

# CAMBRIDGE CITY COUNCIL HOUSING OPTIONS APPRAISAL FINANCIAL REPORT

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### 1 Introduction and Overall Summary

Housing Quality Network Services was invited to assist Cambridge City Council in the financial and technical aspects of its Housing Option Appraisal. We began initial desk top work during 2003 and, following the implementation of the range of financial changes at the national level to 2004/05, have updated our analyses this year. The Council is following a detailed Project Plan during which it is conducting widespread consultation on local priorities (the “Cambridge Standard”) and, to oversee the process and progress, a joint Member and Tenant Working Party has been established, supported by senior housing and finance managers. This draft report is intended to help set out the “baseline” financial position against which further detailed review and consultation work will be set, particularly what we understand to be a detailed “Test of Opinion” to be conducted during the autumn. This full draft report follows a detailed review of assumptions and technical outputs by officers since January with a number of meetings between ourselves and finance officers to clarify assumptions and ensure consistency between outputs. Whilst all financial material will necessarily remain in “draft” form until the end of the project, and the detailed outcomes from the Spending Review may influence future forecasts, we are confident that the financial analysis set out below represents a sound basis upon which the Council can conduct the “Test of Opinion”.

As in previous reports, our view remains that the three main whole stock options are financially viable albeit with large differences in the resources potentially available for capital investment. All three options are able to be consulted upon further.

A **retention strategy** would benefit from a solid and healthy HRA revenue forecast and there would be a need to utilise revenue surpluses towards the capital programme. Our view is that these surpluses are best deployed as Revenue Contributions to Capital Outlay as this delivers the greatest amount of resource in the long term, avoiding the need for the costly interest payments which would arise if the Council undertook unsupported (or prudential) borrowing. Only with these revenue resources, around half of the capital receipts arising from Right to Buy sales (around £10m over and above current plans) and the use of some reserves can a retention strategy meet the Minimum Investment Standard of £59m to 2010/11.

An application for the **Arms Length Management** programme would be based around the Minimum Investment Standard and set at the baseline shortfall of £22.7m. We believe that such a bid would have been successful in previous ALMO rounds, however there are no guarantees of future funding. The application could be increased beyond this level on the basis of the delivery of a more comprehensive programme for decent homes but with less chance of success. The ALMO approach would also benefit from healthy HRA surpluses and the Council would be able to provide for contributions to the capital programme to a overall total investment of £70m to 2010/11. There would still be a shortfall against the headline Stock Condition Survey and Cambridge Standards, both to 2010/11 and over 30 years.

Only a **Stock Transfer** approach is able to fully fund all investment needs of £89m to 2010/11 and over the full 30 years, both at the headline Stock Condition Survey and Cambridge Standard levels of spend. Revenue services would be funded at today’s levels although adjustments for the number of properties over time might be expected. A substantial receipt would be available to the Council to mitigate the adverse impact on the General Fund and to generate considerable levels of additional new affordable housing within the city over the longer term.

We are aware of specific work undertaken to test the expenditure needs and detailed options for the **sheltered stock** and that this could total somewhere in the region of £30m on top of the Cambridge Standard levels of investment. As this is an issue faced by the landlord under all of the options, it is not a feature of our analysis. Put simply, the landlord will have to deal with the specific sheltered stock issues irrespective of whether it is the Council or a newly created Housing Association.

We have also **excluded consideration of PFI** at this stage on the basis that there is a great deal of homogeneity in the investment needs of the stock, with the exception of the sheltered stock. It would be appropriate when considering the detailed solutions for sheltered schemes to consider PFI in this context.

## 2 Policy influences

The key influences at the national level on this project will arise from the Government's Comprehensive Spending Review which was announced on 12<sup>th</sup> July. When the detail for ODPM spending headings is announced, we will know the level of headline spending totals through to 2008/09 and this will allow a greater degree of predictability in resource allocations through to that time. It is not expected that the detailed announcement of housing totals will now be made until September, the key areas affected are:

- The proposed trends in housing subsidy given that rent restructuring places a key emphasis on the importance of national spending settlements for management and maintenance allowances. The recent Review of Rent Restructuring published by ODPM (in early July) proposes that the formulae for rent restructuring are merged such that both councils and housing associations all use exactly the same formula. This would have the impact of complete convergence between sectors (meaning no difference between retention/ALMO/transfer rents) and could have implications for the treatment of allowances within the Housing Subsidy system. The closing date for the consultation process is 30<sup>th</sup> September.
- The plans for round 4 ALMO and future ALMO programmes (rounds 5, 5b and 6) and the resources allocated to them, given the commitments already made to the first three rounds. Although timetables have been announced for the next round of applications (October expression of interest and January 2005 application), there is yet to be any detail on the money available.
- Resource allocations for Regional Housing Board investment to 2008.
- The details of the extra resources allocated to the Housing PFI programme.
- Detailed announcements on the level and arrangements in place for "gap funding" for negatively valued stock transfers, within 2005/06 and for future years. The DPM made reference to £180m in his initial parliamentary statement although there is as yet no detail of the mechanics of access or indeed the period covered.

Necessarily therefore, our analyses cannot be finalised prior to the publication of the detailed results of the Spending Review for housing and regeneration.

### 3 Form of analysis

#### 3.1 General

In appraising the options financially, consideration must be given to basic Government objectives flowing from the Communities Plan. Preferred options must:

- Be financially and technically feasible under current rules,
- Be fundable in the short, medium and long term,
- Be able to meet the minimum Decent Homes Standard for all stock by 31<sup>st</sup> December 2010,
- Demonstrate the extent to which the “Cambridge Standard” for stock and service investment is achievable and the extent to which tenants have been engaged in providing feedback on objectives and priorities for spending,
- Demonstrate the ways in which the Council’s ability to meet wider housing and corporate objectives might be affected.

Where minimum standards can be met, the analysis focuses on the opportunities under each option to further meet the objectives and aspirations of tenants and residents.

#### 3.2 Stock Condition and Investment

The current survey upon which the analysis below is based was carried out in the spring of 2003 by FPD Savills. The outputs represent the need to spend in the following key areas:

- The need to meet the minimum Decent Homes Standard for all stock by 2010,
- General planned maintenance and renewal works over 30 years,
- Renewal and maintenance of non housing assets eg garages,
- The need to carry out specialist works relating to non traditionally built properties and asbestos,
- Ongoing recurrent, revenue funded, expenditure on cyclical maintenance and repair.

The Survey was reported in June 2003 at a “Headline” or industry standard level of expenditure. Since that time, work within this project has developed alternative approaches to investment spending as set out below. We have therefore modelled the financial analyses against three standards. As set out above, none of the standards include the costs for the upgrading a number of sheltered schemes to provide modern 1/2 bed flats, of developing extra care facilities or of returning some accommodation to general needs. Surveyors will be commissioned to undertake a project to provide a number of specific scenarios for each individual scheme. It is estimated that such costs may amount to £30m.

**“Industry Standard” or “Headline” profile:** The current survey report sets out a 30-year capital investment profile based around Industry Standard life cycle replacements with no additional improvements included. Appendix 1 sets out a summary of the outputs. This profile forms the basis of the core financial analysis below. The unadjusted 30 years total is £239.9m (excluding fees and the effect of right to buy sales) and £87m over 7 years from 2004 to 2010/11.

**Minimum Investment (or Minimum Landlord) Standard:** Savills have produced a “Minimum Investment” profile based on dealing with the Decent Homes Standard and other essential expenditure (eg health and safety related costs). This is the absolute minimum spend required in order to satisfy landlord responsibilities and includes work which is extra to the barest minimum of the decent homes standard but in all likelihood could not be realistically avoided by the Council in discharging its basic responsibilities. Essential expenditure is required even though it falls outside of the narrowly defined Decent Homes Standard. The total unadjusted investment requirement in this scenario is £178m over 30 years and £58m to 2010/11.

**“Cambridge” Standard:** This investment standard measures the investment aspirations of the tenants of Cambridge over the 30-year period. The 30-year total is £230.8m or £87m to 2010/11. This standard follows detailed consultation during the spring and summer of 2004 and therefore represents the standard expressed as desirable within the housing stock.

### 3.3 Service improvements

The changes in subsidy allowances introduced in 2004/05 have delivered additional levels of resources for service delivery and improvement. In general, our approach to comparing the finances between the options is to maintain service expenditure at current levels (ie the 2004/05 budget). In so doing, we are able to compare directly whether increased funding might be available or whether the prospects are for future savings.

It is typical for local standards for improvement to include service improvement measures, around eg tackling anti social behaviour. The analysis below sets out the background to the revenue forecasts and it will be important to factor in any additional service expenditure aspirations contained within the Cambridge Standard consultation. These have not been included at this stage but as will be seen elsewhere within the report, there is flexibility within the revenue forecasts under all of the options. Our baseline implies an increasing “per unit” spend on services giving some scope for service improvements.

### 3.4 Development of the Baseline, Scenarios and the 3 Options

We have developed a **baseline forecast** based on the following core assumptions:

- What would happen financially in the future if the Council “did nothing” and the finances were the subject of external market, inflationary and government funding influences?
- What is the level of capital resources available if the Council rolls forward its current policies and do they meet the standards of investment needed?

The detailed assumptions are listed at appendix 2. We have then subjected this output to changes in assumptions to test the sensitivity of the outputs to changes in activity.

We have then **developed a range of funding scenarios** under **retention, ALMO and stock transfer** and compared the revenue and capital resource position for each. Because of the nature of the forecasts at Cambridge, there are a **large range and variety** of different approaches to the use of resources which could be used. These are presented in full detail below. We have measured the impact on revenue,

capital investment in the stock and, in order to illustrate the impact on the Housing Strategy, have set out the level of Right to Buy receipts which are allocated to the strategy and calculated a maximum delivery of new build affordable housing through housing associations assuming a £60,000/property grant rate.

In order to make sense of the forecasts, we have then developed an approach to the three options with an **optimum use of resources** – what we have calculated to be the best use of the resources available over the longer term. This results in the presentation of the **three options upon which the Test of Opinion will be based** in the autumn.

## 4 Baseline financial analysis

### 4.1 General assumptions

We have prepared financial forecasts based on the continuation of the existing housing finance and subsidy regimes for retention and ALMO, and assumptions based on the most up to date information announced by the Government and the Council. The detailed assumptions are contained in appendix 2.

#### ***Key revenue assumptions***

In general, we have projected forward from 2004/05 budgets with a price base of 2004/05, excluding general inflation based on stock levels projected at 1<sup>st</sup> April 2004 (of 7,874 units).

For retention and ALMO, rent restructuring results in average rent increases of 3.50% above inflation from April 2005 to April 2011 moving average rents from £57.43 (on a 52 week basis) in 2004/05 to £73.35 (at today's prices) at the end of the rent restructuring period in 2011/12. Current rents are on average £8.66 below target leading to this large above inflation increase year on year. Right to Buys have been assumed at 110 in 2004/05 to 2006/07 and then reducing by 5% a year, reducing to 77 in 10 years time. In our base analysis, subsidy management and maintenance allowances are assumed to increase 8% in real terms in 2005/06 in line with national spending announcements in 2002. Thereafter, we have assumed 2% real increases in allowances to compensate for rent restructuring at a national level. This is a critical assumption (see sensitivities below) and based on the latest information we have from ODPM.

For stock transfer, rent restructuring would mean that rents would increase at an average 3.38% above inflation each year to 2011/12 giving an average rent of £72.46 (at today's prices) by that year. It should be noted that within the rent restructuring review, ODPM has proposed that the formulae for RSLs and local authorities are to be merged and the 2011/12 targets brought together from April 2005. This would mean that target rents would be as above for all options. Assumptions specific to stock transfer also include the need to pay VAT on external contractor work and an increase in management costs to reflect the "disaggregation" of the service from the rest of the Council.

#### ***Capital Expenditure assumptions***

The base "need to spend" is that from the Headline profile within the Stock Condition Survey. The headline investment needs include an allowance for fees at 8% and a reduction in raw profiles to reflect Right to Buy sales for the retention and ALMO

options. The total needs based on units at 1<sup>st</sup> April 2004 are £89.7m to 2010/11, £109.5m to 2013/14, £173.1m over 20 years and £223.9m over 30 years.

The Minimum Investment Standard requirements are estimated at £59.1m to 2010/11, £73.0m to 2013/14, £121.8m over 20 years and £164.3m over 30 years.

The liabilities resulting from the development of the Cambridge standard have been estimated at £89.4m to 2010/11, £108.1m to 2013/14, £166.0m over 20 years and £215.8m over 30 years.

### **Capital resources**

We have assumed that the level of capital resources for the HRA capital programme will be the Major Repairs Allowance, Supported Capital Expenditure of £0.732m in 2004/05 and 2005/06 and a proportion of useable capital receipts as proposed in the Council's current capital programme. The remaining capital receipts are assumed to be utilised in General Fund programmes to support private sector and new build affordable housing.

Revenue Contributions to Capital Outlay are not assumed within the baseline forecast as the council does not have a firm policy to definitively use surpluses for this purpose.

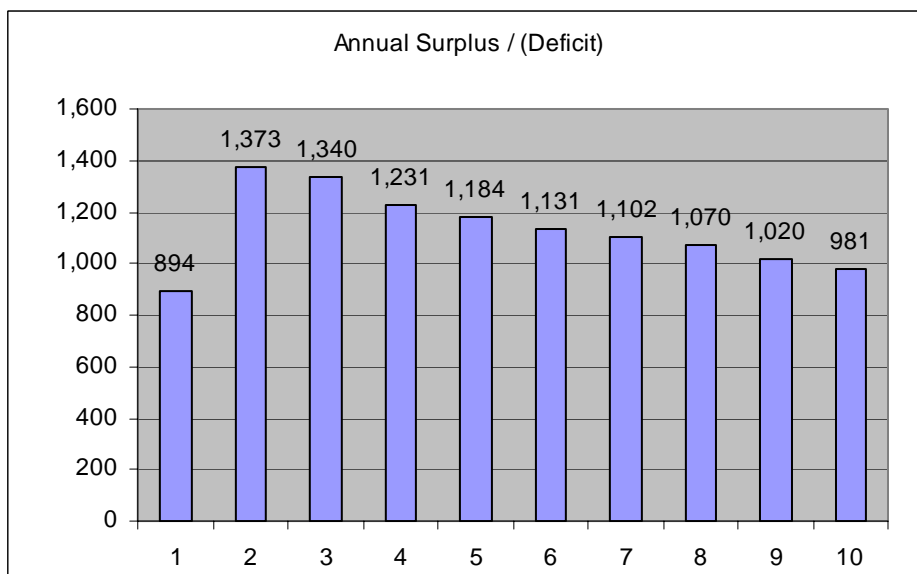
Under retention and ALMO, the new Prudential System could also affect the level of capital resources able to be raised to finance investment having both a "capital" and "revenue" impact. This is also addressed below. Under stock transfer, capital works are funded from within the valuation, ie increased programmes reduce the value of the stock and reduced programmes increase the valuation of the stock.

## **4.2 Retention**

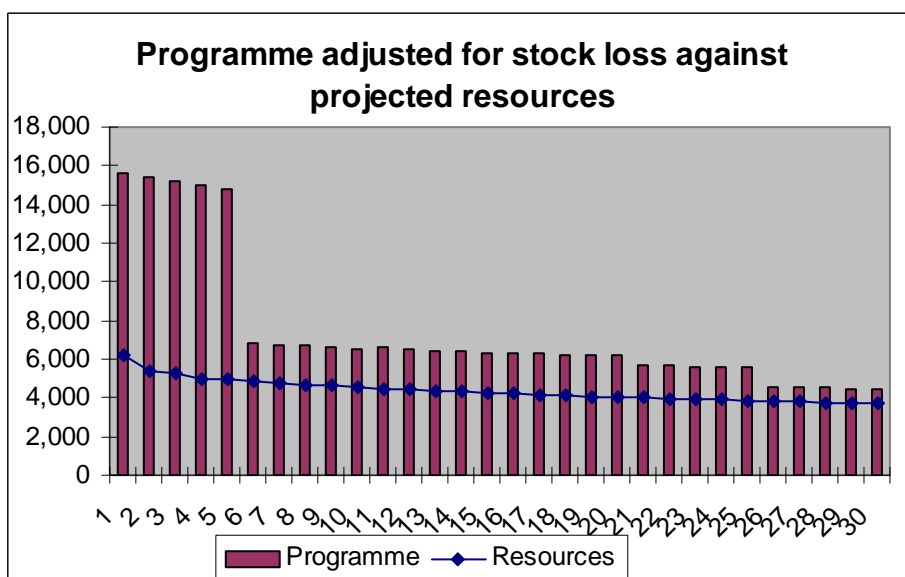
### **4.2.1 Base forecast**

The base retention forecast on these assumptions is summarised in the charts below. Detailed tables setting out the revenue and capital forecasts are included at appendix 3.

#### ***Chart 4.1: 10 year revenue forecast from 2004/05***



**Chart 4.2: Capital profiles (Headline Stock Condition Survey) and resources 2004-2034**



**4.2.2 Notes / commentary**

The forecast revenue position generates annual surpluses/deficits before Revenue Contributions to Capital Outlay (RCCO) to illustrate revenue resources available at the current level of service spending.

The in-year position of 2004/05 is improved in 2005/06 primarily due to a forecast increase in management and maintenance allowances in line with the recent recalculation of subsidy formulae. Surpluses decline as a result of Right to Buy sales and increased cost pressures (for example pension contributions) through to 2011/12, the end of the rent restructuring period. The 2011/12 milestone in year balance is £1.07m.

The HRA is forecast to make in year surpluses over the 30-year period. This is primarily as a result of service expenditure levels remaining at or below the level of predicted management and maintenance allowances for the longer term.

Conversely, the stock investment profile is unfundable to 2010/11 with a shortfall estimated at £53.3m. The investment profile is cumulatively more and more unfundable throughout the 30-year period with an overall £92.5m shortfall on capital over 30 years.

If the minimum investment standard is compared to the available resources the investment gap stands at £22.7m at 2010 and £32.9m over 30 years.

The investment gap on the Cambridge standard is £53.0m at 2010 and £84.4m over 30 years.

The forecast strongly suggests that the Council needs to find additional resources to meet the headline survey profile or alternatively an approach to the reduction of investment programmes must be sought, or a combination of both.

### 4.2.3 Sensitivities

The above base forecast has been subjected to sensitivities to illustrate the following scenarios. These are included in the detailed table at appendix 4 and are summarised below.

- A. *Right to Buy Sales reduce by 25%*:** the surpluses on the account would increase to £1.4m in 2011/12 (compared to £1.07m). The investment gap would be marginally increased for each of the investment standards.
- B. *Right to Buy Sales Increase by 25%*:** the surpluses on the account would reduce to £0.78m in 2011/12 (compared to £1.07m). The investment gap would be marginally reduced for each of the investment standards.
- C. *The impact of management and maintenance allowances –no real increases from 2006/07*:** if the Government does not commit to real increases in management and maintenance allowances through to 2012 rather than 2% per annum, the HRA surpluses would be reduced to £0.157m in 2011/12.
- D. *The impact of management and maintenance allowances –a 4% real increase from 2006/07*:** if the Government commits to real increases in management and maintenance allowances through to 2012 at 4% pa rather than 2% pa, the HRA would go further into surplus with a surplus of £2.1m in 2011/12 compared to £1.07m in the base position.
- E. *The impact of making 10% efficiency savings on capital costs*:** as a result of partnering, if such savings were deliverable, shortfalls would reduce to £44m (7 years) and £72m (30 years).
- F. *The impact of 10% cost pressures on capital costs*:** conversely, if additional cost pressures arose, perhaps as a result of increased unit rates arising from labour shortages in the area, shortfalls would increase to £62m (7 years) and £113m (30 years).
- G. *The impact of the Regional Housing Board continuing Supported Capital Expenditure to 2010/11*:** in the baseline, this has been assumed to stop in

2005/06; if continued to 2010/11, this would give an extra £3.6m in capital resources to 2010/11 reducing shortfalls marginally.

The above analysis highlights the extreme sensitivity of the revenue forecast to medium term government subsidy policy. Should successive settlements put pressure on M&M allowances, the prognosis would be for reduced surpluses on the HRA. More investment at the national level would create further surpluses allowing greater service enhancements locally or further revenue contributions to the investment programme.

However, even under the most pessimistic of assumptions, the HRA is projected to remain in surplus well into the medium term. Conversely, none of the changes in cost and price assumptions are able to bring the investment standard shortfall down significantly. This highlights the importance of the Council and its stakeholders developing approaches to the funding of capital expenditure as part of this Option Appraisal.

### 4.2.4 Summary

The base forecasts highlight challenges for the Council without additional resources for investment:

- The HRA is currently in surplus and the forecast suggests that the HRA will continue with surpluses over the 30-year period.
- There is however a shortfall against the stock investment profile of £53.3m by 2010/11. Shortfalls rise over the 30-year period. In addition there is also a shortfall against the minimum standard of £22.7m and £54.4m against the Cambridge standard.
- There is a need therefore to raise additional resources for capital or to develop investment programmes below the recommended level or a combination of both.

### 4.3 Use of resources

We have therefore analysed a series of funding options under a retention strategy to determine the scope for raising additional resources for capital. The details are contained in appendix 4 and summarised below. There are a wide range of potential scenarios and readers will be able to identify particular combinations as appropriate.

1. **Linking repairs expenditure to reducing property numbers** : this scenario generates additional revenue surpluses available for reinvestment or deployment on the capital programme. Surpluses remain above £1.5m for 30 years and generate an additional cumulative £14m+ of resources over 30 years. This illustrates how the Council is able to deliver the alternative priorities of service delivery and stock investment in a flexible way, depending upon the aspirations of tenants now and over time.
2. **Maximum use of Right to Buy receipts** : use of all RTB receipts would deliver a further £23m of resources over 7 years and £45m over 30 years. No money would be left over for Housing Strategy / new build and this is likely to be untenable given the Council's corporate priorities.
3. **50:50 use of Right to Buy receipts** : the additional capital resources available would total around £10m over 7 years to 2010/11, leaving £12-13m for investment in the housing strategy / new build programmes.

4. **Surpluses used as RCCO** : revenue surpluses within the baseline forecast total £9.9m over 7 years and £35.2m over 30 years and these could be deployed on capital expenditure as RCCO whilst maintaining current reserves over 30 years.
5. **50:50 use of receipts and use of surpluses as RCCO** : this would increase capital resources to 2010/11 by over £20m compared to the baseline, albeit reducing housing strategy investment to £12-13m over the same period. The increase in resource over baseline over 30 years is £53m.
6. **Surpluses used as RCCO with repairs budgets reduced in line with property numbers** : this scenario generates scope for £11.1m of RCCO to 2020/11 and nearly £50m over 30 years. Again this illustrates the impact of taking different decisions about the balance between revenue and capital expenditure over time.
7. **Unsupported (prudential) borrowing of £10m** : we have modelled the impact over 30 years utilising a set aside of 7% a year which reduces debt levels to zero over 30 years. With any left over revenue used as RCCO, the resource base can be increased to £51m over 7 years and £159m over 30 years, reducing shortfalls to £38m and £65m respectively. However, the long term cost of interest means that whilst the amount of investment can be increased in the short term, the amount over time is reduced compared to an approach where only RCCO is used directly. Extra resources of £28m over 30 years under a borrowing approach compares to extra resources of £35m with only use of RCCO. This is because revenue is being used to pay interest when borrowing has been carried out. Borrowing does not therefore suggest the optimal use of resources over time.
8. **Unsupported borrowing of £25m** : we have modelled this over 30 years in order to test the impact and capital resources can be increased to £64m over 7 years. However, the long term cost of the debt would throw the HRA into deficit of £14m over the longer term and is therefore unaffordable without service savings. It would of course be possible to generate these savings but once again, the long term capital shortfall is only £7m below the level using RCCO only. Effectively, this means that the Council would need to make substantial revenue savings (£14m cumulatively) in order to generate an extra £7m capital over 30 years and cannot therefore be seen to be an optimal use of resources.
9. **Spending at the Minimum Investment Standard** : headline shortfalls are reduced to £23m to 2010/11 and £33m over 30 years.
10. **Spending at the Cambridge Standard** : headline shortfalls are changed to £53m to 2010/11 and £84m over 30 years.
11. **Minimum Investment Standard with 50/50 RTB receipts and RCCOs** : comparing the optimal use of resources for capital against the Minimum Standard highlights a shortfall of £2.7m to 2010 and a 30 year total investment available of £184m. If the receipts were left out from 2010/11, this would reduce to £169m over 30 years. The Council could close the remaining gap by deploying reserves (£6m available in 2004/05).
12. **Cambridge Standard with 50/50 RTB receipts and RCCOs** : the optimal use of retention resources still leaves large shortfalls against the Cambridge Standard.

The key conclusion from this review of resource availability and the range of potential funding scenarios under retention is that the best long term use of resources arises from the deployment of revenue surpluses as RCCO. To meet the minimum

standard by 2010, the Council would therefore need to commit receipts over and above current plans.

### 4.4 Arms Length Management Organisation

#### 4.4.1 Introduction

Cambridge shares a typical profile with authorities which have adopted an ALMO strategy where:

- The minimum Decent Homes Standard and other essential expenditure is not able to be met from MRA by 2010/11,
- There is an absolute shortfall of investment resources against Industry Standard expenditure profiles, both to 2010, over 10 years and rising in the longer term,
- Aspirational investment needs are also unable to be met in the short, medium and longer term.

Before advancing any bid, any council would need to be satisfied that there were realistic prospects for achieving a 2\* rating for all landlord services within two years.

#### 4.4.2 An ALMO bid?

The combination of factors where there is an overall investment shortfall and where the Decent Homes Standard cannot be reached with existing resources has been used as the basis for a credible bid for additional ALMO resources.

It may be possible to develop an ALMO bid in excess of the decent homes minimum but not necessarily up to that indicated by the stock condition survey. On the assumption that an ALMO bid is made at least up to the minimum standard then a bid of at least £22.7m would have a realistic chance of success.

It is unlikely that such a bid would reach the “Cambridge Standard” that has been developed to date although of course the Council would be free to bid for whatever it felt reasonable. We believe that a credible bid beyond the barest minimum may be able to be developed, particularly in the context of reaching a Comprehensive and Sustainable Programme for decent homes over the longer term. The longer term shortfalls remain with a bid of £22.7m and the Government would want to see a long term sustainable approach adopted.

The key influence however is the level of national resources for ALMOs, yet to be announced for round 4 as well as future rounds. It is clear that more detailed and penetrating questions are being asked of bidders in rounds since round 2. We suggest therefore that consultation can only proceed on the basis of an ALMO bid of £22.7m given the national context.

Under an ALMO, the Council could bid for additional regeneration resources not linked to a bid based on Decent Homes, for example to remodel its bedsits or other comparatively “unsustainable” properties. This is currently set at 5% of the “decent homes bid”, on the basis of £22.7m therefore, around £1.1m.

Revenue surpluses could be utilised towards stock investment or more likely towards the need to establish and maintain a 2\* service standard. The Council would want to keep its options open in terms of deployment of revenue surpluses but for the

purposes of the “Test of Opinion”, we have assumed that revenue surpluses are available for additional capital investment beyond the minimum standard.

### 4.4.3 Set up costs

Setting up costs have varied from less than £200,000 in the smaller ALMO authorities to over £600,000 in one metropolitan area. Costs may typically vary depending upon the level of consultation, whether a ballot is held, the number of sub-boards within the ALMO etc.

A key advantage many ALMOs have reported to date is the ability to renegotiate service agreements with other parts of the Council to achieve efficiencies, thereby enhancing the opportunities to achieve a balanced HRA into the medium term.

### 4.4.4 Impact on the General Fund

Whilst there are some potential impacts resulting from the ALMO, in time, beginning to source services independently from the Council, the short-term implications on the General Fund have generally been found to be marginal. This is primarily as a result of the continuation of the HRA, which allows a longer-term financial strategy for dealing with recharges to be developed. Nonetheless, the creation of an ALMO has tended to increase transparency of the recharges between General Fund and HRA and highlight anomalies, which exist. A council wishing to pursue ALMO is advised to review such issues at an early stage. Currently ALMO capital investment is funded though additional supported capital expenditure. This may necessitate the council going back into debt or at least using a large part of the reserved capital receipts retained by the Council.

### 4.4.5 VAT

The arrangements in place within agreements in operation at the 19 ALMOs already live are VAT efficient and with no VAT consequence at all.

## 4.5 Stock Transfer

### 4.5.1 Base Valuation

The value of the stock for stock transfer purposes is based on a 30 year cashflow forecast called the “Tenanted Market Value”. The value seeks to capture the value to a landlord of future rents less future costs when sale of the properties on the open market is not possible. Future rents reflect rent restructuring. Future costs reflect current day-to-day management and repairs costs and the Industry Standard capital expenditure profile. It is important to note that the assumptions made affect the valuation: more cost leads to a lower valuation.

An illustrative valuation of the stock (based on 1<sup>st</sup> April 2004 and at 2004/05 prices) is **£89.4m (£11,358 per unit)**. Appendix 4 shows the forecast.

Broadly, this estimate might be seen as a maximum given that the profile does not include additional environmental and remodelling works and protects day-to-day service expenditure at 2004/05 levels. Additional investment in improvements, which would, given recent experiences elsewhere and previous experience in Cambridge, in all probability be needed in order to secure a “yes” vote, would reduce this valuation.

### 4.5.2 Set up costs

These are generally significant in a stock transfer reflecting the transfer of a large service from one organisation to another, completely new organisation. Estimates are around £2.0m. Should a ballot fail, pre-ballot costs would be charged to the General Fund with the exception of statutory consultation costs, which would be charged to the HRA. These latter are generally limited to less than £50,000.

Loan arrangement fees represent a significant set up cost arising from the arrangement of initial financing for the new RSL. On peak borrowing of £100m, we have estimated fees of £2.0m.

This results in total net receipt after set up costs of £85.4m.

### 4.5.3 Use of receipt

The value of the stock becomes the price and a capital receipt to the Council. The use of the receipt is controlled by the Stock Transfer regulations and is utilised to cover the following items in the following ways. The rules on debt clearance suggest that the level of Subsidy Capital Financing Requirement (SCFR) or the measure of debt the Government holds within subsidy for Cambridge's HRA, would need to be "cleared" upon transfer and this is also the basis for calculation of the levy.

**Table 4.3: Use of capital receipt from stock transfer**

Description	£'000's	£'000's
Gross receipt		89,436
Set up costs	2,000	
Loan arrangement	2,000	4,000
Net after set up		85,436
SCFR 2005/06	9,925	
Proj. SCFR 2006/07	10,291	
Debt clearance		10,291
Net after debt		75,145
Levy	20%	15,029
Remaining net receipt		60,116

- The levy calculation is an estimate only; non-dwelling assets are not included in the levy calculation but no adjustment for these has been made at this stage.
- The level of receipt left over for spending or investment is around £60m on the basis of a £89m gross receipt. It should be noted that the amount of £10.291m for the subsidy measure of debt represents "internal lending" from the GF to the HRA; this amount would become available for spending post transfer but is disregarded in calculating the levy.
- ODPM consent to the transfer would be dependent upon the proposals for use of the cash receipt of £70m; typically, investment to mitigate the adverse General Fund impact and in affordable housing are absolute requirements.
- Recent moves on utilising local authorities' VAT advantages could be worth £10m. In these circumstances it has been usual for the new RSL to take full advantage by further reinvesting in the stock. Conversely, recent rulings by the

Inland Revenue suggest that these are subject to Corporation Tax, thereby eliminating the benefits unless the new RSL seeks charitable status.

- Preserved Right to Buy receipts could generate a maximum of £12m.

#### 4.5.4 Stock Transfer valuation sensitivities

We have calculated the change in value from varying some of the assumptions made. This illustrates how the value is not “set in stone” and can vary according to the assumptions made. The value at the level of the Cambridge Standard investment is very similar to the headline/baseline valuation.

**Table 4.4 : Stock transfer valuation sensitivities**

	TMV	/ Unit
Baseline	89,436	11,358
Discount rate 8%	77,030	9,783
Discount rate 6%	104,324	13,249
Management costs - higher 10%	81,738	10,381
Management costs - lower 10%	97,137	12,336
Repairs costs - higher 10%	83,317	10,581
Repairs costs - lower 10%	95,557	12,136
Capital costs - higher 10%	76,957	9,774
Capital costs - lower 10%	101,920	12,944
Cambridge Standard capital spend	89,559	11,374

#### 4.5.5 Impact on the General Fund

The revenue impact on the General Fund is in the following areas:

- Residual costs if the HRA is closed: total support service recharges are around £1.296m in 2004/05, though a review of the schedules to determine “other department” and “within housing” overheads is needed during the lifetime of appraisal project. In practice, some staff in support areas transfer to the HA. It has usually proved possible to reduce this to 50:50 within 3 years through natural wastage etc. Should redundancy become a factor, one off costs would be payable.
- Balances on the HRA: would revert to the General Fund on transfer. Major Repairs Reserve would be repayable through subsidy.
- Mortgage interest: would revert to the GF though this is reasonably small at £14k pa.
- VAT Partial Exemption: there may be an impact on the VAT Partial Exemption calculation for the Council. This needs to be confirmed.

It is likely therefore that there will be sufficient receipt with which to raise interest to mitigate the adverse General Fund consequences, which are a maximum of £1.296m per year. If all of this were to be covered by the deposit of capital receipt to earn revenue interest, the amount required (at a rate of 4.5%) might be around £29m. This would reduce the level of investment in new housing post transfer and highlights the need for a robust approach to determining future costs should a transfer proceed.

### 4.5.6 The provision of new build affordable housing for rent

If the remaining receipts of £39m were to be used for the provision of affordable housing this could be done in a number of ways. Appendix 4 shows the detail.

- Invest the capital receipt and use the interest income generated
- Use the receipt directly.

Affordable housing for rent would be provided through offering social housing grant to Registered Social Landlords. The RSLs would in addition borrow funds to add to the grant to build new homes. The capital receipt could generate an additional 500 properties over 7 years if used as a lump sum or 30-35 per year if the interest on the invested receipt is used as the basis of a long term programme.

In all probability, a combination of both methods might be used where the sum is invested but that capital and interest is drawn down. In addition there may be up to £12m of preserved right to buy receipts that could be used for affordable housing.

### 4.5.7 Summary

Stock transfer is therefore financially feasible with a gross receipt of around £89m at the level of investment programme within the Stock Condition Survey and with day-to-day spending at 2004/05 maintained throughout 30 years. Although potentially large, the adverse impact on the General Fund should be able to be mitigated through appropriate use of the transfer receipt with a large net receipt available for investment in new affordable housing within the Housing Strategy.

## 5 Scenarios and the Options

As will be identified from the above analyses, the range and variety of options is able to be brought down to the “best use of resources” under each of the main management/ownership options. Appendix 4 sets out the potential routes and section 4.3 above focuses on the details of a retention strategy. Revenue is not the key issue for debate within this appraisal and we have built in unit cost growth into the baseline to allow for service improvements identified within the Cambridge Standard.

A **Retention Strategy** is able to meet the Minimum Investment Standard only by 2010/11. The optimal use of resources is to utilise revenue surpluses as RCCO and to avoid unsupported borrowing which is wasteful of future surpluses in terms of interest charges on debt. In these circumstances, the Council must commit to placing 50% of Right to Buy receipts with the HRA programme and to reduce HRA reserves by around £2-3m. This combination of resources is then able to meet the Minimum Investment Standard. **The total capital resources available to 2010/11 are therefore £59m.**

An ALMO approach would be based on a bid to the Minimum Investment Standard of £22.7m coupled with the use of revenue surpluses as RCCO and an extra bid for regeneration investment of £1.1m. **This would generate capital resources to 2010/11 of £70m.**

A Stock Transfer is able to deliver the full investment need for the Stock Survey and Cambridge Standard. There may be greater downward pressure on revenue costs

under stock transfer. **The total capital resources available to 2010/11 are therefore £89m.**

We suggest that these form the realistic bases for programmes of investment under the different options and that Council officers are able to “convert” these amounts into outline but practical programmes to deliver priorities within the Minimum Investment Standard at base, then towards the Cambridge Standard. It is this comparison of resources and delivery with the other, non financial features of the three options, which should form the basis for the “Test of Opinion” to be undertaken in the autumn.