in principle apply most usefully in East Durham where traditional stock transfer valuations are low (because of investment needs and lower levels of income) and spending pressures are greatest in the early years of the business plan.

### **Financial and Legal Implications**

62. In summary the Council faces major financial and legal implications in relation to all of the options available to it for the future financing, ownership and management of its housing stock.
63. If the Council retains its housing stock it faces a deficit of up to £63m in the first ten years of its business plan. The Council will be unable to complete and to sustain a decent homes programme and it will be unable to access borrowing to ameliorate this situation. This will require change in existing housing management structures, the prioritisation of investment programmes and a review of the cost of the Council’s support services to Council housing.
64. If the Council chooses to transfer the ownership of its housing stock the process may take over two years to complete. The costs to the HRA will be significant, with up to £7m required to complete consultation, a ballot and to finalise legal agreements and the warranties required to transfer the housing stock. Any receipt the council receives from the sale of the housing stock must be used to reduce HRA debt. The recipient Housing Association will however, be able to borrow funds to

complete and sustain decent homes, undertake remodelling of obsolete and unpopular stock and possibly engage in building new homes.

65. If the Council chooses to consider a transfer of its housing stock it must consider the effect of transfer on the Council's other services and activities. This includes an assessment of the Council's overall financial position in terms of the General Fund and impact on the corporate structure of the authority.

### **Consultation on Options**

66. From the outset of the option appraisal project, the Council was clear that customers, staff, Councillors, Board members and other key partners should play a major role in the appraisal of options for the housing stock.
67. Customers were engaged from the very beginning of the project in defining objectives and priorities for the Council's housing stock. Customers highlighted their first priority objective as being the ability to access long term funding to support the improvement and repair of high quality affordable homes. Customers also identified protecting tenant rights; the local provision of services; and the regeneration of neighbourhoods as key priorities for consideration when appraising options. These objectives have underpinned the identification of potential options for the future financing, ownership and management of the housing stock.
68. The Council developed a detailed Communication and Consultation Strategy and Tenant Empowerment Statement to guide consultation with all stakeholder groups and to ensure barriers to involvement in the process were identified and removed.
69. Consultation with customers was led by Engage Associates (Independent Tenant Adviser - ITA). The Council's decision to appoint an ITA represents its commitment to ensuring that customers receive independent, impartial advice on potential options and so are empowered to make their own decisions about the future of their homes, neighbourhoods and the services they receive.
70. Consultation with all other stakeholder groups was led by the Council's housing stock option appraisal team (Housing Directions). A summary of the key findings of consultation is set out below.

### **Customer Consultation: Outcomes**

71. Over ninety separate events were offered to customers ranging from summer suppers and quizzes to presentations at well established residents associations. In total 876 people engaged in face to face discussions about the options (4.6% response rate).

72. Two newsletters were also distributed to all 18,700 homes setting out the project's objectives and explaining potential options. Each newsletter included a free post section that customers could return to the ITA. 1,162 customers responded to the first newsletter (6.2% response rate) and 1,099 customers responded to the second newsletter (5.8% response rate).
73. Formal responses to consultation were also submitted by DCH Tenants Panel, the Housing Partnership (linked to EDH) and the Wear Valley Customer Panel (linked to DVH).
74. Consultation with customers found that there is a good understanding of option appraisal and potential options among customers that are actively involved in the option appraisal process or are regularly involved in the activities of the Council's housing management organisations. There was also an appetite amongst this group for stock transfer, particularly to a CoCo. A clear preference of this group is for the Council to transfer its stock to its existing housing management organisations. This reflected a consistent and strong desire amongst most stakeholder groups to preserve local focus and housing service delivery. Transfer to an existing Registered Provider was not a popular proposal because customers taking part in consultation expressed a fear this may mean a reduction in standards of service and a loss of focus on local service delivery.
75. Consultation with customers also found that for customers that are not involved in the option appraisal process and are not regularly involved in the activities of the housing management organisations there is a varied understanding of the option appraisal and the options the Council is considering. There is some reticence amongst this group towards transfer options at this stage, particularly the CoCo model which they found to be complicated. Engage Associates have offered some reassurance that this can be attributed to a lack of understanding of the purpose and benefits of the transfer option and is not uncommon at this early stage in an option appraisal.
76. Consultation with customers also found that there is a considerable amount of confusion as to the role and responsibilities of the Council and the role and responsibilities of its housing management organisations. The Council must take steps to improve this understanding if it is to pursue a stock transfer or make any changes to existing housing management arrangements. This is because transfer of the housing stock is dependent on a positive ballot of all customers. This work should be part of a wider awareness raising campaign for all stakeholders on options and their implications for all stakeholder groups.
77. Consultation with customers also found that they were concerned about apparent disparities in rent levels, the differing standards of service received and differences in the quality of Council owned homes.

## Consultation with Stakeholders: Outcomes

78. The Council's Housing Directions Team delivered an extensive programme of consultation for staff, Councillors, Board members and other key partners. Over 300 stakeholders took part in the consultation and nine formal responses to consultation were submitted by staff forums; the Boards of the housing management organisations; Overview and Scrutiny Committee; and union representatives.
79. All stakeholder groups commended the open and transparent approach the Council has taken to consultation on potential options for the future of its housing stock.
80. There was some consistency in the principles that all stakeholder groups would like the Council to observe the following principles in reaching a decision on the best option or mix of options for the future of its housing stock:
  - The Council's decision on the future of its housing stock should be based on a "whole stock solution". This may involve the implementation of a mix of options, but no one part of the housing stock should benefit to the disadvantage of another part of the housing stock.
  - The Council's approach to implementing options, determining efficiencies, apportioning debt and determining ways to bridge gaps in transfer valuations to determine transfer solutions should be transparent, fair and equitable.
  - Any options that the Council considers must meet customer's first priority objective of bringing additional long term funding. Options should also reflect customer's priorities of protecting local services and tenant rights.
  - All capital receipts received from a transfer of all or part of the stock should be used to reduce HRA debt;
  - If the Council retains ownership of the housing stock it must strive to ensure that a Council owned home is of the same quality as that of a Registered Provider.
81. Consultation with stakeholders found that there is a strong appetite for a transfer of the housing stock. A clear preference of a majority of stakeholder groups is for the Council to transfer its stock to its existing housing management organisations. Stakeholders were not supportive of a transfer of the housing stock to existing Registered Providers. Again this was because stakeholders were concerned that this may mean a reduction in the quality of services, and a loss of local focus.

82. A majority of all stakeholders consulted on potential options also expressed a preference for the principles of the CoCo model as a useful means of preserving the positive characteristics of the ALMOs. However all stakeholders were concerned that the model had not been implemented elsewhere and would like clarification on the relationship of the CoCo with the Council and the Government's support for the model.
83. The Council also undertook consultation with the Department of Communities and Local Government (DCLG) and the Homes and Communities Agency (HCA) to discuss potential options and their implications. DCLG and the HCA confirmed that under self financing whole and partial stock transfer will remain an option for Councils. However, the Government do intend to introduce a much more rigorous assessment to ensure transfer proposals are value for money to tax payers.
84. DCLG and the HCA were clear that if the Council is to pursue a transfer of its stock it must clearly explain why it wishes to do so and how it will fund transfer proposals. DCLG also explained that the Council must also take a "twin track" approach i.e. it must put in place affordable and sustainable self financing arrangements as its progresses with its transfer proposal.
85. DCLG have agreed to work with Consult CIH and other advisers to fully explore the implications of the CoCo model as a transfer option. The Council will meet with DCLG again in January to discuss progress.
86. The opinions of all stakeholder groups consulted on potential options were divided over the best set of self financing arrangements (stock retention) to implement. All groups indicated a preference for the continuation of existing housing management arrangements. However there was a general understanding that a continuation of existing arrangements with no change was unrealistic given the deficit in the first ten years of the HRA business plan. As a result, some groups suggested the creation of two ALMOs to achieve efficiencies; and other groups suggested that the Council consider the creation of one ALMO to manage the housing stock. Across all stakeholder groups there was some consistency in the principles that stakeholders would like the Council to observe in developing and implementing self financing arrangements:
  - Stakeholders should be as involved in the development of self financing arrangements as they were in option appraisal;
  - The continued local delivery of services should be a key consideration;
  - The objectives of the option appraisal should continue to be observed;
  - Front line services should be protected to prevent a decline in performance and reduction in customer satisfaction;



- Service standards, rents and the quality of homes should be made consistent across the area; and
- Decisions on self financing and possible changes to existing housing management arrangements should be informed and implemented as quickly as possible to provide certainty to customers and to staff members.

## **Conclusion**

87. The Council has landlord responsibility for almost 19,000 homes across County Durham. The Council currently uses a variety of housing management organisations to deliver services to customers. These include two ALMOs and one in house management organisation.
88. From April 2012 the Government proposes to introduce a system of self financing that will allow the Council to retain its rental income in exchange for a one off debt allocation to settle existing HRA housing subsidy arrangements. Durham's debt settlement is projected to be in excess of £216M. The Government proposes to cap the Council's ability to borrow at the debt settlement level to control public sector borrowing.
89. The HRA self financing business plan highlights shortfalls of capital resources against spending needs of £63M over the first 10 years of the business plan. The deficit is exacerbated by the Council's inability to borrow above its debt cap to supplement its business plan. The Council can manage these issues in a variety of ways. It can:
- Consider the deferral of works until the pressure in the business plan is not so great. This could impact on the Council's compliance with the decent homes standard and customer satisfaction levels.
  - Start to prioritise capital investment through the development of a detailed Asset Management Strategy. This will assist the Council in efficiently targeting investment on sustainable assets and relieve pressure to invest in the early years of the business plan.
  - Seek to achieve an £2M of efficiencies in housing management and capital investment programmes in addition to the £3M of efficiencies already identified in the Council's MTFP. This may include a reorganisation or rationalisation of existing housing management organisations.
90. The central issue for Durham County Council is that the operation of the debt cap under self financing is incompatible with the investment needs of the Council's housing stock, particularly in the early years of the business plan. Therefore the Council should consider the exploration of a solution that enables the Council and its providers to access required

levels of funding and achieve the full investment profile in all years. This includes a consideration of the transfer of the housing stock.

91. The financial landscape for traditional LSVT has changed significantly and transfer can now only proceed on the basis that expenditure assumptions are in line with those made under self financing. For Durham County Council the maximum transfer valuation for its whole stock is around £56M (including backlog funding and VAT shelter for 15 years). This could reduce the debt settlement to £150M upon transfer, but would leave a gap of £94M that the Council or potential transfer organisations would need to bridge.
92. Funding to bridge the gap could be identified across the Council, a purchasing housing association or through arrangements with lenders to make private finance available. However, these sources are unlikely to be able to bridge the whole gap. If the Council is to consider the further exploration of stock transfer options it must consider the development of a robust proposal to the Government for further debt write off.
93. At a provider level the traditional stock transfer of the housing stock does not work for all the housing stock, with significant dowry funding required for East Durham. For Durham City and Dale & Valley a positive valuation means that a partial stock transfer is possible, but it is likely to leave the remaining HRA with too high a debt to sustain unless further debt write off from the Government is secured.
94. A stock transfer to a CoCo model may have merit in County Durham in terms of borrowing above the debt cap; retention of the HRA debt; the fact that the model is not dependent on traditional LSVT valuations; and good use of existing ALMO arrangements. The CoCo model might apply most usefully in East Durham where the stock valuation is low and spending pressures are greatest in the early years. The CoCo model is currently untried.
95. Extensive consultation found that appetite for stock transfer is highest among involved customers, staff, the Board members of the Council's housing management organisations and partners. The CoCo model was particularly supported by these groups. Stakeholders also expressed a preference for the Council to transfer its housing stock to its existing housing management organisations and not an existing Registered Provider.
96. Appetite for stock transfer is lowest among customers that are not routinely involved in housing services. There was also a varied understanding of the role and responsibilities of the Council and its housing management organisations amongst customers. This group also demonstrated a lack of enthusiasm for the CoCo model at this stage in the option appraisal, with customers seeing it as risky and complicated.

97. Consultation has underlined the fact that if the Council chooses to pursue a stock transfer option it will need to undertake a considerable amount of work to raise awareness of potential transfer options and the benefits of transfer to customers. This work forms an essential part of a transfer project any way and it does not represent an insurmountable barrier to the Council progressing into the next phase of its exploration of a stock transfer proposal.
98. Consultation with DCLG also found that the Government intends to continue to operate stock transfer as a policy post self financing. However, proposals will be subject to rigorous tests and the level of Government support offered to stock transfers in the past is unlikely to be available to the Council. The DCLG has also advised the Council to proceed with the implementation of self financing arrangements from April 2012.
99. The opinions of all groups were divided over the best way of achieving efficiencies in self financing arrangements. However by the end of the consultation process there was a general understanding that a continuation of existing arrangements with no change was unrealistic given the deficit in the business plan. As a result, some groups suggested the creation of two ALMOs to achieve efficiencies; and other groups suggested that the Council consider the creation of one ALMO to manage the housing stock.
100. The absence of a final self financing debt allocation and a revised Housing Transfer Manual means that the Council is unable to take a final view on the best option or combination of options for the future of its housing stock at this stage.
101. However, the financial analysis and consultation that the Council has completed as part of its option appraisal has placed the authority in a strong position to prepare for the implementation of affordable self financing arrangements; and to react positively to the Government's views on future stock transfer opportunities.
102. The Council should continue to work with stakeholders to complete a review of existing housing management arrangements to ensure that they are affordable and sustainable. The Council should also continue to work with the DCLG and the Homes and Communities Agency to explore the possibility of stock transfer and its benefits for County Durham. This represents a move into the next phase of the option appraisal.

## **Section 6: Recommendations**

1. The Council should continue to make arrangements for the implementation of self financing, including continued discussions regarding a potential stock retention scenario by:

- Assessing the impact of the final determinations of self financing debt allocation, on both the HRA MTFP and the 30 year business plan. The 30 year business plan should also be updated to take into account any changes in our long term assumptions i.e. inflation and interest rates.
  - Completing a transparent review of self financing, including a final analysis of the number, shape and organisational structures of retained housing management arrangements.
  - Developing a comprehensive Asset Management Strategy that considers the long term sustainability of neighbourhoods and stock types; develops a comparable investment standard across all areas informed by customer consultation; and links asset modelling and business plan efficiencies to secure financial viability.
2. During this process the Council should continue to explore options for the transfer of its housing stock by:
- Considering the guidelines set out in the revised Housing Transfer Manual once published by the DCLG;
  - Reviewing the tenanted market value of the stock and the issues associated with debt reduction and value for money and determine optimum transfer combinations that maximise investment for the whole stock;
  - Increasing communication with DCLG and the HCA;
  - Developing a comprehensive communication and consultation strategy to raise awareness amongst all stakeholders of the role of the Council, promote transfer options, explain the implications of stock transfer and include a plan for engaging with hard to reach groups.
  - Aiming to submit a formal transfer proposal where feasible to the DCLG by the end of December 2012.

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## **Appendix 1: Implications**

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### **Finance**

In April 2012 Durham County Council will be allocated a debt settlement in excess of £216M by the government to implement a system of self financing for Council housing. From that point the Council must use its own income from rents to invest in improving and maintaining its homes. Council owned housing in County Durham requires £797M of investment over the next thirty years. £388m is required in the first ten years of the business plan, but only £333m is available to the authority. The Council must determine the most appropriate options for dealing with the shortfall in resources and in reducing its debt to ensure a sustainable future for Council housing.

The figures used in this report were correct at the time that analysis and modelling took place. They will be reviewed as part of the update outlined in Recommendation 1.

### **Staffing**

Staff are a key stakeholder in the stock option appraisal process. This includes staff working for the Council and for its two housing service providers, Dale & Valley Homes and East Durham Homes. Any options that the Council considers must also consider implications for employment, terms and conditions and pensions.

The Council has already put in place a permanent Housing Directions Team to complete the option appraisal and implement preferred options. The Housing Directions Team will continue to need support from the Council's finance, legal and procurement teams and the Council's housing management organisations.

The Housing Directions Team will also require additional support from expert financial, legal and stock condition advisers to complete an analysis of stock value, financial performance, asset management and legal issues related to consultation and warranties. Funding to complete this work has already been allocated from the Housing Revenue Account.

### **Risk**

Financial analysis and the outcomes of consultation have underlined some clear risks for the Council when moving into the next phase of its option appraisal.

Risks include:

- The Council's proposal to transfer the housing stock is rejected by the Government on the basis of value for money.
- The Council's proposal to transfer the housing stock is rejected by customers at a ballot.
- The Council's proposal to transfer the housing stock is inequitable and does not achieve a whole stock solution.

- The Council's self financing arrangements are inflexible, unable to respond to potential transfer opportunities in the future and are unaffordable and unsustainable.

A majority of the identified risks are linked to a decision to pursue a stock transfer. The Council can undertake a series of actions to mitigate against these risks and reduce their likelihood. These actions include:

- Observe the guidelines set out in the revised Housing Transfer Manual (due to be reissued in autumn 2011) and continue to work with DCLG and the HCA to prepare a stock transfer proposal that meets Government requirements.
- Develop and implement a comprehensive communication and consultation strategy for stock transfer that explains the role of the Council; the transfer option and implications for all stakeholders. The strategy should be projected over a two year time frame and its central aim should be the achievement of a positive ballot.
- Work with stakeholders to complete a transparent review of the costs associated with a variety of self financing arrangements. The investigation should also consider the project objectives of the option appraisal; local service delivery; and efficiency savings and a whole stock solution.

### **Equality and Diversity**

One of the appraisal's key objectives is to address inequity in the quality of the housing services and neighbourhoods currently provided by the Council. The project also aims to provide all individuals and organisations with an interest in the future of the Council's housing stock with the best opportunities to contribute to the stock option appraisal process, if they wish to do so. This will be accomplished through the implementation of a communication and consultation strategy and a tenant empowerment statement. The Council will use these strategies to address potential barriers to involvement in the project and in improving housing services by providing a variety of involvement mechanisms and a selection of communication methods to suit a variety of needs and requirements.

### **Accommodation**

None

### **Crime and Disorder**

A reduction in crime and disorder is reflected in the option appraisal's objectives. This ensures that potential options consider the reduction of ASB and the designing out of crime in homes and neighbourhoods.

### **Human Rights**

None

**Consultation**

The option appraisal and the Council's decision on the future financing, ownership and management of its housing stock has been fully informed by consultation with customers, staff, Councillors, board members and other key partners. The Council has developed a detailed Communication and Consultation Strategy, Tenant Empowerment Statement and consultation programme for each stakeholder group.

**Procurement**

Specialist financial (Consult CIH) and legal (Trowers and Hamblins) advisers and an independent tenant advisor (Engage Associates) have been procured to support the formulation of potential options and the delivery of the project.

**Disability Discrimination Act**

None

**Legal Implications**

The Council currently has legally binding 'Management Agreements' with Dale & Valley Homes and East Durham Homes for the provision of housing services to its customers. Depending on the option that the Council ultimately selects, these management agreements may be subject to change or redevelopment. There are also significant legal implications if the Council selects the transfer of its housing stock. Trowers and Hamblins, the leading legal consultants in this area of work have been engaged by the Council.