AGENDA ITEM NO. 4

TAUNTON DEANE BOROUGH COUNCIL

EXECUTIVE 7 DECEMBER 2005

REPORT OF STRATEGIC DIRECTOR (Shirlene Adam)

HOUSING STOCK TRANSFER CONSULTATION – FINANCIAL UPDATE

EXECUTIVE SUMMARY

The project update report presented to the Executive on 16 November 2005, briefed Members on the project progress generally, and shared the latest information on the warranted stock condition survey.

This report picks up on that work and provides an update on the financial issues on the project, taking into account:-

- The results of the stock condition survey; and
- The latest budget position of the Council.

1 PURPOSE OF REPORT

1.1 To provide Members with a financial update on the Housing Stock Transfer Consultation project.

2. BACKGROUND

2.1 The final report to Executive in July 2004 on the Stock Options appraisal outlined the expected financial position on housing stock transfer. This included details of the assumptions used, the funding deficit (gap between what the Council wants to do to the housing stock and what funding it has available), and the expected capital receipt.

2.2 Pricewaterhouse Coopers (Lead Advisors on this project) have now updated this financial position to reflect the impact of the stock condition survey, and the latest position of the Councils Housing budgets. Their full report is attached as an Appendix.

3. KEY MESSAGES

3.1 Stock Condition Survey

The information from the warranted stock condition survey (details of which were included in the report to the Exec on 16 Nov) has been reflected in the updated business plan. There is now a future expenditure requirement of £6.4m per annum to meet the minimum standard (the stock options appraisal assumed a future requirement of £6.4m per annum to meet the full aspiration standard).

3.2 Impact of Changes in Rent Restructuring and Housing Subsidy

Final details on both issues will be available during December. Meantime, Pricewaterhouse Coopers have worked with Council staff to consider the likely impact on future budgets.

The likely net impact of the rent restructuring issue is a small increase in the revenue budget position for the council.
The likely net impact of the subsidy changes is an increase in capital resources available to the Council of around £100,000 next year.

3.3 Impact on Options Appraisal

The detailed report outlines the impact of the updated financial position on the original stock options appraisal conclusion.
The stock transfer option continues to be the only option that delivers on all of the Councils priorities for Housing.

3.4 Valuation

The stock condition survey results, the rent restructuring proposals, and revised Council budgets all impact on the valuation.
Based on these updated assumptions the model predicts a revised valuation figure of £36.3m. **It is important for Members note that this figure will be subject to change** throughout the period leading to the ballot, and following the ballot (if the tenants vote yes). For this reason, regular updates on the financial issues on the project will be provided to Members.
The detailed report sets out some of the issues that will have an influence on the final valuation figure (sensitivity analysis) and the assumptions used in the current calculations.

3.5 Capital Receipt

Based on updated assumptions, the potential net capital receipt (after allowing for set-up costs, levy and repayment of housing debt) is £18.9m. **It is important for Members note that this figure will be subject to change – as outline in 2.4 above.**

4. CONCLUSIONS

4.1 The update above, together with the detail set out in the attached Pricewaterhouse Coopers report provides Members with an up-to-date financial position on this project.

4.2 Further reports will be presented to Members at regular intervals as the project progresses, setting out clearly the financial implications of key decisions as they are taken.

5. RECOMMENDATION

5.1 The Executive is requested to note the updated financial position on the project.

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Government and Public Sector

7th December 2005

Taunton Deane Borough Council

Financial update

PRICEWATERHOUSECOOPERS

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Background

1 At the conclusion of the options appraisal in July 2004 the Council's Housing Revenue Account (HRA) business plan predicted that the Council faced a small funding gap (£900,000) in the level of resources required to bring all its properties up to the Decent Homes standard by 2010. The plan illustrated much larger funding deficits to meet the full investment needs of the stock. Over the next ten years the plan predicted that capital resources were required at an average of £6.4m each year. Resources were predicted to be available at an average of £4.7m each year. This meant that existing capital programmes would need to be cut by an average of 26% each year in order to bring expenditure in line with predicted resources.

2 The Council submitted an application to join the government's housing transfer programme in December 2004. At this time it was estimated that the tenanted market value of the housing stock at transfer would be £38.2m (£6,267 per home). The valuation method for stock transfer takes into account the income and expenditure on the stock over the next thirty years. The indicative stock valuation prepared for the programme application was based on current budgets, which reflected the proposed restructuring, and information available at the time on future stock condition (based on historic information with external validation).

3 Since the programme application the Council has commissioned a new stock condition survey which has now been completed. The government has also announced changes to the framework for rent restructuring, and published its draft housing subsidy determination for 2006/07. This paper considers the impact of these factors on the indicative tenanted market value of the housing stock, and on the Council's base financial position.

Base financial position

Resources

4 The Council's prediction of future capital resources is based on estimates prepared by Council finance staff, with advice from PricewaterhouseCoopers on the preparation of the HRA business plan. The Council predicts that capital resources of £4.3m each year will be available to fund investment in Council owned housing stock. The breakdown of this figure is illustrated below:

Table one: Capital resources

Annual resources to 2010	£m
MRA	3.4
Supported borrowing	0.6
Contribution from revenue	0.3
Revised total	**4.3**

5 This compares with a forecast of £4.7m per annum at options appraisal. The main reason for the difference is a reduction in estimates of the contribution to capital expenditure from the housing revenue account. The revised figure reflects current Council budgets. Capital receipts from Right to Buy sales are not reflected in the table as these are currently directed to fund general fund capital programmes.

Expenditure

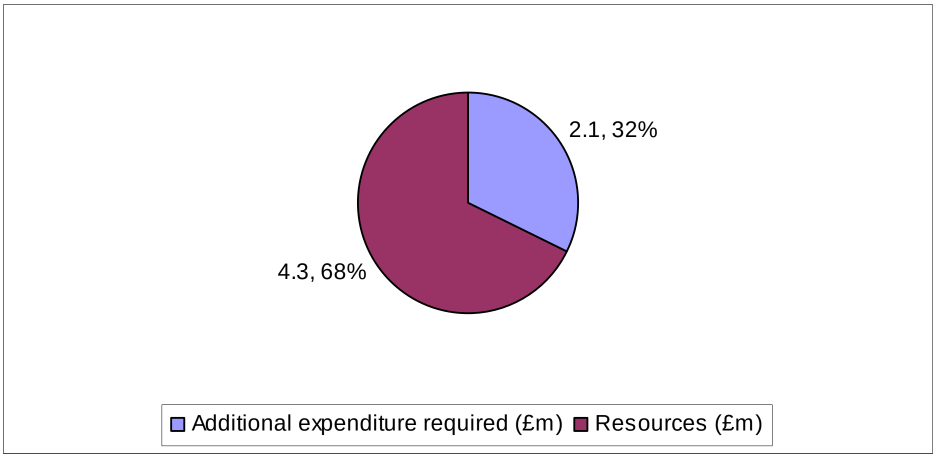
6 Future capital expenditure estimates are based on information from the most recent Savills' stock condition survey. Savills estimate total expenditure of £318[1]m is needed over the next thirty years. £53.4m of this is needed in the first five years, of which £17.1m is required for day to day expenditure on responsive void and cyclical maintenance, and £36.3m on capital works. Savills have also stated that £26.8m of the capital expenditure requirement in the first five years represents works to meet a minimum standard, including decent homes and other statutory landlord requirements.

7 This compares with previous estimates of £31.4[2]m needed on capital expenditure in the next five years, of which £24.5m was needed for a minimum standard.

[1] Figures are at a November 2005 price base and exclude professional fees, VAT and inflation
[2] Based on Council estimates of total five year capital expenditure requirement of £28.2m at 2003/04 price base, uplifted to show 2005/06 price base for comparison purposes. Figures exclude fees, VAT and inflation.

8 In order to predict future expenditure needed, the new stock condition information has been included in a revised HRA business plan. This takes into account the cost of professional fees, inflation and the loss of properties from future Right to Buy sales. The revised plan indicates a future expenditure requirement to meet the minimum standard of £6.4m each year from now until 2010. It should be noted that this amount is required to meet the minimum standard, rather than the full investment needs of the stock. This indicates a funding gap of 32% per annum to meet the minimum standard, as illustrated below:

Figure one: Comparison of total expenditure requirement and available resources



Impact of changes in rent restructuring and housing subsidy

9 The Office of the Deputy Prime Minster (ODPM) has announced changes to rent restructuring as follows:

- Increased weighting applied to target rent calculations for three bed and larger properties
- Changes to the input information to target rent calculations to bring local authority target rent calculations fully in line with those used by Registered Social Landlords (RSLs)
- A limit on the average local authority rent increase for the next two years of 5% each year

10 The changes will impact on the calculation of notional rent for housing subsidy, and actual rent received. Where notional rent increases, this will increase the subsidy that the Council must pay government. This means that the benefit of any increase in actual rents is outweighed by additional subsidy payable.

11 In order to balance this impact, there is an increase in management and maintenance allowances, which represent the notional costs that inform the subsidy calculation. These mitigate the impact of the lost rental income. The net result for Taunton Deane should be a marginal increase in revenue resources. The final settlement will be known in December.

12 The draft subsidy determinations have also indicated an increase in major repairs allowance that is higher than previous assumptions. This would increase capital resources to £3.5m next year, which would reduce the funding gap to 31%. The final settlement will be known in December.

Impact on future options

13 The revised stock condition information is the most significant change to future HRA business plan predictions. Whilst this changes the analysis of future options, it would not change the conclusion of the original stock options work, based on the assessment criteria previously agreed.

14 The original appraisal used the following assessment criteria

- Deliverability

- Meets the current stock's investment needs to meet decent homes
- Meets the current stock's investment needs to meet local priorities for investment to ensure the sustainability of decent homes investment
- Enables investment in new stock to meet significant housing demand in the area
- Promotes improved housing management performance and service standards
- Increases tenant participation
- Enables delivery of Council's corporate objectives and wider strategic housing objectives

15 A summary of the evaluation of the options in July 2004 is set out below:

Table two: July 2004 evaluation

Criteria	Option 1 – Continued ownership and management	Option 2 – Arms length management organisation	Option 3 - PFI	Option 4 – Stock transfer
a) Deliverability	No	No	No	Possibly
b) Meets the current stock's investment needs to meet decent homes	Yes	Yes	Probably not	Yes
c) Meets the current stock's investment needs to meet local priorities for investment to ensure the sustainability of decent homes investment	No	No	No	Yes
d) Enables investment in new stock to meet significant housing demand in the area	No	Probably not	Probably not	Yes
e) Promotes improved housing management performance and service standards	No	Possibly	Possibly	Possibly
f) Increases tenant participation	No	Yes	Possibly	Yes
g) Enables delivery of Council's corporate objectives and wider strategic housing objectives where these have not already been included above.	No	No	No	Yes
Total:				
Yes	**1**	**2**	**0**	**5**
Possibly	**0**	**1**	**2**	**2**
Probably not	**0**	**1**	**2**	**0**
No	**6**	**3**	***3***	**0**

16 A revised analysis needs to take into account the fact that the Council can no longer predict that it has adequate resources to meet Decent Homes as set out below:

Table three: Evaluation of options November 2005

Criteria	Option 1 – Continued ownership and management	Option 2 – Arms length management organisation	Option 3 - PFI	Option 4 – Stock transfer
a) Deliverability	No	No	No	Possibly
b) Meets the current stock's investment needs to meet decent homes	No	Yes	Probably not	Yes
c) Meets the current stock's investment needs to meet local priorities for investment to ensure the sustainability of decent homes investment	No	No	No	Yes
d) Enables investment in new stock to meet significant housing demand in the area	No	Probably not	Probably not	Yes
e) Promotes improved housing management performance and service standards	No	Possibly	Possibly	Possibly
f) Increases tenant participation	No	Yes	Possibly	Yes
g) Enables delivery of Council's corporate objectives and wider strategic housing objectives where these have not already been included above.	No	No	No	Yes
Total:				
Yes	**0**	**2**	**0**	**5**
Possibly	**0**	**1**	**2**	**2**
Probably not	**0**	**1**	**2**	**0**
No	**7**	**3**	***3***	**0**

17 This means that continued ownership and management meets none of the assessment criteria identified at options appraisal.

18 Previously arm's length management did not offer a financial solution to Taunton Deane, as funds are only available to fund an investment gap to meet decent homes, and this was minimal in Taunton Deane at the time of the options appraisal. Whilst there is now an investment gap, ALMO continues to fail to fund resources to meet local priorities and the full investment need of the stock. In order to pursue ALMO at this stage the Council would need to get tenant sign up to a reduced standard of investment, and get Government Office sign up to a revised options appraisal conclusion. Both these would be required before submitting a programme application for ALMO funds before the last round of funding, anticipated to be in February 2006.

19 The Private Finance Initiative continues to offer no financial solution to the needs of Taunton Deane's housing stock.

20 Stock transfer continues to be the only option that provides resources for the short, medium and long term investment in the stock and provides a significant capital receipt for use on the Council's wider housing priorities.

The financial implications of transfer

Valuation

21 The indicative tenanted market value has been updated to reflect

- changes in the rent restructuring framework
- new stock condition information to reflect Savills' survey
- current HRA budgets to reflect anticipated outturn 2005/06

22 At the time of the Council's application to join the housing transfer programme the indicative tenanted market value was estimated at £38.2m (£6,267 per home). A revised calculation indicates a valuation of £36.3m (£5,924 per home).

23 The key changes are illustrated below:

- A review of HRA budgets has indicated a slight reduction overall in costs when compared with income. On the assumption that this is reflected in the costs and income to transfer to the new RSL, this would improve the valuation.
- The valuation assumes that all of the works indicated in Savills' stock condition survey are carried out.
- The rent restructuring changes increase rents for larger properties. The valuation assumes that the Council's rent increase in 2006/07 will reflect the limit of 5% imposed by ODPM. The 5% limit will also apply to local authorities in 2007/08. The valuation assumes that a commitment would be made to transferring tenants that this 5% cap would also apply to post transfer rent increases in 2007/08. In this way their rents would be the same whether transfer took place or not. This assumption will be subject to a decision by Council

Table four: Changes to tenanted market value

Detail	Financial impact
Programme application	£38.2m
Changes in HRA budgets	+£0.1m
New stock condition survey	-£5.3m
Revised rent restructuring	+£3.3m
Revised valuation	£36.3m

24 Full details of the financial assumptions that underpin the valuation are set out at appendix one.

Future valuation changes

25 The valuation will continue to be subject to change between now and ballot, and in the post ballot period (subject to a yes vote). The key reasons for changes include:

- Changes in HRA budgets to 2006/07 that change the costs to be transferred to the new RSL, including the Council's rent policy that will determine 2006/07 rent increases.
- Pension costs. Where there is a deficit on the pension fund, the Council will be required to make good this deficit before transfer. Historically ODPM have accepted that the RSL will make this payment, and reflect it in the valuation. This means the payment is made before calculation of levy, saving 20% of the cost. Ongoing pension contribution rates may also change and this will need to be clarified in the post ballot period as the TUPE list is developed.
- The outcome of the consultation process that may indicate the need for additional services or improvements
- Increases in building costs between now and transfer that are above or below levels currently estimated
- The final number of properties to transfer
- Decisions about assets and services to transfer
- Decisions about transfer of Deane DLO, Deane Help line etc.

26 Key sensitivities are set out below to give an indication of the extent of movement that could occur. Sensitivities are not shown cumulatively.

Table five: Valuation sensitivities

Base case assumption	Revised assumption	Financial impact on valuation
Rent guarantee for transferring tenants that rent increase in 2007/08 will be limited to an average of 5%	No rent guarantee	+£0.15m
Rents for new tenants after transfer are set at target rent level	Rents for new tenants are set at the same level as that of transferring tenants	-£0.57m
Management costs reflect current service, with uplift for diseconomies of scale and VAT	5% increase in management costs to provide an additional £173,000 each year to fund new services.	-£2.3m
Building costs increase by 5% between now and transfer	Building costs increase at 4% between now and transfer	+£1.6m
All HRA shops and garages transfer to new RSL	Council decides to retain all non dwelling assets	-£3.7m
General fund contribution to HRA continues at current rates	Council chooses not to establish a service agreement with the new RSL that reflects the services provided for by current payment from General Fund	-£2.4m

Net capital receipt

27 The Council will be required to pay a levy to ODPM following transfer. Under current regulations the amount payable is calculated as 20% of the difference between the capital receipt associated with the dwellings (after payment of set up costs) and the Council's subsidy capital finance requirement (CFR). it is currently estimated that a levy of £400,000 would be payable. This calculation is set out below:

Table six: Levy calculation

£m	Levy
Tenanted market value	36.3
Receipt re non leviable assets[3]	-3.7
Set up costs	-3.0
Subsidy CFR (notional HRA debt)	-27.8
Leviable receipt	1.8
Levy at 20%	**0.4**

28 The table below sets out the net capital receipt available to the Council after payment of levy, set up costs and attributable housing debt. This calculation assumes that the Council will repay current housing debt, leaving a net receipt of £18.9m after payment of levy. This is in line with previous estimates of a net capital receipt of £18.91m reported at options appraisal in July 2004. Whilst the tenanted market value has reduced, the net capital receipt remains broadly similar due to reductions in the levy payable. The Council may choose not to repay debt attributable to the HRA, but this would leave the cost of this debt as a charge to the general fund budgets.

Table seven: net capital receipt

£m	net receipt
Tenanted market value	36.3
Set up costs	-3.0
HRA CFR (actual HRA debt)	-14.0
Levy at 20%	-0.4
Net capital receipt	**18.9**

Post transfer receipts

29 A separate agreement will be established to determine how income from future Right to Buy sales is shared between the Council and the new landlord. Typically this will allow the RSL an amount sufficient to cover the net income forgone in its future business plan, plus an administrative allowance, with the remainder being paid to the Council. The Council's receipt is not subject to pooling so is 100% useable. It is reasonable to anticipate that this will be higher than the current 25% that the Council is able to use from Right to Buy receipts.

30 It is also possible to establish a mechanism to recover VAT payable by the new landlord on the major improvement works in the first five to ten years after transfer. A separate agreement can then be

[3] Non leviable assets includes all non dwelling assets (garages, shops etc.) No levy is payable on the value that these assets bring to the valuation. This figure is indicative at this stage subject to decisions about the transfer of these assets

established to determine how these receipts are used and shared between the Council and the new landlord. The extent of VAT recoverable will depend on the post transfer works programmes, and decisions about the extent of capital works that may be carried out by the DLO if it transfers to the new organisation. Where the DLO carries out a proportion of post transfer works, this will reduce the VAT payable. This will increase the valuation, but reduce receipts achieved through post transfer VAT recovery. An early feasibility study will be required to determine the extent of VAT recoverable through this route. The benefit of these VAT arrangements will only be possible if the RSL has charitable status due to corporation tax liability for non charitable RSLs that would outweigh the VAT recoverable. This decision is to be discussed at the shadow board.

Future reports

31 The valuation will be reported to members at regular intervals as key decisions are made that have a financial impact.

32 The implementation of housing transfer will result in additional revenue costs for the Council as some of the fixed and variable costs currently charged to the HRA fall on the general fund until a cost reduction strategy is put in place. These revenue impacts include

- Reductions in income from services currently recharged to the HRA
- Untransferred central support costs

33 An analysis of this impact was reported to members in July 2004. This indicated that from a total recharge to the HRA of £2.8m in 2003/04, estimated savings of £1.6m could be achieved from transfer of staff, and sale of services. A residual annual cost to the general fund of £1.2m would then need to be reduced through cost reduction strategies. This analysis is currently being updated by Council officers, with support from PwC. A report will be taken to members once this update is complete. The corporate impact will then be monitored and reported to members on a regular basis.

Appendix one – Valuation assumptions

Introduction

34 This appendix sets out the key assumptions used to develop a cash flow/ financial model which can be used to determine the tenanted market valuation (TMV) of the Council's housing stock.

35 The valuation has been set at a price base of 2006/07 and, accordingly, many of the inputs have been taken from current figures that have been uprated appropriately. This uprating reflects our understanding of Government policy in relation to rent restructuring and local building industry inflation forecasts following advice from Savills to reflect local schedules of rates.

36 The base data for this report is derived from a number of key sources. The sources of the base information and the key issues and potential sensitivities surrounding the major assumptions in the valuation are included within each of the key input areas below.

Detail of valuation assumptions

Housing stock & rents

37 Housing stock and current rent information have been taken from the Council's own records. This shows 6172 properties in 2005/06. It is assumed that there would be 6132 by 2006/07 taking into account stock loss from Right to Buy at a rate similar to current trends. This assumes that approximately 20 properties per year are sold, and that transfer takes place towards the end of 2006/07. The average weekly rent, (excluding service charges) in 2005/06 is £51.75.

38 Future rents have been included in the valuation model on the basis of achieving convergence with target rents within the revised rent restructuring framework for social housing announced by ODPM in November 2005. This reflects the impact of the 5% cap on local authority rents in 2006/07 and 2007/08.

39 The average Jan 99 property value used in the rent restructuring calculation is £43,423 based on information supplied by the Council. This gives an average target rent in 2006.07 of £61.20 which is 12% above estimated actual average rent for that year.

40 Starting rents for 2006/07 assume that the Council will move current rents towards local authority target rents at the maximum rate possible under the current rent restructuring framework, which results in a 5% increase to 2006/07. Final figures will be revised to reflect the Council's rent setting policy once agreed. After transfer it is assumed that rents will converge with target rents by 2011/12 which is achieved with an increase of 5% to 2007/08, then 5.5% each year to 2011/12. This assumes that a rent guarantee is given to transferring tenants to reflect the 5% cap that would apply to local authority rent increases in 2007/08.

Stock turnover (i.e. relet rates)

41 The valuation assumes that new tenants after transfer are charged the full target rent and that there is a

turnover rate of 5.8% each year in line with historic lettings trends. Records for 2005/06 show an increase in turnover to 6.3% but the rate of 5.8% has been used to reflect averages over the previous three years.

Voids & bad debts

42 The valuation assumes that 2% of rent is lost through voids and bad debts which is broadly in line with estimates in the HRA business plan, with some adjustment to reflect the circumstances of the RSL.

Other income

Tenant and leaseholder service charges

43 Service charge income from tenants and leaseholders is based on figures in the Council's medium term financial plan that gives estimated income of £399,000 p.a.

Supervision and management costs

44 Future management costs for the new landlord will be driven by the current cost base of the Council. Some adjustment will be required to reflect the diseconomies of scale the new landlord will experience as a result of separation from the Council, and irrecoverable VAT. A starting management cost budget of £3.5m has been included for 2006.07 (£565 per unit). This represents a 12% increase on current 2005/06 HRA budgets

45 Property specific service costs have been included at the current rate of special management costs in HRA budgets, with an uplift for irrecoverable VAT and inflation to 2006/07. This gives a starting special management cost of £702,838. Supporting people costs of £559,000 and related income is excluded from the valuation in line with current ODPM guidance.

Stock condition information

46 These figures have been taken from the stock survey outputs produced by Savills in November 2005.

Responsive, cyclical and voids repair costs

47 Savills' estimate of revenue repair costs provides for an allowance of £595 per unit in years 1 – 5 increasing to £619 from year six. The early year reduction reflects the impact of the catch up repair provision included elsewhere in the valuation. The allowance is less than current budgets to reflect the impact of the capital programme and avoid double counting.

48 The valuation assumes the building services DLO will transfer and carry out a proportion of revenue repairs in line with current practice. As a result VAT on labour costs for an element of the repair budget will not be payable by the RSL. VAT at 10.5% has been applied to allowances to reflect VAT on materials and work not carried out by the DLO. Prices have been increased by 5% to allow for inflation between now and transfer.

49 Fees have been included at 8% to reflect part of the cost of the current HRA recharge on repairs budgets, as this cost is not included in Savills allowances.

50 The resulting figures are assumed to rise with inflation after transfer.

Catch up, Future major repairs, related assets, improvements, works to non traditional dwellings and the cost of making safe asbestos.

51 Figures are based on information from Savills November 2005 survey in respect of costs for catch up, future major repairs, improvements and works to non traditional properties. Rates for estate works and for the making safe of asbestos are based on average allowances recommended by Savills. A contingency of 2% is included in line with Savills' recommendations. Costs are adjusted to include VAT (17.5%) and fees (8%). They are then uprated to a 2006.07 price base by 5% to reflect inflation before transfer.

52 The resulting figures are assumed to rise with inflation after transfer.

Environmental improvements

53 Savills have advised an average allowance of £1,000 per property is included in the first ten years for environmental improvements. It should be noted that this is a provisional allowance only and further consultation would be required with residents to produce final estimated costs.

Disabled aids and adaptations

54 A provision of £200,000 per annum has been included for disabled aids and adaptations in line with assumptions for minor aids and adaptations in current HRA budgets.