CAPITA

HOUSING AND CONSULTANCY

Hammersmith & Fulham Council

Strategic Housing Stock Options Appraisal

Financial Adviser Report
October 2015 - FINAL

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Executive Summary

Hammersmith & Fulham Council has appointed Capita Property & Infrastructure's Housing Consultancy team to provide clear financial guidance to the Council and key stakeholders so that it can make decisions on the best ways to meet its housing objectives through its Strategic Housing Stock Options Appraisal (SHSOA) project.

Options considered

The table below sets out the options available and those that have been considered in detail in the financial appraisal, and reasons why others have not:

Option	Treatment
Retention in full – ownership and management remains with the Council using in-house service	Considered in full as part of the report
Retention – ownership with Council, management via the set up of a new ALMO	Discussed, but disregarded for the modelling within the report as the Council only recently took the decision to close its ALMO in March 2011 and undertook an appraisal which at that time suggested the in-house option was more viable
Retention – ownership with Council, management with Council, but some estates managed by Tenant Management Organisation (TMO) or Estate Management Board (EMB)	Discussed but as per partial transfer option below, not considered to be a solution that would provide a fair solution for all of the Council's housing stock
Stock transfer (LSVT) of all housing stock including Earls Court (West Kensington & Gibbs Green (WK/GG)) estates	Legal opinion obtained suggests that the transfer of the West Kensington and Gibbs Green estates as part of a full LSVT is not possible due to the contractual nature of the land sale of those estates to Capco. This will mean that the Council needs to retain the 538 units in an HRA and consider transfer for the rest of the stock at this time. The Council is still free to decide who manages the 538 homes. On completion of the Earls Court scheme, it should be possible to transfer the remaining homes to a housing

	association landlord and close the HRA once this is done.
Stock transfer (LSVT) of all housing stock with the exception of West Kensington and Gibbs Green estates	Considered as part of the report with discussion around the pros and cons of the typical landlord solutions , including transfer to a new stand-alone Registered Provider (RP) through to amalgamation within an existing landlord
Partial stock transfer – transfer of individual sets of stock rather than the majority	Not considered as there were no clear estates or types of stock highlighted as being suitable for partial transfer, and this option does not provide a solution for all of the stock.

Modelling undertaken as part of the appraisal

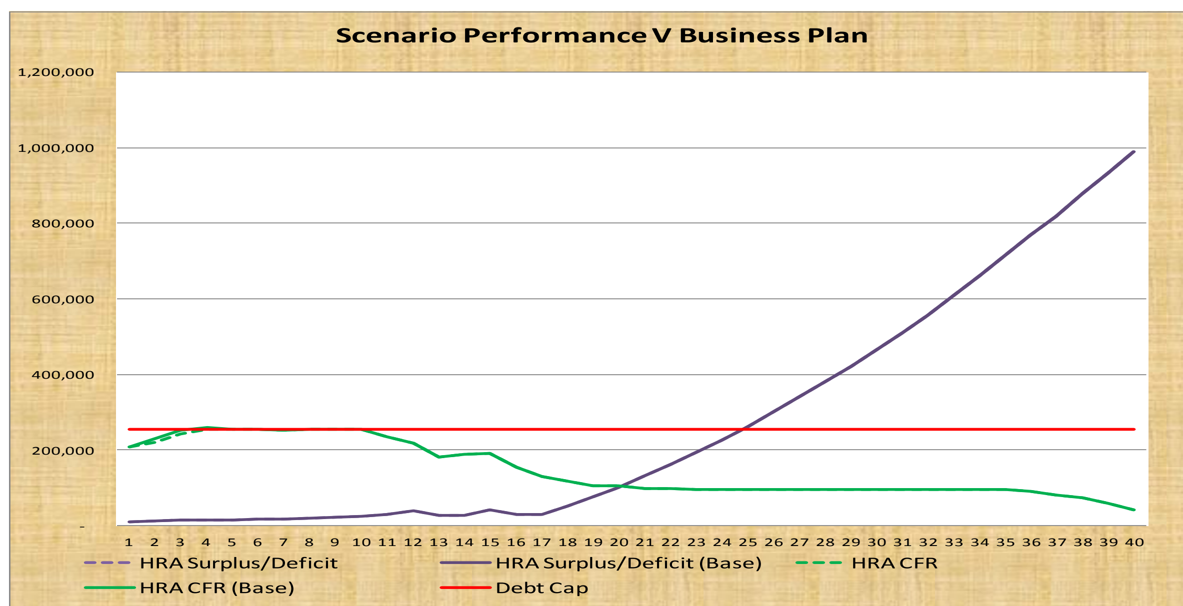
The table below sets out the relevant full financial models that have been prepared as part of the financial appraisal for the retention (R) and transfer (T) options. Yellow cells indicate where the variations occur. The report will also set out a number of sensitivities which show the variation on the output of the modelling in response to assumption changes. The retention models (R) will provide financial cashflow modelling over 40 years of the Council's Housing Revenue Account (HRA) and the transfer models (T) provide financial cashflow forecasts of a stock transfer housing association and a retained HRA containing only the West Kensington & Gibbs Green (WK/GG) properties. R2 and T4 will be the main models used in the report to provide the results of the financial appraisal. All models are based on a July 2015 stock condition survey prepared by Savills, which is designed to provide a minimum level of investment per annum required to maintain the properties to a reasonable standard.

Option		HRA Model	Transfer Model	Start Date	Main Stock	WK/GG	Equity Share	Rents	SCS Std	VAT Shelter % retained
Retention	R1	Yes	No	2015	12,260	inc stock	16	Old	Minimum	N/A
Retention	R2	Yes	No	2015	12,260	inc stock	16	New	Minimum	N/A
Transfer	T1	Yes - retained WK/GG	Yes - Main stock	2015	11,722	538	16	Old	Minimum	50%
Transfer	T2	Yes - retained WK/GG	Yes - Main stock	2015	11,722	538	16	New	Minimum	50%
Transfer	T3	Yes - retained WK/GG	Yes - Main stock	2015	11,722	538	16	New	Minimum	75%
Transfer	T4	Yes - retained WK/GG	Yes - Main stock	2017	11,622	538	16	New	Minimum	75%

Retention of all stock

R2 is a business plan for the HRA which contains all current HRA housing stock. The modelling reflects the rent regime that was announced by the Chancellor of the Exchequer on 8 July 2015, to reduced rents by 1% per annum for each of the next 4 years from April 2016, allowing no inflation. It reflects the very latest estimate of the minimum level of investment per annum required to maintain the properties to a reasonable standard as calculated by stock surveyors, Savills in July 2015, together with the capital budgets for works already promised to residents for 2015/16 and 2016/17. This model also assumes that the plans for the redevelopment of West Kensington and Gibbs Green estates under the land sale agreement to Capco, are achievable in line with the assumptions made. These assumptions are that:

- Leaseholder properties and other RP properties required to be bought back from owners to redevelop the area can be bought at the estimated values;
- That the properties can be purchased at the right time and that the vendor can be re-housed without delays;
- That the funding from Capco in the form of receipts in advance of land transfer is available;
- The replacement homes not taken up by leaseholders and freeholders are available for sale in year 10 and can produce the level of sales receipts estimated;
- There is no slippage in the currently predicted timescales for the redevelopment of the site and therefore the capital receipts are realisable within the expected timescales in the HRA to fund the required investment whilst the Council is at its debt cap and unable to borrow.
- The compensation and replacement home deal for residents is as set out in the draft contracts appended to the Land Sale Agreement.



The graph shows that the current full HRA projections (R2) would mean that the Council would need to borrow to its maximum debt cap of £254m by 2018/19 and stays at that level until 2024/25. Combined with this, it shows that even to achieve this, the HRA revenue working balances would need to fall between £1 million and £3 million below the level considered prudent in years 4 to 8 as a result of loan repayments due. Taken together, in the next 10 years, this will mean a short fall on investment compared to the needs of the stock identified in the survey of around £67.5 million through borrowing restrictions and an additional £1 million due to use of HRA reserves not considered prudent.

If the £67.5 million of work is re-phased to a time when it can be afforded then the works need to be pushed back annually from years 5 to 10 and would only be completed in year 15. This figure is heavily reliant on receiving realisable capital receipts (which only happen when the land transfers) from the West Kensington and Gibbs Green scheme at the expected time and delays would cause the figure to rise. The push back of capital investment brings with it the risk that not doing the works at the correct time leads to increased repairs costs and / or void properties and loss of income. Either of these outcomes would reduce the resources available for investment and exacerbate the problem of reduced investment still further.

The HRA modelling assumes that:

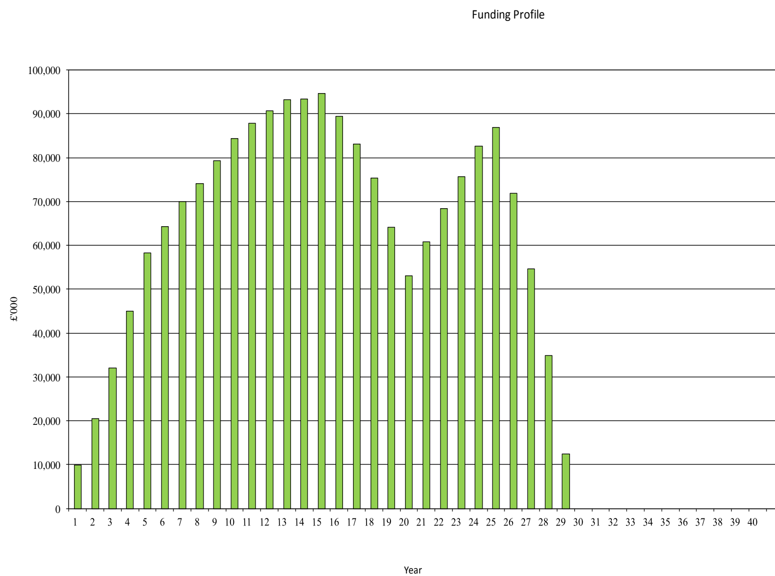
- The Council resumes movement to target rent post budget cuts and CPI+1% + £1 rent rises in accordance with pre budget assumptions
- The effect of forced void sales is not included
- The effect that increasing rents for high earners may have is not included
- Any cost pressures on the buy-back of properties within the West Kensington and Gibbs Green scheme do not materialise
- West Kensington and Gibbs Green realisable receipts assumed from 2017/18 – this is still to be confirmed

The Council's HRA is in a position whereby the costs of managing and maintaining the stock will keep flowing whilst the regeneration work is happening at the same time. The two investment requirements are applying pressure to the business plan at the same time. The regeneration work is committed and therefore has a first call on the HRA resources. It would be advisable to have headroom in the HRA available to protect the Council in the event of up to a 2 year delay in receiving the West Kensington and Gibbs Green realisable receipts to avoid further delays in capital investment and the uncertainty of the availability of the receipts, however the current assumptions show that this cannot be accommodated. The new imposition of rent reductions from April

2016 leaves the Council with fewer resources in the immediate future and therefore some very difficult decisions to make.

Transfer of all stock plus retention of West Kensington & Gibbs Green development

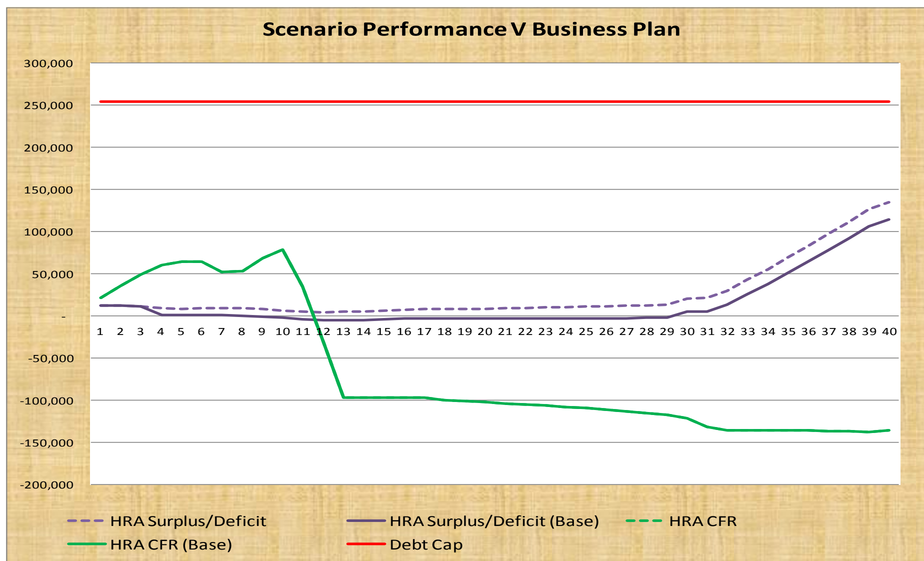
T4 consists of a stock transfer model (LSVT) for the main stock of 11,622 properties (11,722 as at July 2015 less an assumed 100 propertied sold under RTB in 2 years) and a HRA retention model of 538 Council tenanted / replacement properties that are part of the West Kensington & Gibbs Green land sale.



Stock Transfer Business Plan assuming:

Stock Valuation = Minus £16.533 million
Assume price = nil
Debt write off required = £208m

Facility = £95m
Peak debt = £94.756 million
Peak Year = 15
Repay Year = 30



West Kensington / Gibbs Green retained HRA Business Plan assuming:

Retain debt of £11.8 m with the Council HRA revenue and Major Repairs Reserve balances retained are sufficient to keep HRA positive

The modelling shows that a transfer of the main stock and the write off by the Government of the associated HRA debt estimated at £208 million, could produce a fundable business plan for the transfer organisation. It assumes that the new landlord pays nothing for the stock. What this means is that despite the fact that the valuation of the stock is negative (- £16.533 million here) because rents will be cut by 1% per annum for 4 years from next year, a transfer landlord could still afford repay the loan that builds over time to £95 million by year 15 within 30 years. It would not need to increase rents beyond those the Council would need to charge in order to achieve this. In addition, the landlord would be able to undertake works at the time that they are needed to maintain the stock and manage the services as assumed in the HRA. The £95 million facility required would be for the management of the existing stock only and there may be additional facilities made available for new build opportunities not available in the HRA due to the debt cap.

In addition, the retained HRA model can be seen to be managed with a positive HRA revenue balance to deliver the sale and replacement of the West Kensington and Gibbs Green estates and generate capital receipts post year 10, which may be of use in agreeing a business case for transfer. It can be seen that the scheme requires a high level of borrowing up to year 10 (£79million) but then capital receipts are generated after year 12 as properties received to replace leaseholder buybacks are sold.

It should be noted however, that the valuation of the stock is negative and in the past would have been eligible for additional Government “gap funding” to support the fact that the income expected over time is less than expenditure. This form of funding is not currently available and as such this means that the business plan is under more pressure and has less of a margin to support additional costs. This version of the transfer business plan does not therefore include any cost associated with the set up costs of a new organisation and this may be something that has to be funded from Council resources. A recent ALMO stock transfer of 5,000 units had a budget for set up costs of around £2.5 million. The cost is not fully variable with stock numbers, but would be higher than £2.5 million for Hammersmith & Fulham.

In summary, the retention solution comprising of an HRA for all stock will mean that some properties may not receive the investment they require at the right time, which will lead to further repairs costs and/or increased void properties. It is the high level of borrowing in the early years to support the West Kensington and Gibbs Green scheme combined with the immediate rent reduction and structural works to tower blocks which is causing the Council to hit its debt cap. However, if the main stock and the West Kensington and Gibbs Green stock are separated by means of a transfer, then it would appear that both the main stock investment and the West Kensington and Gibbs Green scheme could be achieved at the right time without either scheme’s investment requirements impacting upon the other.

Benefits of arising from transfer

The three LSVTs that have taken place since the introduction in 2012, have been required to show that there are benefits to the Government arising from stock transfer that would warrant the funding of the write-off of debt. These have so far been:

Benefit of Transfer	Saving Generated to Government
Irrecoverable VAT on costs to housing association	Any VAT not reclaimable by an Housing Association is additional revenue to Government over time
Avoidance of long term empty homes (especially blocks of properties)	Tenants placed in private rented homes if the Council cannot maintain social homes – Local Housing Allowance (LHA) for a private rented home is greater than Housing Benefit (HB) for a social home. The Government save the difference in cost if voids are avoided
New build homes	Moving tenants from private rent to social rent saves Government value of LHA-HB. Govt saves from new homes. Benefit calculated based on weekly rent values
Additional jobs / avoid lost jobs	Increased tax revenue / reduced benefits costs / economic impact on local area
Additional apprenticeships	Increased tax revenue / reduced benefits / social welfare increased
Energy efficiency / structural & thermal works (non-traditional build)	More cash in tenants' pockets - positive mental health effect / reduced health costs
Newly arising non-decent homes being able to be brought to decent standard	Avoids private letting costs
Additional investment in the stock / area	More sustainable homes / better neighbourhoods / lower ASB costs
Regeneration of areas	Attraction of investment to areas generates economic benefits from employment and private investment in community initiatives / schools
Council includes land in transfer that could be deemed to attract additional private funding for new build	New build benefits as above

These benefits have not however so far ever had to cover debt write-off relating to an assumed cut in rents. The debt write-off required usually arises from differences in the level and time of capital investment compared to the self-financing assumptions and the addition of VAT on costs. The level of debt write-off relating to the rent cut is estimated to be £110 million (the amount assumed to reduce the valuation to nil rather than minus £16.533 million), with the additional £98 million (excluding debt premia) relating to costs of works that need to be done in the early years rather than on an average basis, irrecoverable VAT and pressures on debt recovery arising from new Government policies. The debt write-off relating to the rent reduction will require a conversation with GLA / DCLG. This is a fundamental change in rent policy and is over and above the cost/benefit requirements placed on the most recent transfer organisations.

Other areas to consider to bridge the gap

The amount of debt-write off is assumed to be around £208 million plus debt premia. To reduce this sum there are several areas that could be considered and have been discussed in detail above:

- Increase the valuation – either by reducing expenditure assumed, or by increasing income. It should be noted that income arises mainly from rents which are controlled by Government legislation and also that the valuation is minus £16.533 million so before the £208 million is reduced, the valuation would need to become positive.
- Assume that the retained HRA can keep more debt than the £11.8 million attributable to the retained stock and still maintain a positive HRA.
- Look to include land in the transfer agreement that GLA/ DCLG agree is a contribution to the valuation.
- Seek to utilise capital receipts post year 12 from the retained HRA to deliver development potential either to the new landlord or other housing associations in the area to deliver wider economic benefits.
- Identify the support of the negative value of £16.533 million as being private investment in the stock.

1. Introduction

1.1. Hammersmith & Fulham Council has appointed Capita Property & Infrastructure's Housing Consultancy team to provide clear financial guidance to the Council and key stakeholders so that it can make decisions on the best ways to meet its housing objectives through its Strategic Housing Stock Options Appraisal (SHSOA) programme.

1.2. On 1 December 2014, the Cabinet approved a report containing amongst other procurement related decisions, the following recommendations:

- "That approval be given to proceeding with and producing a Strategic Housing Stock Options Appraisal (SHSOA) for the future financing, ownership and management of the Council's housing stock, as set out in section 5 of [the Cabinet] report;
- That approval be given to carrying out an initial residents' engagement programme to ascertain residents' initial views on the possible options open to the Council with regards to its housing stock, set out in Appendix 1 [of the Cabinet report], as the first stage of any strategic housing stock options programme;
- That approval be given to the establishment of a 'Residents Commission on Council Housing', for strategic oversight of the Stock Options Appraisal comprising of approximately a dozen residents supported by the programme manager."

1.3. The same Cabinet report also gave the key reasons for making the decision as being:

- To confirm the Cabinet's priority to work with Council housing residents to give them ownership of the land on which their homes are built;
- To explore the options available to give greater powers to residents of the Council's housing estates across a broad range of areas;
- A stock transfer option may allow access to borrowing currently limited by the HRA debt cap and therefore access to the funding to increase the provision of affordable housing within the Borough, as well as giving more flexibility in terms of being able to maintain homes at a decent standard;
- The Council is committed to devolving more control to the community."

The Programme Team and Programme Board have been set up and consultants appointed. A Residents' Commission on Council Housing (RCCH) has also been set up. It is the intention that the Council's tenants and leaseholders will be central to the process and decision making at all times and the Residents' Commission plays an important role in ensuring that this objective is achieved.

1.4. It was seen as imperative to the appraisal process that the following key stakeholders were either involved or kept fully appraised:

a) DCLG, HMT, GLA and the HCA;

b) Tenants and the TRAs;

c) Leaseholders;

d) LBHF Councillors and officers, H&F Business Board, Housing Service Management and employees.

1.5. As financial advisers, we have worked as part of the Delivery Team with Programme and Project Managers, other external advisers, members of finance staff from the Council's Housing Service and other corporate managers. We have also had the opportunity to work with and provide presentations and training as required to the Residents' Commission on Council Housing (RCCH), which has been set up specifically to review the evidence presented as part of this appraisal. We would like to place on record our thanks to all of those involved with whom we have worked closely to produce this report for their enthusiastic and timely responses to our requests for information, and also to the RCCH for the detailed attention and dedication they have shown.

1.6. This report, as part of the overall SHSOA report is for approval by the RCCH and the Council's Strategic Housing Stock Options Appraisal Programme Board.

2. Background

2.1. From 2004 to 2011, the Council managed and maintained its housing stock via H&F Homes Ltd which was an Arms Length Management Organisation (ALMO), set up for the purposes of accessing additional support for achieving the Decent Homes Standard. This was successful in delivering a programme of £215 million of work before wound up and the service being returned "in-house" to the Council.

2.2. It is an important outcome of the Strategic Housing Stock Option Appraisal (SHSOA) that any option chosen is capable of the preserving the level of investment made in the homes and that the investment is built upon to deliver sustainable homes for the future. The Decent Homes Standard was reached through the provision of additional support that recognised that the homes were below the standard and "catch up" investment was required. The standard is only ever achieved at a point in time. Without continuous investment at the right time in accordance with the specific lifecycle replacement requirements of components within the Council's properties, homes can become non-decent very easily. Additional investment funding for ALMO's and Councils with housing stock is no longer available as all Councils are assumed to have met the Decent Homes Standard.

2.3. Upon a change of Government in 2010, the Coalition Government progressed a radical set of reforms to the Council Housing financial regime, abolishing the Housing Revenue Account (HRA) subsidy system and replacing it with a new 'self-financing system' whereby each Council that owned stock was able to leave the subsidy system through a one off adjustment to its debt. This new system was introduced in April 2012. Hammersmith & Fulham Council is one of the 180 or so Councils to be affected by this change.

2.4. In general terms, the abolition of the HRA Subsidy system and replacement with self-financing for stock owning Councils from 1 April 2012 has left them with the responsibility of managing their own housing debt. The Council must manage and maintain the housing stock to at least the Decent Homes Standard, but is limited by a "debt cap" on what it can borrow and when to do this. This will be discussed in more detail within our report.

2.5. Over the five year life of that Parliament, the Coalition Government also introduced some additional, substantial reforms which impact on the strategic role of Councils as well as its landlord role. These included:

- New planning arrangements including for the delivery of affordable housing on mixed developments;

- A change in guidance on the setting of social housing rents which from 1 April 2015 provided that Registered Providers of social housing should only increase rents by the Consumer Price Index (CPI) + 1% rather than the Retail Price Index (RPI) + 0.5% plus up to £2 per week where rents were below an agreed target rent. This guidance was set with a view that rents should already have converged to target (although for most Councils previously setting rents as part of the subsidy system this was not the case) and that the historic difference between CPI and RPI was around 0.5%. This being the case, the two calculations of increase should not be materially different and social housing providers should not be adversely affected. This guidance was said to be in place for up to 10 years. Until 2015, rent setting guidance was just that, it was guidance to be followed, but Councils could make alternative arrangements in consultation with tenants and understanding the financial implications that might arise if the guidance was not followed;

- Substantial other changes to the housing benefit regime – culminating in the eventual absorption of the pre-existing benefit arrangements into a new Universal Credit which is currently being rolled out. This included two key changes that would directly affect the management of social housing and the collectability of rental income:
    - the restriction of benefits paid in relation to the number of people in the social home compared to the number of rooms in the home, and the subsequent need for tenants to move to a more affordable home; and
    - the payment of the housing element of benefits being made direct to tenants rather than directly to the landlord;

- A re-invigorated Right to Buy regime whereby a large part of the resources are channelled back into replacement housing using the 1-4-1 replacement scheme and an affordable rent regime. The increase in discount available to the tenants has increased the number of homes sold in Hammersmith & Fulham. The majority of homes sold to tenants are not sold freehold, they can only be sold under a leasehold arrangement which means that services and maintenance of the

properties usually continues to be provided by the Council along with services to tenants and service charges are levied on the leaseholders;

- The abolition of the TSA and the absorption of many of its previous functions into a Regulatory Committee of the HCA. This resulted in the introduction of a new code of governance and a more risk-based approach to the monitoring of Registered Providers of housing;

- A new approach to stock transfer and the introduction of a revised Housing Transfer Manual (with a limited lifespan) which needed to consider the introduction of self-financing. This manual introduced a cost/benefit exercise and full business case study to justify the write off of housing debt that exceeded the purchase price for the housing stock. Earlier this year, three Councils successfully completed stock transfers under the new guidance.

2.6. Following the General Election in May 2015 and the subsequent formation of a Conservative government, as a result of the election manifesto and the budget on 8 July 2015, a package of measures designed to reduce welfare benefits by £12 billion over the next four years bill and to promote home-ownership and re-provision of social housing have been announced. Implementation of the measures is still being developed. These measures will have an impact on social housing nationally, but may have a greater impact on London Councils such as Hammersmith & Fulham as a result of the relative difference in property values:

- Legislation (rather than guidance) to be introduced to reduce actual rents as at 8 July 2015 and their relative target or formula rents from 1 April 2016 by 1% (real reduction no inflation allowed) per annum for four years. After that there is no guidance available yet as to what rates will be allowable. Current thinking is a return to CPI+1% in line with policy from April 2015. This also currently assumes that social landlords cannot set rents for new tenants to the target rent. Councils and some transfer housing associations are lobbying the policy makers on this point;

- The Right to Buy (RTB) will be extended to tenants of all housing associations. At present, existing tenants transferring to a housing association as part of a stock transfer from a local authority retain the RTB on transfer and therefore in early years post transfer will not be detrimentally affected. New tenants post transfer,

have the Right to Acquire which does not have such generous discounts. Non-transfer housing association tenants are restricted from buying their homes. This new provision is expected to increase the number of properties sold and thereby encourage home ownership. The receipts from the sales are to be re-invested in new homes provided by the housing association;

- It has been recognised that as a result of extending the RTB to housing associations, the organisations' business plans will suffer as a result of the loss of net income. In order to address this, a further measure has been announced that is expected to require Councils (only) with housing stock to sell off a proportion of their higher value stock as it becomes void. The intention is that this income will then be used to compensate housing associations for the loss of income associated with their RTB sales. The current suggested level at which a property is deemed to be "high value" varies by region nationally;

- Under a "pay to stay" initiative, tenants in social housing whose household income exceeds £30,000 per annum nationally (£40,000 in London) will be required to pay rents that are set in line with the market rent rather than the social rent currently charged. For Councils, it is intended that the additional rent will be paid over to the government, so no benefit will be seen in the Council's HRA business plan. Housing associations are expected to be able to keep the additional rent towards providing new homes. The method of identifying households that exceed the threshold has yet to be determined. There will undoubtedly be operational management issues associated with managing the fluctuations in a tenant's circumstances.

- A review of lifetime tenancies

2.7 During September 2015, the HCA invited Councils to attend one of two seminars which gave representatives the opportunity to discuss issues of concern relating to:

a) disposal of high value properties;

b) high income social tenants;

c) the review of lifetime tenancies.

We were able to obtain a place at one of the seminars for Director of Finance and Resources, Housing at Hammersmith & Fulham. Her insight from that seminar is included within this report.

2.8 In January 2013, Hammersmith & Fulham Council entered into a Conditional Land Sale Arrangement (CLSA) in order to re-develop a number of homes on the Council's estates at West Kensington and Gibbs Green, the conditional sale agreement was triggered by EC Properties LP on the 14th November 2013. The land is now sold although residents continue to live in their homes and the land does not transfer to the developer until replacement homes are provided. Legal advice provided to the Council says that during the period of re-development which is likely to be at least ten years, the homes affected on these estates cannot be transferred to a housing association as part of an option that involves stock transfer, as the land is sold. The scheme involves the demolition and replacement of a number of Council tenanted homes and leaseholder (ex RTB) properties as well as some properties currently held by local housing associations on long leases. For the purposes of this appraisal when considering stock transfer, it is assumed that the homes affected by this scheme and those homes that replace them remain with the Council for the foreseeable future. The agreement would allow the replacement homes to be transferred to a housing association at a later date, but for simplicity of modelling and uncertainty around the timing, we have assumed they are all retained. A transfer in future would also more likely be based on a tenanted market value rather than market value, unless the homes were vacant at the time of sale.

3. Financial Appraisal Methodology

What options are available for Hammersmith & Fulham?

3.1 As noted in 2.8, the 538 properties on the Council's estates at West Kensington and Gibbs Green are sold and all options assume land transfers to the buyer under the sale agreement to the same timetable. This means that if stock transfer is considered to be the most favourable option and a positive ballot achieved, the Council would still need to maintain a Housing Revenue Account (HRA) and would retain housing debt calculated in relation to the retained properties only.

3.2 In addition, the Council is assumed to retain ownership in the short term of Edith Summerskill House which contains 68 properties (2 of which are currently owned by leaseholders). It is intended that the site will be transferred to the Joint Venture (JV) who will then novate the site to a Registered Provider (RP). The RP will then develop the site out using funds granted from the Council in the form of S106 grant and 1-4-1 replacement receipts. The Council may also need to retain debt in relation to these properties, and for the purposes of this exercise it is assumed that this is the case.

3.3 The main housing stock which may be considered under both retention and transfer consists at August 2015 of 11,722 Council homes. These homes need to be managed in future together with continued servicing responsibility for 4,842 leaseholder properties. Fundamentally there are two main options, but within those there are several alternative methods of delivery. The two main options the Council has chosen to consider are:

3.4 a) Retain ownership of the properties and manage them either by:

- Continuing with the in-house housing service;
- Setting up a new ALMO to take over the management and maintenance of the stock on behalf of the Council.

Or

b) Transfer the ownership of the stock to a Registered Provider under Large Scale Voluntary Transfer (LSVT) and choose the type of landlord to make the transfer to:

- Stand alone company which would involve forming a new Registered Provider (or housing association) to include the people within Hammersmith & Fulham Council

who are engaged in housing-related work (usually those funded by the HRA), together with any additional posts that may be required. This could if desired be a Mutual company (similar to that set up on the transfer of housing stock to Rochdale Boroughwide Housing in 2012), or a community gateway or some other form of tenant-led organisation;

- Set up a new group with an existing stand-alone Registered Provider where Hammersmith & Fulham Council sets up a new a Registered Provider which becomes a subsidiary of a newly formed group;

- Hammersmith & Fulham sets up a Registered Provider and this new organisation joins an existing group of housing associations as a new subsidiary of the existing group;

- Transfer ownership of the stock to an existing Registered Provider where there is no group structure (i.e. no individual subsidiary companied) and the housing stock is owned and managed by a single landlord;

- Partial transfer – i.e. only transfer out selected estates leaving the majority of housing in Council ownership.

3.5 Appendix A sets out the various options described above in diagrammatic form.

3.6 The main differences between the two headline options are set out in the table at Appendix B.

3.7 The detailed solutions within each of the headline options, together with their respective pros and cons are set out below.

The process within the financial appraisal

3.8 The financial appraisal is based on preparing traditional financial valuation and business planning models that consider the financial viability of the various options over the next 40 years. The assumptions used to populate the models are based upon all current known and evidenced information taken from:

a) The Housing Service's financial records of costs and income and the existing HRA business plan;

b) Independent property surveyors Savills Stock Condition Survey freshly prepared for the purpose in July 2015;

c) A full reconciliation in July 2015 of the addresses on the Council's asset management system with the addresses in the Stock Condition Survey and those on Council's rent list;

d) Rent increases in future in accordance with Government guidance;

e) Estimations of inflation based on the Council's predictions and within expected tolerances for stock transfer valuations;

f) Current loan information provided by the Council's finance officers;

g) Funding for transfer based on Capita Asset Services' funding adviser's knowledge of the market;

h) A corporate impact assessment involving senior managers of the majority of corporate services in the Council;

i) Discussions with officers of the Housing Service over a number of months to agree the relevance and reliability of the outputs from the modelling.

3.9 There are two main scenarios:

a) Retention of all of the Council's housing stock within a Housing Revenue Account with an associated 40 year business plan;

b) Transfer of the main housing stock excluding the West Kensington & Gibbs Green (WK/GG) estate properties that are part of the West Kensington and Gibbs Green development scheme and the land is sold. There are two financial models in each transfer case – a stock transfer model and a retained HRA for the 538 units.

The table below sets out the relevant full financial models that have been prepared as part of the financial appraisal, for the retention (R) and transfer (T) options. Yellow cells indicate where the variations occur. We have also set out a number of sensitivities which show the variation on the output of the modelling in response to assumption changes. R2 and T4 will be the main models used in the report. The retention models (R) will provide financial cashflow modelling over 40 years of the Council's Housing Revenue Account (HRA) and the transfer models (T) provide financial cashflow forecasts of a stock transfer housing association and a retained HRA containing only the West Kensington & Gibbs Green (WK/GG) properties / replacement properties. R2 and T4 will be the main models used in the report to provide the results of the financial appraisal. All models are based on a July 2015 stock condition survey prepared by Savills, which is

designed to provide a minimum level of investment per annum required to maintain the properties to a reasonable standard.

Option		HRA Model	Transfer Model	Start Date	Main Stock	WK/GG	Equity Share	Rents	SCS Std	VAT Shelter % retained
Retention	**R1**	Yes	No	2015	12,260	inc stock	16	Old	Minimum	N/A
Retention	**R2**	Yes	No	2015	12,260	inc stock	16	New	Minimum	N/A
Transfer	**T1**	Yes - retained WK/GG	Yes - Main stock	2015	11,722	538	16	Old	Minimum	50%
Transfer	**T2**	Yes - retained WK/GG	Yes - Main stock	2015	11,722	538	16	New	Minimum	50%
Transfer	**T3**	Yes - retained WK/GG	Yes - Main stock	2015	11,722	538	16	New	Minimum	75%
Transfer	**T4**	Yes - retained WK/GG	Yes - Main stock	2017	11,622	538	16	New	Minimum	75%

3.10 R1 and R2 are both full 40 year HRA business plan models that contain the 12,260 units of stock (excluding Edith Summerskill House) that the Council held as at July 2015, together with 34 shared ownership properties (the equivalent of 16 fully owned properties. Both models assume a start date for the assumptions modelled of 1 April 2015, and contain the advised level of investment to maintain the stock to a reasonable standard as determined by the Savills stock condition survey prepared in July 2015. The models both assume that the Council's Housing Service would continue to provide the management and maintenance of the properties and that the costs are based on the current budgets and forecast efficiency savings already agreed by the Council. The difference between the two models is the rent increase assumption. R1 assumes the rent increases that the Council would have expected before the announcement in the Budget of 8 July 2015. R2 assumes the only change is to reflect the rent reduction of 1% per annum from April 2016 and no re-letting to new tenants at target rent.

3.11 T1 and T2 reflect the same assumptions as R1 and R2 but from the perspective of the transfer of 11,722 units of stock (as at 1 April 2015) and the retained HRA of 538 units at West Kensington & Gibbs Green with the equivalent rent options. T2 assumes a VAT shelter inclusion of 50%. T3 then assumes the same as T2, but includes a VAT shelter proportion of 75% which we will demonstrate provided a fundable transfer plan. T4 moves the T3 transfer plan forwards to the more likely period of transfer with a 1 April

2017 start date. The detailed assumptions underpinning these models and associated sensitivities are set out in section 4 of this report.

3.12 Both sets of models are based purely on future cashflows that might be reasonably expected and where expenditure exceeds income, then borrowing will be required to fund the difference. Where income exceeds expenditure, there is the opportunity to either pay off debt or to build revenue balances. As the Council already owns the housing stock, the retention models (R) do not need to assume a purchase price and business plans are produced assuming the constraints of local authority capital financing apply. The transfer models (T), take the predicted net cashflows for 30 years and apply a discount factor to them to work out the time value of that net income or expenditure if all received today – that is known as the Net Present Value (NPV). This will give us the price that a social landlord would be prepared to pay for the stock. Having calculated a price, the transfer models then provide a typical business plan that will allow a landlord to buy the stock, let, manage and maintain it and fund a loan over 30 years to do so. The HRA modelling uses 40 years of cashflows as it is able to borrow using public (PWLB) loans that can have a 50 year repayment term. The transfer plans aim for repayment in 30 years as this is typically the maximum loan period that a bank would consider for lending. This approach allows us to compare the two scenarios.

3.13 In determining the strengths of the options, the key areas that will need to be considered are finance and governance. Some options will appear to offer greater financial viability, but this may come at the cost of the ability to control decision making. Some options may be more financially attractive to the Government (who remain a key stakeholder in the process if grants are required to pay off debt), but such options may not be attractive to tenants and leaseholders in terms of a standard offered or the ability to feel part of the way the estates are managed and maintained.

4. Financial Modelling Assumptions

4.1. The option appraisal is underpinned by 40 year financial business plan modelling. The models consider income and expenditure cashflows over 40 years, taking the current actual estimates and applying assumptions for real change and inflation in future. Future assumptions are made using knowledge of the economic situation, evidence in the form of rent rolls from the Council systems, data from the asset management system, a stock condition survey prepared specifically for this purpose in July 2015 and annual accounting and trend data information. We also rely on Council officers to provide additional historic and current details surrounding the budgets used.

4.2. As far as possible, each model uses the same base data as explained in the paragraphs below so that direct comparisons can be made. Where this differs, an explanation is provided.

4.3. The HRA business plan model assumes a start date of 1 April 2015 with associated cashflows from that date. The transfer valuation and business plan models assume a transfer date of 1 April 2015 initially for comparative purposes. We have then created a “rolled forward” version of the transfer model which assumes a start date of 1 April 2017 (a transfer is likely to be sometime in 2017/18 if this goes ahead). All 2015/16 assumptions used as the base for the HRA model are rolled forwards with considered relative values of inflation to give a 2017/8 start date for the transfer models.

4.4. In the options that consider stock transfer of the majority of the housing stock, we have also prepared a HRA business plan for the West Kensington & Gibbs Green development scheme which is the “retained” housing stock plan. This assumes a start date of 1 April 2015.

Stock Numbers

The HRA business plan models R1 and R2 consider the estimated stock numbers as at 31 July 2015 for the entire Council housing stock including the West Kensington and Gibbs Green redevelopment, but excluding Edith Summerskill House which is assumed to be a separate project. A full list of addresses for stock (tenanted, void and leasehold) was provided as at 31 July 2015 from the Council’s asset management system. This was reconciled firstly to the Council’s asset list included in the accounts for 31 March 2015, then also to the rent list and also to the list of properties provided to Savills for the purpose of undertaking a survey. We also reconciled the movements in stock from 1

April 2015 to 31 July 2015 arising from sales of homes to freeholders and leaseholders and also the buy-back of properties from leaseholders required as part of the West Kensington & Gibbs Green redevelopment. Having reconciled all of these lists, a reconciled version taking into account all movements at that date has been agreed as the starting point. There are no demolitions planned that affect the stock numbers as in the case of the West Kensington & Gibbs Green scheme, the Land Sale Agreement provides a replacement home as soon as one is demolished.

The HRA housing stock for the 2015 opening stock is:

Council – main stock	11,722
Council – WK/GG	538
Total	**12,260**
Leaseholders / equity share receiving services	4,693
Leaseholders / equity share – WK/GG	149
Total Leaseholders	**4,842**

4.5. The HRA stock numbers have then been adjusted in 2015/16 and future years to take account of an estimate of RTB sales. The estimated sales number for the rest of 2015/16 is 60 and for 2016/17 is 40 giving an estimated reduction in properties prior to a transfer option in 2017/18 of 100 homes. RTB sales are assumed from 2017/18 to 2021/22 to be 40 per annum and thereafter reduce to 20. These figures are in line with estimates by the Council based on RTB sales since 2012, but have not been adjusted to factor in any increases in RTB sales arising from the “pay to stay” policy, nor do the stock numbers reflect increases in sales due to the proposed forced sale of high value voids.

4.6. The transfer models T1 – T4 exclude the West Kensington and Gibbs Green scheme properties, but these are then included in a separate Retained HRA model required for the Council which assumes only the 538 tenanted properties and the 149 leaseholders. Freeholders on estate who receive estate services only have not been included. The transfer and the retained models are both required for this option.

T1, T2 and T3 all contain the following stock numbers based on 2015:

	Transfer	Retained
Council – main stock	11,722	
Council – WK/GG		538
Total owned	**11,722**	**538**
Leaseholders receiving services =	4,661	
Equity Share holders =	32 *	
Leaseholders / equity share – WK/GG		149
Total Leaseholders	**4,693**	**149**

* Equivalent to 16 full units

T4 assumes an April 2017 start date and therefore the Council held numbers are reduced by the 100 assumed RTB sales between July 2015 and April 2017. We have not assumed that all of the RTB sales result in additional leaseholder numbers. Instead, we have assumed that the cost of services provided and the resultant income in the form of service charges is unchanged as a result of the stock reduction through RTB sales. This infers that the tenanted service charges in effect become collectable from the new RTB leaseholders, or would not be provided:

	Transfer	Retained
Council – main stock	11,622	
Council – WK/GG		538
Total owned	**11,622**	**538**
Leaseholders receiving services	4,661	
Equity Share holders	32 *	
Leaseholders / equity share – WK/GG		149
Total Leaseholders	**4,693**	**149**

* Equivalent to 16 full units

4.7. For the purposes of the transfer modelling, we do not assume at this stage any future reductions in stock numbers due to RTB sales. This is because a housing association business plan is normally compensated by being allowed to keep a sum that would make them no better or worse off as a result of the RTB sale. They can keep all receipts from RTB sales at present with the balance being used to fund replacement homes. The assumption of RTB sales with the compensating income adjustment would not make a difference. Equally future RTB sales are not included in the valuation of the stock as they may not arise and in that event, a new landlord may be paying in advance for the right to receive income from RTB sales that do not materialise. This has always been seen as too much of a risk for the Regulator.

Rents

4.8. Rents in R1 and T1 are calculated based on an average of the known list of actual 2015/16 rents per week for each property and assume that current tenant rents increase in line with a rent restructuring policy agreed with tenants. This policy was slightly different from the one announced by the Government from April 2015 which assumed no convergence from that date. The Council policy assumes that rents are rise by CPI+1% plus a maximum of £1 per week (52 weeks) until they reach the formula (or target) rent. There are a small number of properties where the rent is above target and in the table below are termed" high rent properties". These are properties that have a higher rent which was historically set in accordance with the previous administration's policy. The current administration's policy is for these to reduce towards target over time.

4.9. Rents in R2 and T2 and T3 for 2015/16 are similarly calculated based on the average of the known list of actual 2015/16 rents per week for each property. However, the rents reduce in line with the Government's proposal in the Budget of 8 July 2015 which is to assume that for the four years from April 2016, rents will decrease in real terms by 1% per annum from that rent in place on 8 July 2015. Target rents will also follow the same percentage reduction. This also means that new tenants are not assumed to move to target rent on re-let of a property. For R2, rents from April 2020 onwards are assumed to resume the Council's rent policy which we understand was agreed with tenants in 2014 of moving towards target again at CPI + 1% + £1. For T2 and T3, it is assumed that

the transfer organisation would only increase its rents by CPI + 1%, thereby basing its business plan on slightly lower rents in future than the Council.

4.10. The average opening rent per unit for the HRA in 2015 is **£107.42**, and target rent of **£119.26** per week based on 52 weeks. The transfer rents mirror this, but are broken down into more detailed categories:

Actual 2015/16 rents for the main stock:

Main Stock Bedsit	Main Stock One Bed	Main Stock Two Bed	Main Stock Three	Main Stock Four Bed	Main Stock Five Bed	Main Stock Six Bed	High Rent One Bed	High Rent Three Bed	High Rent Four Bed	High Rent Five Bed
£ 83.14	£ 96.11	£ 105.72	£ 121.46	£ 145.73	£ 159.87	£ 162.54	£ 158.65	£ 163.96	£ 193.63	£ 273.37

Target 2015/16 rents for the main stock

£ 89.37	£ 103.96	£ 117.15	£ 132.94	£ 152.88	£ 170.65	£ 172.95	£ 99.65	£ 137.34	£ 154.29	£ 174.69

4.11. T4 assumes a start date of April 2017, so its starting rents are based on the 2015/16 current rents which are then reduced by two annual reductions of 1%. There is then an assumed continuation for two years of a further 1% reduction per annum and then a return to an increase of CPI + 1%. It should be noted however, that there is no guidance about how rents will be allowed to rise post April 2020, so the assumption mirrors the policy that was in place pre the Budget announcement. If the rise in future is capped at CPI for example, then both the Retention and the Transfer models will be hit by a reduction in income.

4.12. By 2017/18, under the new rent rules, the average rent per week in the R2 retention model (with reduced rent assumption) would be £105.27 and for the West Kensington and Gibbs green stock only, will be £105.79 per week. For T4, the opening 2017 rents are:

Actual rent 2017/18 per week:

Main Stock Bedsit	Main Stock One Bed	Main Stock Two Bed	Main Stock Three	Main Stock Four Bed	Main Stock Five Bed	Main Stock Six Bed	High Rent One Bed	High Rent Three Bed	High Rent Four Bed	High Rent Five Bed
£ 81.48	£ 94.19	£ 103.62	£ 119.04	£ 142.83	£ 156.69	£ 159.30	£ 155.49	£ 160.69	£ 189.78	£ 267.93

Target rents 2017/18:

£ 87.59	£ 101.89	£ 114.82	£ 130.29	£ 149.83	£ 167.25	£ 169.51	£ 97.67	£ 134.61	£ 151.22	£ 171.21

Void percentage losses are calculated for each model in the same way and are based on current evidenced performance taking into account recent changes in trend as a result of the movement of tenants to smaller properties as a result of Welfare Reform changes up to 2015.

The void rates assumed across the stock are:

2015/16	1.55%
2016/17 onwards	1.8%

4.13. The percentage annual rent lost through bad debts is calculated for each model in the same way and is based on current evidenced performance. These percentages reflect the economic climate and changes arising from Welfare Reform and the introduction of Universal Credit whereby the housing benefit element of payments is to be paid direct to tenants on a monthly basis rather than straight to the landlord. In the case of the Council, this has been received one week in advance of the rent being due. In future the rent will need to be paid by the tenant. Pilot projects have shown significant increases in arrears arising (some as high as 8%) as a result of direct payments. These figures do not include any additional assumption in relation to arrears that may arise if those earning £40,000 or more are charge at or near market rent as this is not possible to predict with any certainty at this time.

The bad debt rates assumed across the stock are:

2015/16	3.5%
2016/17	4.0%
2017/18 onwards	4.5%

Other Income

4.14. Both models reflect other income coming into the HRA and based on actual budgets determined by past performance and known changes. The assumption for the transfer models is that if income is currently being received by the HRA, then the assets that this income relates to will transfer and therefore the income (and related expenditure – see below) will transfer to the new landlord. Any assets taken out of the HRA on transfer and retained by the Council would therefore give a net reduction in income to the landlord and reduce the valuation of the stock.

4.15. This other income arises from shops, garages, land rents, hostel rents and tenant and leaseholder service charges, water rate collection and advertising income. The transfer models take into account income due from the properties in the main stock and include the recovery of the cost of irrecoverable VAT where applicable. The retained HRA contains the income relating to the West Kensington & Gibbs Green properties only and as this would remain with the Council would have no VAT impact. The HRA business plans include income from all assets in the HRA. Other income also contains an annual budget which reflects the income received from the recharge of the cost of the value of capital works done to leaseholder properties over the period of the business plan at an assumed recovery rate of 80%. This income is calculated by reference to the works separately identified for leaseholder properties in the Savills survey.

4.16. Tenant service charges are assumed to rise by 3% annually, garage and shop rents rise by CPI, hostel rents rise by CPI + 1%, sheltered charges are cash limited in 2016/17 and then rise by CPI and all other income is assumed to rise by CPI only.

Management Costs

4.17. Management costs for each base model (transfer and HRA) are based on the current costs of Council's Housing Service as included in the 2015/16 HRA budgets and rolled forward to 2017/18 with relevant inflationary assumptions.

4.18. The HRA business plan models R1 and R2 assume that all of the costs will be required in future, but also that the agreed budgeted efficiency savings starting in 2016/17 at £1.1 million and rising to a total reduction on current costs of £2.61 million by April 2019 are included in the plan. It is assumed that all of these savings would be made from the cost of running and managing the stock that could transfer and therefore are also assumed in total in the T1 to T3 models.

4.19. Costs are analysed between staffing and non-staffing costs. Staffing costs are assumed to rise by 1% per annum until 1 April 2020 in line with current public sector pay advice and then rise by CPI. Non-staffing costs are assumed to rise by CPI only for all years as the Council has negotiated contracts on this basis. Expenditure would normally be assumed to rise by RPI (at least 0.5% higher than CPI), so the Council has already taken mitigating action to reduce costs as a result of impending losses in income.

4.20. The transfer models assume the same starting costs before the addition of VAT. The management costs have been analysed to allocate the retained West Kensington / Gibbs Green HRA model as share of the costs and additional management to run a

reduced service. Taken in total, the management costs for the transfer model and the retained HRA model will be higher than the HRA with all of the stock as there are initially diseconomies of scale in separating the overall management as there will be duplication of strategic management.

4.21. It is assumed that the majority (if not all) of the Council's Housing Service staff will TUPE transfer to the new organisation and also that the non-staffing costs currently incurred will also be required. The HRA is currently charged with costs arising from corporate services for example, corporate management, financial, legal, IT, accommodation, HR, insurance premiums, facilities management and shop management as well as other strategic and policy support. The sum total of this is estimated at around £6.6 million per annum. An early corporate impact assessment has been undertaken to determine how many Council employees may be affected by changes in ownership of the stock. This shows that managers across the services have identified 10 full time equivalent posts that would need to transfer to the new organisation, accounting for a total of £478,000 of salaries and on-costs. £390,000 of costs have been identified that would no longer be incurred for recharge by the Council if the service was not used. £513,000 of costs have been identified as being required for a retained strategic housing budget as the Council will retain some wider statutory duties and monitoring roles. Some services are carried out using external contracts and these have also been subject to an early review to determine how these might need to be split.

4.22. There will be always be some diseconomies of scale arising from corporate recharges, but there are ways to mitigate this. It is assumed that where appropriate, corporate staff would TUPE transfer to a new organisation to continue their service. A new landlord may also contract with the Council for some services particularly where there are contractual arrangements that are difficult to disaggregate. Usually the new landlord will expect to contract for their own services or may indeed in the case of a group already have arrangements in place. For the purposes of this appraisal the T1 to T4 models assume that if the HRA is receiving a charge from the corporate centre then there is an equivalent budget in the transfer model (with VAT where applicable). This means that the transfer business plan has a budget to either take on staff under TUPE or buy in a service, minimising the effect on the Council.

4.23. The transfer models assume VAT on non-staffing costs, as currently housing associations cannot reclaim the VAT on their day-to-day running costs (Councils are able to recover VAT). VAT is therefore an additional cost (see also Cost Sharing groups below).

4.24. Management costs in the transfer model T1 to T3 are assumed to rise in the same way as the HRA. For T4, the starting management costs have been increased by the relevant inflationary increases from 2015/16 to 2017/18, and then continue with the same inflationary rises as described above.

Investment Costs, Repairs and Maintenance

4.25. Savills have produced a set of Stock Condition Surveys covering the housing stock held by the Council (including that sold but not yet transferred on the West Kensington and Gibbs Green Estates) and also the leasehold stock for which the Council has the responsibility to repair but also for which it can make a charge to the leaseholder for within certain limits. These works are usually structural, external or to common areas of blocks in which flats have been sold under the Right to Buy. During the last round of stock transfers, it became a requirement in the Housing Transfer Manual that local authorities should consider the impact a stock transfer may have on leaseholder service charges when ownership of the freehold transfers from the Council to a private registered provider. The government wishes to ensure that, where additional capital works are made possible by transfer, leaseholders are protected from excessive charges in relation to these works. The Secretary of State will therefore require local authorities to include in the transfer contract a stipulation that service charges for leaseholders of the transfer landlord, relating to capital works, should be capped at no more than £10,000 (or £15,000 in London) in the five year period following transfer. The assumption made in the "other income" section of 80% recovery of costs is expected to meet the criteria. The surveys produced showed separate 40 year profiles of capital and revenue maintenance spend for:

- Council owned main stock properties
- West Kensington & Gibbs Green existing tenanted properties and replacement properties Leaseholder / equity share main stock properties
- Leaseholder / equity share Kensington & Gibbs Green properties

The West Kensington & Gibbs Green profile of expenditure shows continued spending requirements whilst the site is being prepared, followed by a period of time whereby the homes will not need any capital works as they are newly built and then after time, a lifecycle of replacement works commence.

4.26. The survey of the main stock provides us with the advised level of investment to maintain the stock to a reasonable standard and the profile over time that the works should be done by. These standards are set out in the tables below and are shown at July 2015 prices, based on 11,722 properties per the reconciled lists. These figures are inclusive of preliminary works costs but exclusive of professional fees and VAT:

LBHF	Year 1= 2015							Stock	11,722	
Year	1 to 5	6 to 10	11 to 15	16 to 20	21 to 25	26 to 30	31 to 35	36 to 40	Total	Unit Ave
Catch/Up	£497,925	£0	£0	£0	£0	£0	£0	£0	**£497,925**	**£42**
FMW	£87,661,201	£69,482,607	£78,700,950	£52,144,488	£94,980,373	£57,214,366	£96,883,748	£57,395,112	**£594,462,845**	**£50,713**
Improvements	£1,067,350	£0	£0	£0	£0	£0	£0	£0	**£1,067,350**	**£91**
Related Assets	£1,485,961	£1,464,502	£1,186,513	£639,346	£711,779	£932,224	£1,241,838	£1,191,717	**£8,853,880**	**£755**
Revenue	£75,911,420	£75,911,420	£75,911,420	£75,911,420	£75,911,420	£75,911,420	£75,911,420	£75,911,420	**£607,291,356**	**£51,808**
Contingent Major Repairs	£3,506,448	£2,779,304	£3,148,038	£2,085,780	£3,799,215	£2,288,575	£3,875,350	£2,295,804	**£23,778,514**	**£2,029**
Exceptional Extensives	£33,134,810	£24,634,810	£13,234,810	£13,209,810	£13,209,810	£11,934,810	£16,434,810	£11,934,810	**£137,728,480**	**£11,750**
Disabled Adaptations	£3,500,000	£3,500,000	£3,500,000	£3,500,000	£3,500,000	£3,500,000	£3,500,000	£3,500,000	**£28,000,000**	**£2,389**
Total	£206,765,115	£177,772,643	£175,681,730	£147,490,843	£192,112,596	£151,781,394	£197,847,166	£152,228,863	£1,401,680,351	£119,577

All costs are exclusive of Professional Fees, VAT, management and administration costs and are based on today's prices. Costs are inclusive of preliminaries.

Main stock leaseholder costs based on 4,528 units that are chargeable for these works:

LBHF	Year 1= 2015					Stock			4,528	
Year	**1 to 5**	**6 to 10**	**11 to 15**	**16 to 20**	**21 to 25**	**26 to 30**	**31 to 35**	**36 to 40**	**Total**	**Unit Ave**
Catch/Up	**£51,061**	**£0**	**£0**	**£0**	**£0**	**£0**	**£0**	**£0**	**£51,061**	**£11**
All Catch Up	£51,061	£0	£0	£0	£0	£0	£0	£0	**£51,061**	£11
Year	**1 to 5**	**6 to 10**	**11 to 15**	**16 to 20**	**21 to 25**	**26 to 30**	**31 to 35**	**36 to 40**	**Total**	**Unit Ave**
FMW	**£14,527,145**	**£10,659,230**	**£6,485,777**	**£7,365,347**	**£12,354,338**	**£6,000,971**	**£15,044,164**	**£11,093,906**	**£83,530,877**	**£18,448**
Windows	£9,154,563	£3,145,971	£1,727,680	£1,366,873	£4,341,378	£1,595,936	£9,154,563	£3,145,971	**£33,632,933**	£7,428
Pitched Roof	£90,185	£265,375	£340,104	£606,434	£218,290	£448,828	£472,930	£281,948	**£2,724,094**	£602
Flat roofs	£229,207	£1,805,907	£480,853	£363,472	£1,238,374	£252,277	£569,932	£1,897,215	**£6,837,236**	£1,510
Rainwater goods / Ext Joinery	£401,572	£681,615	£671,223	£448,347	£412,020	£84,332	£401,572	£681,615	**£3,782,295**	£835
Walls	£40,148	£239,879	£1,061,999	£1,292,669	£1,720,578	£366,994	£561,094	£1,800,338	**£7,083,698**	£1,564
Environmental Works	£502,185	£964,480	£613,643	£748,567	£314,373	£209,828	£848,330	£560,124	**£4,761,531**	£1,052
Communal services	£3,064,952	£2,045,087	£1,156,176	£2,181,682	£2,991,853	£2,248,898	£1,954,887	£1,909,513	**£17,553,048**	£3,877
Communal doors	£581,034	£1,002,342	£274,636	£236,567	£894,792	£379,558	£606,935	£250,696	**£4,226,561**	£933
Communal Windows	£463,298	£508,575	£159,464	£120,737	£222,679	£414,320	£473,921	£566,488	**£2,929,482**	£647
Year	**1 to 5**	**6 to 10**	**11 to 15**	**16 to 20**	**21 to 25**	**26 to 30**	**31 to 35**	**36 to 40**	**Total**	**Unit Ave**
Contingent Major Repairs	**£581,086**	**£426,369**	**£259,431**	**£294,614**	**£494,174**	**£240,039**	**£601,767**	**£443,756**	**£3,341,235**	**£738**
Contingent Major Repairs	£581,086	£426,369	£259,431	£294,614	£494,174	£240,039	£601,767	£443,756	**£3,341,235**	£738
Year	**1 to 5**	**6 to 10**	**11 to 15**	**16 to 20**	**21 to 25**	**26 to 30**	**31 to 35**	**36 to 40**	**Total**	**Unit Ave**
Exceptional Extensives	**£11,414,707**	**£10,214,707**	**£4,794,707**	**£4,654,707**	**£4,654,707**	**£4,454,707**	**£5,804,707**	**£4,454,707**	**£50,447,656**	**£11,141**
Solid wall insulation	£2,000,000	£2,000,000	£0	£0	£0	£0	£0	£0	**£4,000,000**	£883
Asbestos	£500,000	£200,000	£200,000	£10,000	£10,000	£10,000	£10,000	£10,000	**£950,000**	£210
Structural works High Rise	£3,150,000	£3,150,000	£30,000	£30,000	£30,000	£30,000	£30,000	£30,000	**£6,480,000**	£1,431
Structural works cornish	£0	£0	£0	£200,000	£200,000	£0	£0	£0	**£400,000**	£88
Complex M&E	£1,500,000	£600,000	£300,000	£150,000	£150,000	£150,000	£1,500,000	£150,000	**£4,500,000**	£994
Scaffold	£4,264,707	£4,264,707	£4,264,707	£4,264,707	£4,264,707	£4,264,707	£4,264,707	£4,264,707	**£34,117,656**	£7,535
Other	£0	£0	£0	£0	£0	£0	£0	£0	£0	£0
Year	**1 to 5**	**6 to 10**	**11 to 15**	**16 to 20**	**21 to 25**	**26 to 30**	**31 to 35**	**36 to 40**	**Total**	**Unit Ave**
Total	£26,573,998	£21,300,306	£11,539,916	£12,314,668	£17,503,218	£10,695,716	£21,450,637	£15,992,369	£137,370,829	£30,338

All costs are exclusive of Professional Fees, VAT, management and administration costs and are based on today's prices. Costs are inclusive of preliminaries.

West Kensington & Gibbs Green Council tenanted stock / replacement stock based on 538

LBHF	Year 1= 2015					Stock			538	
Year	1 to 5	6 to 10	11 to 15	16 to 20	21 to 25	26 to 30	31 to 35	36 to 40	Total	Unit Ave
FMW	**£0**	**£0**	**£535,977**	**£535,977**	**£1,274,211**	**£1,375,338**	**£4,227,143**	**£4,328,271**	**£12,276,917**	**£22,820**
Kitchen	£0	£0	£0	£0	£1,071,955	£1,071,955	£0	£0	**£2,143,910**	£3,985
Bathrooms	£0	£0	£0	£0	£0	£0	£803,966	£803,966	**£1,607,932**	£2,989
Electrics	£0	£0	£0	£0	£0	£0	£0	£535,977	**£535,977**	£996
Heating	£0	£0	£535,977	£535,977	£0	£0	£1,339,944	£1,339,944	**£3,751,842**	£6,974
Windows	£0	£0	£0	£0	£0	£0	£809,023	£809,023	**£1,618,045**	£3,008
Doors	£0	£0	£0	£0	£0	£0	£535,977	£535,977	**£1,071,955**	£1,992
Pitched Roof	£0	£0	£0	£0	£0	£0	£0	£0	**£0**	£0
Flat roofs	£0	£0	£0	£0	£0	£0	£0	£0	**£0**	£0
Rainwater goods / Ext Joinery	£0	£0	£0	£0	£0	£0	£535,977	£0	**£535,977**	£996
Walls	£0	£0	£0	£0	£0	£0	£0	£0	**£0**	£0
Environmental Works	£0	£0	£0	£0	£202,256	£0	£0	£202,256	**£404,511**	£752
Communal services	£0	£0	£0	£0	£0	£303,383	£0	£0	**£303,383**	£564
Communal doors	£0	£0	£0	£0	£0	£0	£101,128	£0	**£101,128**	£188
Communal Windows	£0	£0	£0	£0	£0	£0	£101,128	£101,128	**£202,256**	£376
Year	**1 to 5**	**6 to 10**	**11 to 15**	**16 to 20**	**21 to 25**	**26 to 30**	**31 to 35**	**36 to 40**	**Total**	**Unit Ave**
Revenue	**£5,231,099**	**£1,696,424**	**£1,610,461**	**£1,610,461**	**£1,610,461**	**£1,610,461**	**£1,610,461**	**£1,610,461**	**£4,497,278**	**£8,359**
Responsive	£3,709,773	£1,214,141	£1,205,949	£1,205,949	£1,205,949	£1,205,949	£1,205,949	£1,205,949	**£66,600**	£33,300
Void	£0	£0	£0	£0	£0	£0	£0	£0	**£0**	£0
Cyclical	£1,521,326	£482,284	£404,511	£404,511	£404,511	£404,511	£404,511	£404,511	**£4,430,678**	£8,235
Year	**1 to 5**	**6 to 10**	**11 to 15**	**16 to 20**	**21 to 25**	**26 to 30**	**31 to 35**	**36 to 40**	**Total**	**Unit Ave**
Contingent Major Repairs	**£0**	**£0**	**£21,439**	**£21,439**	**£50,968**	**£55,014**	**£169,086**	**£173,131**	**£491,077**	**£913**
Contingent Major Repairs	£0	£0	£21,439	£21,439	£50,968	£55,014	£169,086	£173,131	**£491,077**	£913
Disabled Adaptations	**£151,692**	**£151,692**	**£151,692**	**£151,692**	**£151,692**	**£151,692**	**£151,692**	**£151,692**	**£1,213,534**	**£2,256**
Disabled Adaptations	£151,692	£151,692	£151,692	£151,692	£151,692	£151,692	£151,692	£151,692	£1,213,534	£2,256
Year	**1 to 5**	**6 to 10**	**11 to 15**	**16 to 20**	**21 to 25**	**26 to 30**	**31 to 35**	**36 to 40**	**Total**	**Unit Ave**
Total	**£5,382,791**	**£1,848,116**	**£2,319,569**	**£2,319,569**	**£3,087,331**	**£3,192,504**	**£6,158,381**	**£6,263,554**	**£30,571,815**	**£56,825**

All costs are exclusive of Professional Fees, VAT, management and administration costs and are based on today's prices. Costs are inclusive of preliminaries.

West Kensington & Gibbs Green leaseholder stock based on 128 properties chargeable for these works

LBHF	Year 1= 2015					Stock			128	
Year	1 to 5	6 to 10	11 to 15	16 to 20	21 to 25	26 to 30	31 to 35	36 to 40	Total	Unit Ave
FMW	**£0**	**£0**	**£0**	**£0**	**£48,120**	**£72,180**	**£175,639**	**£72,180**	**£368,120**	**£2,876**
Pitched Roof	£0	£0	£0	£0	£0	£0	£0	£0	**£0**	£0
Flat roofs	£0	£0	£0	£0	£0	£0	£0	£0	**£0**	£0
Rainwater goods / Ext Joinery	£0	£0	£0	£0	£0	£0	£127,519	£0	**£127,519**	£996
Walls	£0	£0	£0	£0	£0	£0	£0	£0	**£0**	£0
Environmental Works	£0	£0	£0	£0	£48,120	£0	£0	£48,120	**£96,241**	£752
Communal services	£0	£0	£0	£0	£0	£72,180	£0	£0	**£72,180**	£564
Communal doors	£0	£0	£0	£0	£0	£0	£24,060	£0	**£24,060**	£188
Communal Windows	£0	£0	£0	£0	£0	£0	£24,060	£24,060	**£48,120**	£376
Year	**1 to 5**	**6 to 10**	**11 to 15**	**16 to 20**	**21 to 25**	**26 to 30**	**31 to 35**	**36 to 40**	**Total**	**Unit Ave**
Contingent Major Repairs	**£0**	**£0**	**£0**	**£0**	**£1,925**	**£2,887**	**£7,026**	**£2,887**	**£14,725**	**£115**
Contingent Major Repairs	£0	£0	£0	£0	£1,925	£2,887	£7,026	£2,887	**£14,725**	£115
Year	**1 to 5**	**6 to 10**	**11 to 15**	**16 to 20**	**21 to 25**	**26 to 30**	**31 to 35**	**36 to 40**	**Total**	**Unit Ave**
Total	**£0**	**£0**	**£0**	**£0**	**£50,045**	**£75,068**	**£182,665**	**£75,068**	**£382,845**	**£2,991**

All costs are exclusive of Professional Fees, VAT, management and administration costs and are based on today's prices. Costs are inclusive of preliminaries.

of high-rise and low-rise blocks to confirm their structural integrity. Given that this was

a sample survey, further detailed investigation is required into the level and type of investment required in the future. A provision has been included within the Stock Condition Survey in the interim and this has been included within the category described as "Exceptional Extensives".

4.28. R1 and R2 both assume the works required within the level of investment to maintain the stock to a reasonable standard from 2017/18 onwards. For 2015/16 and 2016/17, the HRA business plan models assume the capital programme works agreed by the Council and as consulted upon with the tenants. Year 1 & 2 spend therefore is profiled accordingly:

Survey Years			Catch up Works	Future Major Repairs	Improvements	Related Assets	Responsive, Void & Cyclical	Contingent Major Repairs	Disabled Adaptations	Exceptional Extensive	Leaseholder Major Works
			£	£	£	£	£	£	£	£	£
1	to	1		45,963,779			13,949,800		925,926		5,271,296
2	to	2		37,473,148			13,949,800		925,926		5,115,741

4.29. These HRA models contain the costs from year 3 (2017/18) contained in:

- Council owned main stock maintained to a reasonable standard
- West Kensington & Gibbs Green Council tenanted/replacement stock standard
- Leaseholders main stock standard
- West Kensington & Gibbs Green leaseholders standard

4.30. The HRA business plans R1 and R2 include £768 million of capital investment (excluding fees & VAT) for 30 years from 1 April 2015 (£1.055 billion over 40 years) and £466 million of day-to-day repairs works over 30 years (£621 million over 40 years).

4.31. Fees at 8% are added to capital investment costs, but in the HRA business plans, VAT is fully recoverable so is not shown as a cost. Inflation on revenue day-to-day repairs is assumed to be CPI only from 2016 to 2024 as the Council has external contracts in place that are linked to CPI increases only, then rises by RPI thereafter. Capital investment costs are assumed to rise by RPI + 0.25% until April 2021 from when it assumed to rise by RPI only. It should be noted that in the HRA model RPI is expected to exceed CPI by 1.8% in 2016/17, 1.3% in 2017/18, 1.2% in 2018/19, 1.1% in 2019/20 and then 1% from 2020/21 onwards. These figures are based on the OBR 5 year forecasts for both

measures at July 2015. The traditional expectation of the difference between the two measures was 0.5% but over the last year this has increased to at least a 1% differential.

4.32. Future major works, contingencies and day-to-day revenue repairs costs are assumed to vary directly with stock reductions, but all other cost categories are assumed to be fixed.

4.33. Transfer models T1, T2 and T3 all assume the Savills advised level of investment to maintain the stock to a reasonable standard from April 2015 and the surveys for the main stock Council owned properties and the main stock leaseholder properties. The costs for tenanted and leaseholder properties/replacement properties in West Kensington & Gibbs Green estates are included in a retained HRA business plan for these properties using the same inflationary costs as the R1 and R2 models.

4.34. Transfer model T4 also assumes the same Savills standard but starting in 2017/18. It has the same survey, but an assumption that the total costs will have increased by two years' worth of inflation at CPI + 0.5% (the equivalent of the old RPI assumption), so this is 2.41%. The use of the survey in this way is consistent with the assumption that in reality over time, work will be done to improve some homes more than others and those with no work done may decline in standard more rapidly. As a result over all, any works done in 2015/16 and 2016/17 cannot be said to reduce the value of works required from 2017/18 onwards. If transfer is chosen as the option to take forwards, a further survey of the stock prior to transfer will provide a more accurate business plan assumption nearer the time. This assumption also allows funders to rely on a warranted survey for early expressions of interest in funding that may be required.

4.35. Transfer models T1 to T3 include capital investment for the main stock Council owned and leaseholder of £696 million over 30 years (at 2015/16 prices) or £899 million over 40 years plus £455 million of day-today repairs over 30 years (£607 million over 40 years). T4 includes £713 million of capital works in 30 years (at 2017/18 prices) or £921 million over 40 years. The equivalent repairs and maintenance totals are £466 million over 30 years or £622 million over 40 years.

4.36. The retained HRA model contains the costs of the surveys for West Kensington & Gibbs Green estates which is a total of £31 million on capital and revenue repairs over 40 years.

4.37. Fees at 8% are added to capital investment costs and VAT is assumed to be a cost at 20% on capital and revenue maintenance as all contracts are external. The repairs

contract has another nine years to run before it could be considered for replacement with an in-house service. In-house provision saves the cost of VAT on the staffing element of the costs. It is assumed in models T1 and T2 that there is a VAT shelter in place that will allow the recovery of VAT on capital works over the first 15 years after transfer. It is then assumed that 50% of this VAT that can be recovered is retained by the landlord to increase the valuation of the stock. In transfer models T3 and T4 it is assumed that 75% of the VAT shelter income is included in the valuation to improve it further.

4.38. Inflation on revenue day-to-day repairs is assumed to be CPI only from 2016 to 2024 as the Council has external contracts in place that are linked to CPI increases only and it is assumed these will novate under transfer. It is then assumed that they will rise by CPI + 0.5% following the traditional assumption for the difference between RPI and CPI rather than a difference of 1% as seen in the HRA modelling. Capital investment costs are assumed to rise by CPI + 0.5% for all years in line with traditional valuation assumptions that DCLG are likely to accept as reasonable.

Funding Rates

HRA Plans

4.39. The HRA business plans assume that the PWLB loans that are in place are repaid as they mature and interest is calculated in relation to specific loans. Any additional borrowing to finance capital works is assumed at an average of 4.5% from 2015/16 to 2020/21 rising to 5.5% thereafter. Any additional borrowing is assumed to be repaid as soon as the cash is available to do so. Borrowing to fund the West Kensington & Gibbs Green scheme in the early years is assumed to be internally borrowed without interest charges primarily using the funds received in advance of land transfers from Capco under the Land Sale Agreement.

Transfer Plans

4.42 At this early stage, no approach has been made to potential lenders, but clearly assumptions have had to be made about the level of funding costs that the transferee landlord will have to bear if a transfer is pursued. The assumptions built into the plan are based on Capita Asset Services’ experience of advising on the funding of a large number of successfully completed transfers, including one of the three transfers that took place in the most recent transfer round, completing in March 2015.

4.43 Funding costs are made up of a number of elements, these being:

- Arrangement fees, typically payable as a lump sum upon completion of the facilities, which is usually coterminous with transfer;
- Interest on loans drawn under the facilities put into place calculated at a rate made up of two elements:
    (i) the lender's cost of funds (i.e. what they have to pay themselves to secure monies for on-lending), and
    (ii) the lender's margin, which represents their profit element on the lending;

- Non utilisation fees applying to the balance of facilities which have been put into place but remain undrawn from time to time calculated at a specified rate, which is typically 40% to 50% of the lending margin set;
- Management fees, an annual fee to cover the cost to the lender of monitoring and managing the loans that they make.

4.44 Arrangement fees, lender's margins, non utilisation costs and management fees are all within the gift of the lender, and the rates that the transferee landlord will have to pay, although influenced by general market conditions, will also depend upon the level of competition that can be generated for the provision of loans. This in turn will depend upon the attractiveness of the organisation and its business plan as an investment opportunity.

4.45 Lender's cost of funds depend upon the style of loan that are taken up, in particular whether these are locked into a fixed rate of interest or left to run on a floating rate basis.
Floating rate loans are priced on **L**ondon **I**nter **B**ank **O**ffered **R**ates (LIBOR) which reflect the rates at which banks are lending to and borrowing from other banks. LIBOR are set and clearly published on daily basis by the Intercontinental Exchange (ICE). LIBORs are set for different short term periods (e.g. 1, 3, 6, 8 and 12 months) with 3 months being the most commonly used.

4.46 If floating rate funding is used, a rate will be set when the loan is drawn for a period of, say, 3 months at the ICE rate then prevailing, and this rate will apply to the end of the 3 month period when it will be reset for a further 3 months at the ICE rate then prevailing. This process is known as a rollover.

4.47 Fixed rate loans are priced from interest rate swaps, which can have any period of between 1 year and the maturity of the facilities, and are published on Reuters screens, and elsewhere. Swap rates move on a continuous basis, and the rate applying to any

interest rate fixing will depend upon the rate prevailing at the time that the fixed rate is entered into. This rate will then apply to the loan for the agreed period of fixing, at the end of which it will either revert to a floating rate basis or be re-fixed, until such point as it has to actually be repaid.

4.48 In terms of the assumptions built into the funding model, we have used assumptions about the lender controlled elements which we consider to provide some margin of comfort, but which are not unreasonably conservative in the light of recent offers of funding that we have seen, including the last round of stock transfers.

The assumptions made are:

Cost element	Payable	Assumption
Arrangement fee	Up front	1.25%
Margins	years 1 to 5	1.75%
	year 5 onwards	2.00%
Non utilisation fees	years 1 to 5	0.70%
	year 5 onwards	1.00%
Management fees	annual	£20k index linked

4.49 Appropriate assumptions for the underlying cost of funds are more difficult to judge, as these depend not only upon how the markets move between now and the point of transfer and beyond, but also upon the balance between fixed and floating rate loans the organisation wishes to maintain. Floating and fixed rates each have different benefits and risks, with floating rates currently being cheaper and more flexible, but subject to a high level of risk of future rate increases, whereas fixed rates confer certainty of cost, but can be expensive and be more costly if rates at the time of fixing prove high in retrospect.

4.50 The balance between fixed and floating rate funds to be run is a matter for the board of the new organisation to determine (in consultation with its advisers and the lenders) in the light of the final business plan, and the prevailing economic conditions and outlook. If institutional investors were to be involved in the funding, then the loans that they provide are likely only to come in the form of fixed rate or index linked loans, and this in itself will have an impact on the treasury strategy to be pursued. Decisions on the strategy to be pursued will not usually be made until the form of the funding to be used,

the identity of the lenders concerned and the shape of the final business plan are known and have been fully considered.

4.51 For the purposes of the assumptions built into the business plan, and to keep the model simple at this stage, we have assumed that the loan facilities will take the form of bank facilities of a scale large enough to accommodate the organisation's projected peak debt requirement and which will run out to the point at which the business plan shows that debt can be fully repaid. It has been assumed that 80% of debt will be held on fixed rates of interest throughout the plan with 20% remaining floating. A fixed rate of 3.5% (before margins) has been assumed for the fixed rate debt and LIBOR has been assumed to start at 2.25% and increase in steps to 4.50% over a 3 year period.

4.52 This allows for a weighted average rate of interest to be built into the plan, as illustrated in the table below:

Financial year ending 31.03	Proportion of debt held as		Assumed rate		Weighted average Rate of Interest
	Fixed	Floating	LIBOR	Fixed	
2018	80%	20%	2.25%	3.50%	3.25%
2019	80%	20%	3.50%	3.50%	3.50%
2020	80%	20%	4.00%	3.50%	3.60%
2021	80%	20%	4.50%	3.50%	3.70%
future years	80%	20%	4.50%	3.50%	3.70%

For the purposes of comparison the table below sets out current rates of interest:

Current interest rates	
Floating:	
LIBOR	0.58%
Fixed rates:	
5 years swap	1.42%
10 year swap	1.84%
15 year swap	2.04%
25 year swap	2.11%

Set Up Costs

4.53 Set up costs of a stock transfer have not yet been included in any of the modelling, other than as noted above the cost of the funding arrangement fee of £1.18 million which is built in to the business plan as a percentage of the facility required (1.25% of £95 million). This in itself is one of the largest costs and only falls due and payable by the new landlord on the day of transfer when it commits to the loan it requires. Pre 2012, the set up costs could be used as a capital cost that could be offset by the Council against a capital receipt from the sale of the stock, before calculating the amount of debt that needed to be paid off by the Government. In the latest Housing Transfer Manual, set up costs were not allowed to be taken into account as a deduction from the capital receipt before calculating the debt write-off required, but for accounting purposes, the Council is still able to use the capital receipt to offset the cost in its accounts. Set up costs were a matter for both parties to agree as to who would fund them. This may be a negotiation point for the Council and any new landlord if the option progresses to stock transfer. Where set up costs are funded by the new landlord's business plan, they are not allowable as part of the valuation and therefore put additional pressure on the business plan.

4.54 Set up costs traditionally were split into pre and post ballot costs where the pre ballot costs were all picked up by the Council (and where an HRA is closed, the HRA revenue balances could be used to pay the set up costs) and post ballot costs could be split between the new landlord and the Council in an agreed manner. More recently with ALMO transfers, ALMO reserves have been used to pay for set up costs of the new company so that they have control over the procurement of services. In older transfers many costs such as funding advice and business planning advice were not required to a large extent pre ballot, they could wait for the outcome of the ballot before need to take such advice. In the recent transfers, the need to agree a business case in order to agree the debt write-off required before permission is even given to go to ballot, has meant that many of the traditional "post ballot" costs were incurred far earlier in order to prepare the business case. The post ballot costs for example of the Council tended to be less as a result of a large proportion of the commercial deal being agreed in order to make the business case for transfer.

4.55 The amount of set up costs can vary to some extent with the size of the stock transfer, but not in all areas. For example, the number of properties transferred will affect the conveyancing costs (as every property needs to be conveyanced), but some of this may be done by the Council's own staff. Again, the costs of a ballot will vary with number of tenants (and if consulted, leaseholders) as all those consulted need to be given the consultation material and ballot papers. Consultation costs vary depending on how

difficult it is to get to speak to tenants and whether the Independent Tenant & Leaseholder Adviser's team does this, or in-house staff are used.

4.56 In general, we normally see set up costs ranging between £2.5 million and £5 million in total. The set up costs for a transfer for Hammersmith & Fulham may exceed this figure depending on the amount of detailed work required to achieve a successful ballot outcome and set up a viable transfer organisation. The transfer process for LSVT post 2016 is still unknown and the extent to which the process will change is unknown. For this reason, the Council will need to be prepared for larger costs where necessary.

4.57 The valuation of the housing stock is negative and as such there is significantly less opportunity for the new landlord to fund its own proportion of the set up costs. If the Council is intent on achieving its outcomes through a transfer it will need to consider the cost of the transfer as an investment in the future security of the borough.

5. Headline Option – Retention of Hammersmith & Fulham housing stock

Background

5.1 In common with all local authorities who owned housing stock at 1 April 2012, the previous Housing Revenue Account (HRA) subsidy system of Government financing of Council housing was replaced by Self-Financing for the HRA. This allows the Council to keep all the rents from its Council housing properties and that income is used to manage, maintain and invest in the homes to ensure that the properties are maintained to at least the Government's Decent Homes Standard.

5.2 In return for this freedom, the Council received a one-off debt adjustment under Self-Financing leaving it with debt which it is expected to service and be able to theoretically repay within 30 years if required. Whilst this is the prudent assumption that mirrors housing association business plans, Hammersmith & Fulham Council has an HRA business plan model that can consider whether it can repay its debt if needs be within 40 years as the Council can borrow over up to 50 years from the Public Works Loan Board (PWLB). Councils do not have a specific requirement to pay off their loans within a specified period, but it is prudent to show that this could be done (i.e. that HRA revenue reserves exceed the loan outstanding). The one-off debt redistribution bought the Council out of a system whereby it was receiving an annual subsidy from Central Government.

5.3 The Council's housing debt settlement calculated under HRA Self Financing at 1 April 2012 was £254.617 million. This is known as the debt cap, or the maximum borrowing for housing purposes that the Council can carry at any time. At 1 April 2012, the Council was given a cash payment of £197.354 million to reduce its debt theoretically to the calculated HRA settlement figure. The Council's actual borrowing was less than the borrowing notionally used by the Government as part of the calculation meaning that the actual housing debt at that date reduced to £217.381 million. The difference between this figure and the debt cap is £37.236 million which is referred to as "headroom" – i.e. the amount of further borrowing available to the Council should the expenditure required to manage and maintain the properties and service the debt exceed the income from rents and service charges, or to invest in new build properties.

5.4 If the headroom is used and the Council reaches its debt cap, it cannot borrow any more to fund housing expenditure until the debt is reduced. To date, the Government have shown that they have no intention of either increasing or removing the debt cap for

Councils, as this would affect public borrowing levels and ultimately lead to an increase in interest rates.

5.5 Where the Council reaches its debt cap, then depending on the profile of expenditure required to maintain the stock (determined by the stock condition survey), homes may become non-decent if resources are not available at the time of need. Lack of headroom also constrains any aspirations for new housing development within the HRA. The Council currently owns all of the homes and related assets that are let to its tenants. It also manages and provides services to leaseholders who have purchased their homes over the years under the Right to Buy scheme, but by virtue of the type of property they have purchased cannot normally take on the freehold.

What does retention mean?

5.6 The housing stock was previous managed by the Council's Arms Length Management Organisation (ALMO), but since 2011, the Council's Housing Service now manages these homes and assets on including the collection of rents and the management, maintenance and investment in the properties. Responsibility for making final decisions with regard to the properties such as the setting of rents and the level of expenditure provided on those properties has always been with the Council.

5.7 "Retention" means that the Council will continue to own the properties. It will also retain the responsibility for maintaining them to the Decent Homes Standard. If the Council chooses to retain all of the properties in the Housing Revenue Account (HRA) it will need to manage the risk of being able to provide the services required by tenants and leaseholders and to maintain them within the resources available to it.

5.8 Since April 2012, self-financing for the HRA has allowed the Council to keep the rents that it collects from tenants in order to provide management services and maintain and invest in the homes to the Decent Homes Standard. The Council was given the freedom from the previous HRA subsidy system and is required to manage a level of housing debt which in 2012 was calculated to be manageable and repayable given the expected rental income and assessments of expenditure.

5.9 Self-financing transferred the risk of investment in the housing stock and the risk of inflation management to local authorities where previously the HRA subsidy would have been adjusted to take account of inflationary pressures and build cost inflation. In April 2015, the Government guidance capped the increase in rents to the Consumer Price Inflation (CPI) + 1% , rather than Retail Price Inflation (RPI + 0.5%) which assumed the CPI would be 0.5% lower than RPI, and also recommended that Councils did not set rents that would continue to converge to target. Hammersmith & Fulham Council however consulted with its tenants and it was agreed that a mechanism to continue to

move rents towards target in 2015/16 should be implemented to maintain the investment in the homes. Given this change in policy, where expenditure increases in line with RPI and if RPI is greater than CPI by more than 0.5% this places inflationary pressure on the HRA. The debt calculated in self-financing assumed that rental income rises by 0.5% above expenditure to fund the loan.

5.10 Further more, in order to meet the Government's target of a reduction in the benefits bill of £12 billion nationally, legislation is to be introduced to require all social landlords including Councils to reduce the annual rent by a real 1% per annum for each of four years from April 2016. The Council has attempted to mitigate expenditure rises by agreeing contract increases in line with CPI only, however the new policy will cut rental income rather than assume it rises by more than costs. This puts an additional burden on the Council in terms of managing its HRA business plan.

5.11 With the retention option statutorily, consultation with tenants and/ or a ballot is not necessary. However, this may be desirable if the option to re-establish an ALMO is considered viable.

5.12 **Retention does not reflect a "no change" option**. For Hammersmith & Fulham, the option to retain the stock will mean that changes still need to happen in terms of the investment in the stock and the level of services provided as a result of the recent Government announcements affecting Council housing. This will be addressed in the description of the options below.

Retention – The Council's Housing Service continue to manage the housing stock

5.13 Closure of H&F Homes Ltd in 2011 involved the functions of management and maintenance of the homes in Hammersmith & Fulham being returned to the direct management of the Council. The ALMO staff and services provided are now within the Council's Housing Department.

5.14 All decisions about how the homes are managed, the services provided and the maintenance and investment standards are within the Council's responsibility, in addition to the strategic decision-making responsibilities that have always existed within the Council. The Council undertook an option appraisal in 2010 which included consultation with tenants and leaseholders. The outcome was that "a significant majority of tenants and leaseholders are in favour of the Council's proposal to establish a directly managed Housing and Regeneration Department" [Cabinet Report 10 January 2011].

5.15 The table below sets out a summary of the pros and cons of the option for the Council to retain ownership of the housing stock and provide the housing management via the Housing Service:

Option	Pros	Cons
Housing Service continues – keep housing management function in house	• Maintain the benefits of the return of the housing service in-house in 2011 • Council would have total control over housing decision making • Debt write-off is not required • Set up costs are not required. The costs of re-establishing an ALMO in terms of re-organisation of the housing service and relocation of staff are likely to be similar to that of setting up a stock transfer and there would be no capital receipt against which to offset the costs • A ballot of tenants is not required unless the Council wish to offer tenants the option of re-establishing an ALMO • The closure of the ALMO recognised that additional resources available via this route are no longer available and the vehicle had served its purpose.	• Tenant and leaseholder empowerment and influence over decision-making may be adequate but the final decision rests with the Council • Council will need to continue to manage its HRA debt and business plan • Resources available to the Council are restricted by the self-financing debt cap and as such, the properties cannot be maintained to the Decent Homes Standard • A comparable standard of investment for all tenants cannot be achieved which will leave tenants paying similar rents for different standards of property • The Council cannot borrow beyond its Self-financing debt cap to improve the properties it owns • HRA debt will not be written off • HRA self financing will bring challenges in

	• Unless there are reductions in levels of service, staff will be largely unaffected in the short term.	maintaining current levels of service provision especially as a result of the impending rent changes and forced sale of void properties • The availability of the land for the use of the community cannot be guaranteed • Housing needs may be lost within the Council's list of priorities • Development and/or remodelling of estates will be delayed until resources become available • Development in the short term cannot be easily supported as there is no headroom in the HRA to build social housing • Cost sharing opportunities are not available • No "new money" in the form of VAT shelter or cross-subsidy

Retention – Re- establishing an ALMO to manage the stock

5.16 The Council would retain ownership and ultimate responsibility for all of the stock it currently owns. Re-establishment of an ALMO would involve creating a new provider of management and maintenance services which would operate under a fixed term

management contract. At the end of each contract period, there would be a review of how the service should be provided in future.

5.17 An ALMO is usually run by a Board of Management made up tenants, independent people with professional skills to help run the service and Councillors. The groups often have equal numbers of representatives, but this is not always the case. Tenants have a direct mechanism by which they can influence how their homes are managed, but the decisions relating to the strategic management of the assets remains with the Council.

The role of the ALMO Board includes:

•scrutinising the effectiveness of management company (ALMO);
•monitoring the performance of the ALMO;
•drafting the constitution of the ALMO;
•agreeing the company's Annual Delivery Plan with the Council;
•approving the budgets;
•agreeing policies and make decisions on financial matters;
•making sure that the ALMO is run lawfully and ethically.

5.18 All other financial decisions such as the rent that will be set and the amount that can be spent on the properties belong with the Council. The Council has the final decision on what actually happens to the assets of the HRA.

5.19 The table below sets out a summary of the pros and cons of the option for the Council to retain ownership of the housing stock and re-establish an ALMO to manage the properties on its behalf:

Option	Pros	Cons
Re-establish an ALMO that manages and maintains stock on a renewable contract	• Tenants may have equal representation on the ALMO Board and as such have some control over decision making	• A ballot of tenants would be required to establish an ALMO • The costs of re-establishing an ALMO in terms of re-organisation of the housing service and relocation of staff are likely to be similar to that of setting up a stock transfer and there would be no

		capital receipt against which to offset the costs • The set up costs would be equivalent to that of setting up a transfer landlord, but without the benefits that would be determined to arise from transfer and without any loss of responsibility for the properties • Council will need to continue to manage its HRA debt and business plan • The Council's decision-making / influence over management would be diluted • Resources available to the Council are restricted by the self-financing debt cap and as such, the properties cannot be maintained to the Decent Homes Standard • HRA self financing will bring challenges in maintaining current levels of service provision especially as a result of the impending rent changes and forced sale of void properties • A comparable standard of investment for all tenants cannot be achieved which will leave tenants paying

		similar rents for different standards of property • The availability of the land for the use of the community cannot be guaranteed • The ALMO cannot borrow to improve the properties it manages • HRA debt will not be written off and the Council retains the risk of managing this debt in future • An ALMO usually exists on a renewable contract, so there is less certainty of continued provision of the service • Development and/or remodelling of estates will be delayed until resources become available • Development in the short term cannot be easily supported as there is no headroom in the HRA to build social housing • Cost sharing opportunities are not available • No “new money” in the form of VAT shelter or cross-subsidy • There are no additional resources available for ALMOs now.

Retention – Establishing Tenant Management Organisations (TMOs) / Estate Management Boards (EMBs)

5.20 The Council could consider retaining its housing stock, but allowing some estates to be run by Tenant Management Organisations (TMOs) or Estate Management Boards (EMBs). A TMO is a means by which Council or housing association tenants and leaseholders can collectively take on responsibility for managing the homes they live in. Those resident members of the TMO create an independent legal body and usually elect a tenant led management committee to run the organisation. The TMO can then enter into a legal management agreement (contract) with the landlord, which would be the Council in Hammersmith & Fulham's case. The TMO is paid annual management and maintenance allowances in order to carry out the management duties that are delegated to them.

5.21 TMOs can take different forms and sizes. Many are tenant management co-operatives, others may take the form of not-for-profit companies. Some TMOs manage just a handful of homes while others manage large estates of two or three thousand properties. The small TMOs may rely mainly on voluntary effort but most employ staff such as housing managers, caretakers and repair workers. The services managed by the TMO vary with local circumstances but may include day-to-day repairs, allocations and lettings, tenancy management, cleaning and caretaking, and rent collection.

5.22 The table below sets out a summary of the pros and cons of the option for the Council to retain ownership of the housing stock and establish TMOs to manage stock on some of its estates:

Option	Pros	Cons
Establish TMOs to manage some estates	• Management of the specific estates run by the TMO may be managed more efficiently than by the Council as the management organisation is focused on its own estate and not a wider stock area. • On the spot management by a dedicated team with	• A feasibility study would need to be undertaken to determine which estates this would suit. Whilst funding is available for this, it can take a considerable amount of time to do • An offer to tenants and a ballot of tenants on the estates would be required

	local knowledge can lead to quicker more effective management of tenancy issues, better rent collection rates (where undertaken) and faster responses to repairs for those homes. • Tenant satisfaction tends to be higher. • TMOs can get more involved community welfare and neighbourhood regeneration increasing community cohesion and inclusion. • TMOs can undertake a stock transfer to a housing association (or group) in future	to establish a TMO which will incur set up costs which are not required under any other retention option • The TMO would need to be assessed for competency to manage • Council will need to continue to manage its HRA debt and business plan • The Council's decision-making / influence over management would be diluted • Allowances available to the TMO are based on those available to the Council as part of its HRA and therefore are no greater than within the whole HRA • Allowances can be reduced in future • HRA self financing will bring challenges in maintaining current levels of service provision especially as a result of the impending rent changes and forced sale of void properties • Whilst this option may suit some residents of some estates, a comparable standard of investment for all tenants in

		Hammersmith & Fulham cannot be achieved which will leave tenants paying similar rents for different standards of property • The availability of the land for the use of the whole community cannot be guaranteed • HRA debt will not be written off and the Council retains the risk of managing this debt in future • A TMO usually exists on a management contract, so there is less certainty of continued provision of the service • Development In the short term cannot easily be supported as there is no headroom in the HRA to build social housing • Cost sharing opportunities are not available • No “new money” in the form of VAT shelter or cross-subsidy

5.23 The establishment of TMOs is a costly and time-consuming exercise. The objective of this appraisal is to find a solution that will protect the homes and communities across Hammersmith & Fulham for all of its tenants and residents. The TMO option is attractive for some residents, but would not provide a holistic solution for all tenants within the timescales required to avoid the reduction in investment needed.

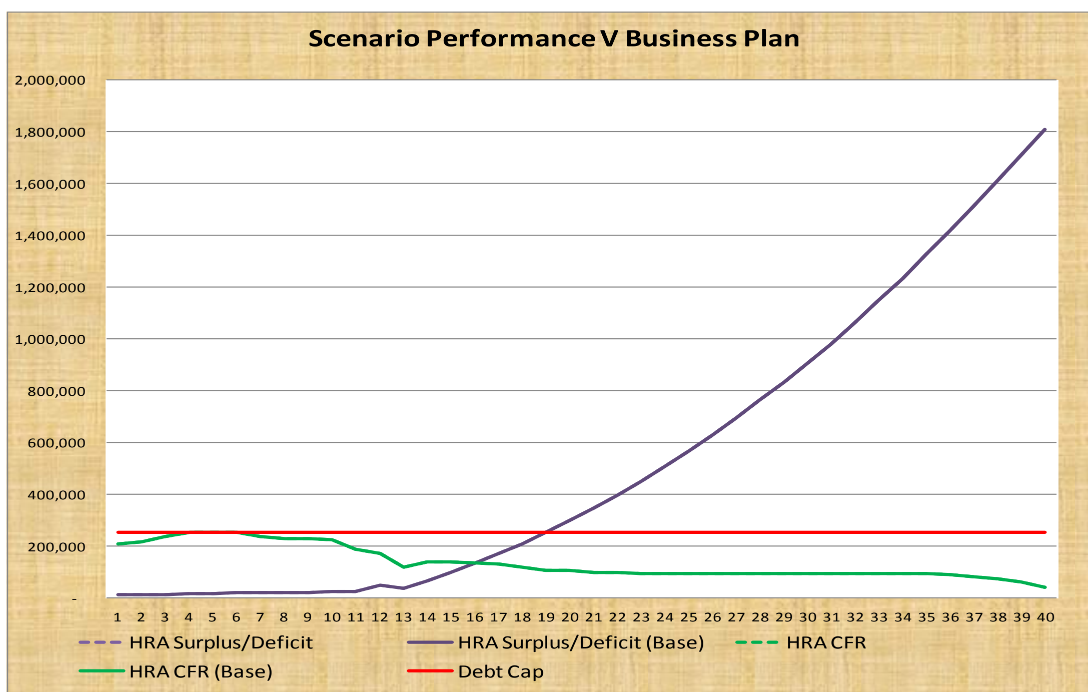
HRA Self-Financing Business Plan

5.24 The HRA self-financing business plan includes the main housing stock of 11,722 properties as at 31 July 2015, the 538 properties on the West Kensington & Gibbs Green estate that are part of the re-development scheme, and an assumption that Edith Summerskill House site will be transferred to the Joint Venture (JV) who will then novate the site to a Registered Provider (RP). The current plan is that the RP will then develop the site out partly using funds granted from the Council in the form of S106 grant and 1-4-1 replacement receipts. The Council will get nomination rights. These 68 properties are therefore excluded from the stock numbers. It also includes the costs and income associated with managing 4,693 leaseholder units. The assumptions used are those set out in section 4 above, with the annual savings. There would be no set up costs associated with this option as this is the service that exists at present.

5.25 The results of modelling a 40 year business plan for the HRA on the basis of the Council's retention of the stock are set out below and termed R1 and R2 as explained in Section 3 above.

R1 HRA Business Plan Model Outputs

5.26 R1 is the scenario that assumes the current assumptions on expenditure and other income (as the Council's Housing Service now), but assumes that the rent in future would be based on the former rent guidance, i.e. increasing by CPI + 1% + £1 convergence.



5.27 The graph above demonstrates for this scenario that the actual debt that the Council will need to borrow (the green line) reaches the debt cap of £254.617 million in 2018/19. For the two years after that, the investment that the Council would need in the stock at that time exceeds the income available to fund it and the Council cannot borrow any more to do the works. The total works that would not be able to be carried out at the right time would be £8.8 million. Where the red line is above the green line, there is capacity to borrow (also know as “headroom).

5.28 The blue line is the HRA revenue working balances. These can be seen to run along at a low level, just above the agreed minimum working balance level until year 10 of the plan. The West Kensington & Gibbs Green scheme is due to be completed by this time, releasing capital receipts. At that point the balances start to rise and by year 16, the blue line crosses the green line showing that even though there are still outstanding loans (the green line is above zero), the Council does have sufficient cash reserves to pay that debt down if it needed to. The loans in reality are not paid down because they are fixed maturity PWLB loans that fall due for repayment at specific dates.

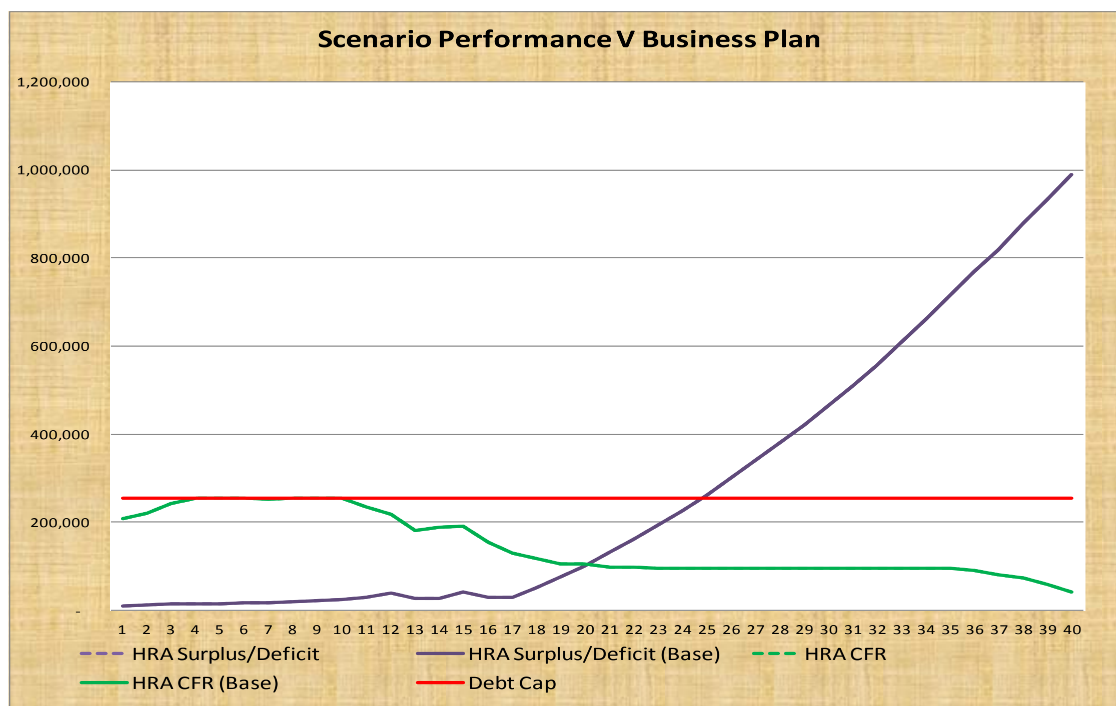
5.29 Appendix C(i) shows the actual figures that are being shown in the graph above and how the shortfall arises. The table below shows when the work could be afforded if the works were pushed back:

Survey Years			Future Major Repairs £
1	to	**1**	
2	to	**2**	
3	to	**3**	
4	to	**4**	**-5,258,226**
5	to	**5**	**-2,242,929**
6	to	**6**	**1,537,814**
7	to	**7**	**5,963,341**
8	to	**8**	
9	to	**9**	
10	to	**10**	

5.30 In summary, before the rent changes were introduced, the HRA business plan was reasonably able to deliver the investment to maintain the stock to a reasonable standard going forwards together with the West Kensington & Gibbs Green scheme at the same time, but would still have needed to delay some works for a couple of years.

R2 HRA Business Plan Model Outputs

5.31 R2 is the scenario that assumes the current assumptions on expenditure and other income (as the Council' Housing Service now), but assumes that the rent in future would be based on the 8th July 2015 Budget rent guidance (which will become legislation this time), instigating a 1% real reduction in rents from April 2016 for four years and then returning to assumed increases of CPI + 1% + £1 to convergence to target.



5.32 The graph above demonstrates for this scenario that the actual debt that the Council will need to borrow (the green line) reaches the debt cap of £254.617 million in 2018/19 and stays there for seven years. This is the point at which the West Kensington & Gibbs Green scheme then starts to provide capital receipts from the disposal of vacant properties not taken up by leaseholders.

5.33 During that seven year period, the investment that the Council would need to put into the stock at that time to maintain to maintain the stock to a reasonable standard exceeds the income available to fund it and the Council cannot borrow any more to do the works. The total works that would not be able to be carried out at the right time would now be £67.5 million. The additional shortfall in the works that can be done arises simply from the reduction in rents from April 2016.

5.34 The blue line is the HRA revenue working balances. These can be seen to run along at a low level now until year 15 and which from 2018/19 for five years is below the agreed minimum working balance level. The West Kensington & Gibbs Green scheme is still due to be complete by year 10 but the rent reduction has worsened the situation. Post year 16, the balances start to rise and by year 20 now, the blue line crosses the green line showing that even though there are still outstanding loans (the green line is above zero), the Council does have sufficient cash reserves to pay that debt down if it needed to.

5.35 Appendix C(ii) shows the actual figures that are being shown in the graph above and how the shortfall arises. The table below shows when the work could be afforded if the works were pushed back:

Survey Years			Future Major Repairs £
1	to	1	
2	to	2	
3	to	3	
4	to	4	-17,881,653
5	to	5	-10,563,977
6	to	6	-7,380,228
7	to	7	1,752,154
8	to	8	-1,402,894
9	to	9	-10,813,826
10	to	10	-7,958,568
11	to	15	54,248,992
16	to	20	0
21	to	25	
26	to	30	
31	to	35	
36	to	40	

5.36 Whereas in the case of R1, the pushback of the works was over a period of two years, which is unlikely to cause any decline in the properties or major increase in day-to-day responsive repairs or increased numbers of voids, the profile would show that works required in year 4 (2018/19) may not be completed until year 15. This figure is heavily reliant on receiving capital receipts from the West Kensington and Gibbs Green scheme at the expected time and delays would cause the figure to rise. It is also based on the minimum level of investment to maintain the stock to a reasonable standard and therefore delaying work to this extent is likely to lead to properties becoming non-decent and/or long term void with little prospect of being able to let to even to sell vacant properties especially if the works required are structural and the properties are in blocks.

5.37 Any increase in void rates arising would result in further losses of income and an increase in revenue repairs costs without making the investment in replacing the

relevant element, e.g. a roof, will leave even less resources available to fund the works. The effect of this at this time has not been modelled, but it can be seen that if there are less funds available, then the shortfall will rise further and thus cause work to be pushed back even further and compounding the problem.

5.38 The Council has high blocks and non-traditional concrete structures that are reaching an age whereby remedial action is needed. The specialist survey included in the table as “exceptional extensive works” shows that this work needs to start by 2017/18. This problem is not uncommon and is being seen by a number of Councils who have this type of construction in their stock. To delay these works would put those properties at risk of becoming long term voids and in significant numbers. If this work is not to be delayed, then works to maintain the Decent Homes Standard would have to be delayed leading to non-decency. There are insufficient resources at the right time to deliver all of the investment needed.

5.39 If transfer is chosen as an option to take forwards, the detailed implications of the shortfall in investment will form part of the business case put forward to support debt write-off. The implications of not doing the work will also need to be included to see how the problem impacts on the stock.

5.40 It can be seen that the effect of the rent reduction is so significant, that the HRA business plan cannot support the minimum amount of investment to maintain the stock to a reasonable standard, let alone a higher standard, so the additional standards have not been modelled in this report. In addition, there are no longer additional funds available to ALMOs to deliver works, and which taken together with the fact that the Council took the decision in 2011 to close the ALMO to save money, means there is no merit in modelling an ALMO option. Such an option would only show a worse position.

5.41 As referred to in 5.36 above, the model also assumes that the plans for the redevelopment of West Kensington and Gibbs Green estates under the land sale to Capco, are achievable in line with the assumptions made. These assumptions are that:

- Leaseholder properties and other RP properties required to be bought back from owners to redevelop the area can be bought at the estimated values;
- That the properties can be purchased at the right time and that the vendor can be re-housed without delays;
- That the funding from Capco, which is cash received in advance of a land transfer, is available;
- The replacement homes not taken up by leaseholders and freeholders are available for sale in year 10 and can produce the level of sales receipts estimated;

- There is no slippage in the currently predicted timescales for the redevelopment of the site and therefore the capital receipts are realisable within the expected timescales in the HRA to fund the required investment whilst the Council is at its debt cap and unable to borrow.
- The compensation and replacement home deal for residents is as set out in the draft contracts appended to the Land Sale Agreement.

5.42 There a number of factors that at this time are either unquantifiable or cannot be quantified with reasonable certainty that would increase the pressure on the HRA retention business plan. The following areas will need to be monitored and future modelling would need to reflect any changes:

- Models assume the Council resumes movement to target rent post budget cuts and CPI+1% + £1 rent rises following the pre-budget assumptions– there is no certainty that this will be possible and there is no clarity yet beyond the four year rent cut. Rents may only be able to rise by CPI only;

- The effect of forced void sales is not included and as the details of the scheme have not yet been announced by the Government, any estimates of the possible receipts this may generate for the Council and the Government cannot be relied upon. An early exercise based on an analysis of the Council's stock portfolio at April 2015 and suggested assumptions of what might be included show that 33% of properties in Hammersmith & Fulham fall under the expensive voids category. The rate at which they become void and sellable depends on whether a 12 or 53 month trend is applied. If these two scenarios are applied to the portfolio (using an average value) to project receipts over the next five years, it might raise £279 million resulting from an estimated 536 sales (12 month trend) or £300 million resulting from an estimated 574 sales (53 month trend) respectively. However, at present we have no estimate of how much of this would be retained by the Council or how it could affect the HRA;

- The effect that increasing rents for high earners may have is not included – this may increase either the void turnover, or the Right to Buy sales, or nothing at all. The additional rental earned is paid over to the Government;

- There are cost pressures on the buy-back of properties within the WK/GG scheme – as the time moves on, the market values of properties begin bought back are increasing;

- West Kensington and Gibbs Green realisable receipts are assumed from 2017/18 – this is still to be confirmed and if delayed would extend the borrowing need and would further delay the investment required;

- It would be advisable to have additional headroom to protect the Council against up to a 2 year delay in the West Kensington and Gibbs Green realisable receipts – all of the headroom is used during the first 10 years so the HRA business plan is at risk if the call off of land transfers by the buyer is delayed and investment will be further delayed.

5.43 The Council's HRA is in a position whereby the costs of managing and maintaining the stock will keep flowing whilst the regeneration work is happening at the same time. The two investment requirements are applying pressure to the business plan at the same time. The regeneration work is committed and therefore a first call on the HRA resources and the additional imposition of rent reductions from April 2016 leaves the Council with some very difficult decisions to make.

6. Headline Option – Large Scale Voluntary Transfer (LSVT) of the main housing stock

What is a Large Scale Voluntary Transfer?

6.1 A Large Scale Voluntary Transfer (LSVT) (also known as housing stock transfer) involves a Council transferring ownership of its homes with the agreement of its tenants to a new or existing Registered Provider (RP). Transferring the ownership of the homes, means transferring the risks and responsibilities for management and maintenance of the properties and relieves the Council of its liability for housing debt.

6.2 The key features of an LSVT are:

- Transferring tenants are offered benefits such as rent guarantees, stock investment programmes and rights as assured tenants equivalent to those they enjoy as secure tenants;
- Transfer organisations' funding is provided by the private sector (banks and/or capital markets) and does not count for public expenditure purposes. They can borrow to invest in homes, neighbourhoods, services and new development;
- Transfer can only take place if tenants agree at a ballot. If tenants vote "no" transfer cannot proceed;
- Resident representatives make up at least a third of the board of an LSVT landlord and under some models that can extend to an outright resident majority.

6.3 The majority of stock transfers involve the sale of the whole of a Council's stock and subsequent closure of the Council's Housing Revenue Account (HRA) with any HRA reserves at closure being transferred to the General Fund rather than the new landlord. It is also possible to transfer smaller parcels of stock, individual estates for example – this is known as a partial stock transfer. However, unless there are less than 50 properties remaining with the Council, then the HRA must remain open and the HRA reserves would not be available to the General Fund. Transfers of less than 500 homes are known as Small Scale Voluntary Transfer (SSVT) and are subject to different rules.

6.4 In Hammersmith & Fulham's case, there are 538 properties on the West Kensington and Gibbs Green estates which are part of the Earls Court redevelopment scheme. As a result of the land sale, legal advice says that the properties in this scheme would not be able to transfer as part of a stock transfer undertaken before the scheme is completed. This means that the Council must therefore keep its HRA open and retain a proportion of debt relating to these homes. It would also not be able to close the HRA and transfer HRA balances to the General Fund. The Council is still free to decide who manages the

538 homes, which may be the transfer landlord acting as agent for the Council. On completion of the Earls Court scheme, it should be possible to transfer the remaining homes to a housing association landlord and close the HRA once this is done.

6.5 Stock transfers began around 25 years ago and to date there have been around 180 whole stock transfers and numerous partial transfers. 2010/11 saw the first transfers where a Council had an existing ALMO managing the stock, and virtually all transfers since then have involved ALMO transfers with the ALMO converting to an RP. Previously transfers were from Councils that had managed the housing via a traditional Council Housing Service. 2011/12 saw Rochdale Boroughwide Homes (an existing ALMO) become the first Mutual housing company, which has a governance structure that includes employees in its membership.

6.6 Following the issue of a new post self-financing Housing Transfer Manual in November 2013, the first three authorities have completed stock transfer under the new rules in Spring 2015 (Durham, Gloucester and Salford).

6.7 In order to achieve a stock transfer a Council would need:

- To identify a landlord able to purchase the stock to transfer at an agreed valuation;
- Where the agreed valuation is less than the HRA debt, make a business case to the Government for financial support to write off the remaining debt and obtain a place on the Disposals Programme;
- Obtain a positive ballot of tenants in favour of transfer to the new landlord;
- Draw up a contract with the new landlord containing all of the terms of the transfer;
- Obtain Secretary of State's permission for the transfer;
- Complete transfer of ownership of the homes and associated assets.

6.8 The Government has traditionally approved an annual Disposals Programme for LSVT's, which has included a budget for debt write-off. The current programme is for transfers completing by 31 March 2016. The Government is also consulting with the sector with regard to the level of a programme post 2016 that might be required and in June 2015, Councils with an interest in stock transfer were asked to make contact with DCLG. Officers from Hammersmith & Fulham, together with a representative from Capita attended a meeting with DCLG and the GLA to inform them of the stock option appraisal which had already commenced to register an interest in a possible stock transfer. Other Councils have also registered an interest with DCLG.

6.9 At the time of writing, there is a Spending Review being undertaken by the Government and the outcome of this with respect to support funding for transfers post March 2016

is unknown. However, the process appears to be mirroring that in 2013 which resulted in the approval of a programme for disposals in 2015 and 2016.

What is the financial mechanism for LSVT?

6.10 Using Hammersmith & Fulham as an example, as at 1 April 2015, the Council currently has housing debt of £205.302 million, which is £49.315 million less than the debt cap. It is estimated that at the start of 2017/18, which is the earliest date a transfer could take place, the HRA business plan indicates that following some repayments of loans as they mature, the HRA debt would be £220 million made up of £190 million of loans and £30 million of internal borrowing with the Council to support the purchase of properties to deliver the scheme on the West Kensington & Gibbs Green estates.

6.11 If the Council was able to transfer all of its housing stock, the value of housing debt attributable at April 2017 to that stock would be £220 million, i.e. its actual loan liability rather than its debt cap. However, if the Council keeps some of the stock, then the Council would need to calculate a sum of debt that it would keep in respect of those properties it does not transfer. Early estimates of this are around £12 million In the event of a decision to proceed with a business case for transfer, there may also need to be a discussion around the treatment of the internal loan with Council and how this is managed. For the purposes of this example, we would assume that the housing debt at point of transfer relating to the transfer stock is £220 million - £12 million = £208 million.

6.12 The housing stock to be subject to transfer is valued at what is known as the Tenanted Market Value (TMV), which is a Net Present Value (NPV) calculation based on 30 future years of income and expenditure cashflows that may be assumed to arise from the properties in the HRA that would be expected to transfer. The net cashflows arising are discounted at a relevant rate (usually 6% - 7%) to give a transfer value or purchase price that a new landlord would be prepared to pay for the housing stock on the day of transfer to take over the ownership. This value assumes that the new landlord will receive the expected future rents and service charges from the tenants and using this money can afford to service and repay a loan (usually within 30 years) which would fund the initial purchase of the stock, together with the cost of the estimated management, maintenance and required investment to maintain at least the Decent Homes Standard at the time it is needed in the properties for at least 30 years. Whilst we use 30 years of cashflows for the calculation of the purchase price (a standard mechanism), the transfer business plan model looks at income and expenditure over the full 40 years.

6.13 The TMV is affected by the size and profile of income and expenditure. Increases in expenditure push the valuation down, as does the need for proportionately higher levels of expenditure compared to income in the early years. The key elements of the calculation are:

- Rental income and service charges;
- Management and service costs;
- Day-to-day repairs costs;
- Investment required to achieve and maintain the Decent Homes Standard (per a stock condition survey).

This method of valuation is the accepted calculation in the Housing Transfer Manual. A NPV calculation does not take account of future inflation nor interest rates.

6.14 Having calculated a TMV (or new landlord's purchase price), that figure is compared to the expected value of housing debt attributable to the transfer stock at the date of transfer (e.g. £208 million in our example above). Where the purchase price is less than the value of HRA debt, the Council would need to make a business case for Government support in the form of Overhanging Debt (OHD) grant in order to pay off all of its housing debt on transfer.

6.15 The landlord's payment for the stock would need to be used by the Council to pay down part of the debt, and the OHD would be used to pay off the remaining debt and associated early repayment debt premia. Where OHD is required, the transfer would not result in a capital receipt for the Council as a direct result of the sale, but would leave the Council free of housing debt.

6.16 Where a TMV exceeds the value of attributable debt at transfer (and associated debt premia), the Council would still be required to use the new landlord's payment to pay off its housing debt and any surplus capital receipt would be retained by the Council, but may be subject to a Government levy.

6.17 In most cases, as a result of the self-financing debt allocation which was also based on a NPV of 30 years of net cashflows in 2012, the attributable housing debt will exceed the TMV of the stock and OHD will be required. This occurs for a number of reasons, but primarily because:

a) RP's cannot recover VAT on expenditure in the same way as a Council can. The cost of irrecoverable VAT in a TMV results in a lower value. The self-financing valuation used to calculate the debt allocated assumed that VAT is not a cost;

b) Councils considering transfer are often at or close to their debt cap and have no resources to pay down any debt;

c) The self-financing valuation assumed that expenditure to maintain the Decent Homes Standard would be incurred on an equal annual basis, where as in reality the expenditure arises in lifecycles. Where expenditure needs occur earlier and at a higher level than an annual average, the TMV calculated will be lower than the self-financing valuation;

d) Rents in the self-financing valuation were expected to rise by RPI + 0.5% + convergence to target. We now know that this has changed with the ability to converge being removed from April 2015, and a real rent reduction of 1% per annum for four years from April 2016. The rental income expected therefore in future is significantly less than the self-financing value and therefore will give a lower TMV.

Over-Hanging Debt Grant (“OHD”)

6.18 Over Hanging Debt grant is a cost to the Government of covering any remaining housing debt that the Council would have on transfer over and above the purchase price of the housing stock, together with the cost of early repayment debt premia.

6.19 In transfers prior to the introduction of the Housing Transfer Manual 2013, OHD was provided by the Government without strict comparison to the level of future benefits that transfer could deliver. This was largely due to the fact that the housing debt that a Council held prior to self-financing was historic and bore no relation to the future income and expenditure from the stock. Some Councils were totally housing debt free at transfer and would receive a capital receipt, others had high levels of debt and needed grant funding.

6.20 Transfers taking place in 2014-15 and 2015-16 have had to demonstrate using a cost/benefit analysis as part of a full business case, that where OHD grant support is needed a stock transfer will result in benefits that cannot be achieved if the stock remains in the HRA. The monetised value of these benefits must exceed the cost of the debt written off using OHD and the debt premia. If OHD is granted, then there is an expectation that this will be the maximum amount to which the Government will be exposed. Pressure is exerted on the value of Government support required and so the gap between the value of housing debt and the purchase price must be minimised. The grant to write off debt can be seen as a benefit to the Council in that it is receiving

national support directly into the local area, which it would not have otherwise been entitled to.

Business Case Required For Transfer

6.21 Where OHD is required, an application to the GLA will need to be submitted before formal consultation can take place with tenants. The application consists of a full business case for transfer to include:

- **the Strategic Case covering drivers for change, with strong emphasis on macro benefits**, for example – how many new homes can be built? Can decency be maintained? Can new employment be achieved? Can new forms of governance drive out efficiencies? Will tenants have a greater say in the management of their homes? How will housing demand be addressed?

- **the Economic Case covering the financial position which monetises the benefits shown in the strategic case to demonstrate the benefit to cost case** – this considers the cost of debt required for write off to the monetary benefits that have been identified as part of the Strategic Case. The approach to this exercise is described in the following section on the benefits of transfer to the Government;

- **the Commercial Case covering indicative fundability of the transfer, asset management, delivery risks and landlord selection** – the transfer business plan will include indicative funding based on the rates that funding advisers expect to be available (with a level of prudence at this stage). This will provide an estimate of the level of funding facility that the transfer would require. Potential transferees are expected to have undertaken some soft market testing with funding institutes to gain evidence of expressions of interest to support a transfer in the event of a successful ballot. This provides evidence that the plan is fundable, but does not commit either the transferee or any funder to any deal. In terms of asset management, the business case will need to show that it is based on a recent stock condition survey (warrantable for transfer purposes) and that the work identified in the survey is deliverable within the plan. The choice of landlord is important for two reasons which are not necessarily inclusive: transfer to an existing landlord may sometimes offer opportunities for savings in set up costs, but may not ultimately achieve a positive tenant vote, nor the level of tenant involvement in decision making desired. In the case of transferring ALMO's it has been shown that the existing company can be converted to an RP as efficiently as transferring to an existing landlord and is usually the option that best meets the tenants' choice. Either way, the Government expect to see that tenants have been involved in the choice of preferred landlord as part of the Commercial Case;

- **the Financial Case covering the specific costs of the proposed transfer**. Criteria include demonstrating that the transfer value has been maximised and any debt write-off requirements minimised;

- **the Management Case covering the timely delivery of the transfer project**.

Is Stock Transfer still an option?

6.21 At the time of writing, stock transfer is still an option open to Councils and there is a Housing Transfer Manual the covers the period up to 31 March 2016. In 2012, it was suggested that the introduction of self-financing would spell the end of stock transfer as the HRA debt write off seen in the past, may not necessarily be a "given" in future. However, in Autumn 2012, DCLG indicated that it was prepared to enter into dialogue with a small number of local authorities (six) regarding stock transfer as a possible option. The criteria for transfer at that point had not been developed and existing guidance needed to be reviewed and replaced. Before any new guidance in the form of a Transfer Manual could be issued, it required a consultation process with professional advisers. Key members of Capita's LSVT financial advisory team were included in this process.

6.22 Following a longer than expected period of consultation, the new Housing Transfer Manual was issued in November 2013 and the three remaining Councils still considering transfer at that time were asked to submit business cases to be considered for permission to ballot the tenants. The Councils who were involved had worked throughout the summer of 2013 on the presumption that there would be an opportunity to submit a bid and carried out work towards this at risk. Bids were submitted in January 2014, with three positive decisions for permission to ballot tenants being issued in April and May 2014. Following positive ballot outcomes, all three transfers completed during March and April 2015.

6.23 There were new initiatives and considerations included in these business cases which included:

- a proportion of the VAT shelter being taken in to increase the purchase price (and reduce debt write off);
- new build development in the transfer business plan to deliver benefits;
- invest to save initiatives;
- a cost/benefit analysis of the benefits arising from transfer compared to the cost of debt write off;

- repayment of market debt and market premia (not previously redeemed);
- commercial decisions in place pre ballot.

6.24 There is a legal requirement for tenants to be balloted as part of the consultation process for LSVT. A Council that requires debt write-off cannot proceed to ballot its tenants without the permission of DCLG. For a ballot to be successful there needs to be a majority of the tenants who vote to be in favour of transfer (this is not the same as a simple majority of tenants). DCLG have the final say in whether a transfer can actually take place and it is more persuasive if a Council can show that more than 50% of the tenants as a whole are indeed in favour. A positive ballot outcome is essential if transfer is the chosen option, otherwise the costs of the consultation and the preparation for transfer would be wasted and the Council would still need to work out how it would manage the HRA in future within its resources.

Opportunities arising from transfer

6.25 Stock transfer has the ability to bring new money into the borough. It can also create new methods of delivering services that are currently provided by the Council. Transfer can also lever in funding from other partners as match funding. It can also bring in employment through the additional resources that can be spent. This does not necessarily mean that a transfer would be able to invest in a higher standard, but rather that it may be an option which would avoid cuts.

VAT Shelter

6.26 A VAT Shelter is a legal HMRC approved mechanism by which a registered provider (private not local authority) purchasing stock through stock transfer can recover VAT on the costs of its investment in the housing stock, where otherwise they could not. The VAT shelter is something that only arises from the transfer of existing housing stock from a Council to a landlord under LSVT and would not occur under any other option.

6.27 A local authority has a special VAT status in relation to the income it receives from renting social homes and is able to fully recover VAT on expenditure relating to the management and maintenance of those homes. A housing association however, whilst it has the same rental income, does not have the special status and its income is exempt from VAT. As such this restricts the recovery of the VAT it incurs on its expenditure. Non-employee costs are 20% higher than the Council would incur. The valuation of the stock for transfer initially assumes that the VAT is a cost, and thus is lower than it would have been otherwise. If, by some mechanism, the new landlord is then able to recover VAT it assumed it could not, then that VAT is a saving which is viewed as income. The

VAT Shelter is such a mechanism that has been developed for LSVTs and income arising is known as “VAT shelter savings”.

6.28 VAT shelter savings can be generated for up to 15 years from transfer and are based on the amount of capital investment required in the stock over that period. Given that Hammersmith & Fulham have over 11,500 homes, the VAT arising will be substantial, particularly as the expenditure required is predominantly in the early years. Traditionally, the VAT arising after transfer under the shelter has been shared between the new landlord and the Council. This is shared in a number of ways depending on the underlying financial issues in the transfer. The VAT shelter is often used to cover off liabilities that come to light during due diligence work. The most recent transfers have for the first time been required by DCLG to include a share of the VAT shelter income in the valuation to increase the purchase price paid by the new landlord upfront, thus reducing the cost of debt write-off to the Government. This has still left a minimum of 50% of the VAT shelter savings to be used by either or both parties and this is agreed locally.

6.29 In Hammersmith & Fulham’s case, if the current minimum investment profile to maintain the stock to a reasonable standard in the stock is assumed, then over 15 years there would be around £86.7 million available from the VAT shelter at 2017/18 prices. A substantial amount of this will be needed to support the valuation and business plan but there could be around 25% left to be shared or used to cover liabilities. VAT shelter in recent transfers has been used to:

- Cover Council set up costs;
- Cover pension fund deficits arising as a result of transfer;
- Address environmental land and property issues such as asbestos and contaminated land;
- Improve the offer to tenants;
- Support the transfer business plan and thus reduce the amount borrowed, or ease pressures on the plan to allow banks to lend at more preferential rates.

6.30 The VAT savings arising are usually deemed by the auditors to be capital income in the hands of a local authority. This means that if the Council has projects of a capital nature it wishes invest in, with stock transfer it will have capital receipts from the VAT shelter to spend. An alternative that can be used if the Council has revenue issues to address is to allow the new landlord to use the VAT shelter to provide and fund services for the Council e.g. homelessness service, at lower or no cost to the Council. The VAT shelter is then being used to indirectly make revenue savings for the Council’s General Fund.

Cost Sharing Groups

6.31 Businesses and organisations looking for cost efficiencies often work with others to share costs and resources. Under UK law many of these arrangements result in VAT being charged between the participants. This is not a problem for those participants who can reclaim the VAT on those arrangements but it is an issue for those organisations which are unable to recover the VAT in full. This includes housing associations, certain charities, universities, banks and insurance companies.

6.31 A VAT exemption, known as the Cost Sharing Exemption ('CSE'), was introduced in the UK on 17 July 2012. For businesses making exempt supplies (such as financial services and insurance firms, housing associations and universities) as well as organisations with non-business activities (such as some charities), it will enable them to reduce their irrecoverable VAT cost.

6.32 The exemption applies when two or more organisations (whether businesses or otherwise) with exempt and/or non-business activities join together on a co-operative basis to form a separate, independent entity, a cost sharing group (CSG), to supply themselves with certain services at cost and exempt from VAT. As a result a 'cooperative self-supply' arrangement (a term the EU Commission use) is created.

6.33 The CSG is a separate taxable person from that of its members. It is therefore able to make supplies for VAT purposes to its members. These supplies will be exempt if the relevant conditions are met. This type of arrangement enables the creation of the same economies of scale for smaller businesses and organisations as larger businesses and organisations naturally enjoy. Thus the more members of a CSG there are the greater the potential savings and lower the costs per member of operating the relevant CSG.

6.34 The cost sharing exemption applies only in very specific circumstances and will not cover all shared service arrangements. The exemption only applies to the supply of services and not to the supply of goods unless they are part of the service supplied. The opportunity to form Cost Sharing Groups has not been widely taken up since its introduction in 2012, and if this opportunity is to be taken up, we would recommend that specific tax advice is obtained from a VAT consultant.

Income from Right to Buy Sales

6.35 The Council is currently able to keep a proportion of its Right to Buy (RTB) sales proceeds to invest in its stock and to compensate the HRA for the loss of future expected net income, and after a certain number of sales it may generate funds to part fund new development of homes. Despite the ability to retain a fair proportion of the

sales receipts, there is still a proportion of those proceeds that is pooled and paid over to the Government. Once funds are generated for replacement homes (known as 1-4-1 replacement receipts), these can only count as 30% of a development cost and so the Council would still need to borrow to fund the balance or give the money to a housing association to develop. If it cannot use the receipts, then they would be returned to the national pot meaning a loss to the local area.

6.36 After transfer, existing tenants retain a Preserved Right to Buy (new tenants would currently get the Right to Acquire). Under new housing transfer rules introduced post self-financing, the new transfer landlord is able to keep all of the proceeds from Preserved Right to Buy sales – no element is pooled, no element is shared with the Council, but after allowing for a compensatory amount for the business plan, the remainder would be ring-fenced for new build. If the funds for replacement cannot be used by the landlord, only then would they be required to be returned to the Government. There is also currently no requirement to match fund the receipts for new build but the provision of new social housing without further borrowing is almost impossible as a result of the discounts given. Under a transfer contract, the Council could require the new landlord to pass the receipts on to another local landlord if repayment was likely. This ensures that 100% of the income from RTB sales remains locally. The Council cannot do that within the HRA.

6.37 The Right to Buy is being extended to all housing associations and at the time of writing the details of the policy are still being negotiated with the housing sector. Whilst with a new stock transfer association, the existing tenants would have the Right any way, it is uncertain as to how the proceeds will need to be used in future and whether stock transfer landlords will be affected by the changes.

Cross-Subsidy

6.38 If the housing stock is transferred into a group of housing associations, there is an opportunity for cross-subsidisation from other members of the group to provide funds towards projects in Hammersmith & Fulham. A group may be able to use the value in its existing assets (asset cover) to support additional borrowing or bond finance for members of the group.

6.39 This is subject to the financial structure of each particular group and would need to be considered critically if this option was chosen. For example, stock transfer housing associations from around 2007 - 2009, that benefited from gap funding agreements with the Government to assist their transfer, or those that have not yet reached their peak debt (the full drawdown of their bank facility), may find it difficult to raise additional funds in this way as the assets will be required to support their own funding

facility. In addition, the recent announcement of the cut in rental income over the next four years will seriously restrict existing associations' ability to fund projects.

6.40 Cross-subsidy works both ways and the assets of Hammersmith & Fulham may be used in future schemes to support borrowing for project of another member of the group. However, one thing is certain - cross-subsidy is not an option available to either of the retention options through the HRA.

Land Transfers

6.41 There may be opportunities for the Council to support a transfer business plan that can deliver regeneration and redevelopment through the inclusion of additional land in the deal. Elsewhere this has been considered as a contribution to the transfer to achieve better value for money than the HRA, but each case would be measured on its own merits.

Mutualism

6.42 March 2012 saw the completion of a stock transfer from Rochdale Council to Rochdale Boroughwide Housing which became the UK's first tenant and employee co-owned mutual landlord. Being a Member of the new mutual association provides a brand new way in which tenants and employees can contribute to the success of the association and its communities by working together for the benefit of all. Membership gives tenants and employees a voice with the right to receive information, have representation on and stand for election to the Representative Body. It also gives a vote to have a real influence on how the association is run.

6.43 The Mutual model was seen as adopting the Coalition Government's principles of the "Big Society". The new Mutual RBH operates in a way that engages tenants and employees to take real decisions on what the priorities are for their tenants and how the society will be run to achieve these.

6.44 A Mutual organisation is best set up as a stand alone organisation. If the Council is minded to consider a transfer to such an organisation, then it should seek legal advice as to whether a subsidiary of a group could adopt Mutual principles without the parent being a Mutual. Whilst previous legal advice in 2012 did not rule out the possibility of a Mutual being a subsidiary within a group structure, it indicated that this would be difficult to set up and manage given the decision-making role that the parent company would ultimately have. This has potential conflicts of interest within the concept of Mutualism.

Sale of High Value Voids

6.45 DCLG are currently consulting with Councils about the implementation of a policy which is designed to provide financial support to housing associations to compensate them for the loss of properties arising from the extension of the Right to Buy as discussed above. The policy originally suggested that Councils (only not housing associations) would be forced to sell their higher valued properties as they become void and the proceeds should be used to fund housing association reprovision. The full details of how this will work have not yet been announced, but from a consultation seminar it seems that this may be based on:

- A formula driven sum to be paid over to the Government;
- The cash sum would need to be paid regardless of whether the houses were sold - so Councils would have a choice on how to fund the payments;
- The formula would take into account sizes of properties and values;
- Some stock such as larger (5-6 bed properties), sheltered stock, rural stock, new build may be exempt;
- The Council will be able to keep receipts to cover conveyancing and debt costs;
- The funds will be paid into a national pot not a regional pot;
- There may be annual reviews.

The period of time over how long this will last is unclear.

6.46 Depending on the date of implementation of the scheme, it is highly likely that prior to any transfer in 2017/18, Hammersmith & Fulham will be affected by this policy given the property values that it experiences and will start to lose housing stock. Some Councils elsewhere in the country will be affected to a lesser extent. The current policy as proposed does not extend the requirement to housing associations to sell voids, but that does not mean that the Government will not seek to force new stock transfer organisation to adopt the policy.

“Pay to Stay”

6.47 A further policy that is to be implemented involves the charging of at or near market rent to those households in social rented accommodation that are deemed to be higher income households. This policy would see “households” (where that term is not yet fully defined) that earn £40,000 or over in London and £30,000 or over elsewhere, charged a higher rent than the social rent they currently pay. The proposal as it stands is that for Councils, the additional income that is raised will be paid over to the government so the HRA will not benefit from the income; for housing associations, they will be able to retain the income to provide funds for replacement homes. During the consultation

seminar, it was suggested that Councils may be able to lobby to keep the market rents. Whilst this policy at present brings no benefit for the retention option, it may be argued that at least in a transfer option, the income is retained locally for use rather than being used nationally. This would bring more local benefits that could be used to support the cost of debt write off.

6.48 The following is still to be determined:

- What is a "household" – whose income will be counted? Tenancy holder, or beyond?
- How will the income level be determined and by whom? – HMRC?
- If HMRC records are used, how will the tax year tie in with the rent year?
- How often would a person's income be reviewed?
- Who will cover the bad debt that might arise? – 100% of the extra income may be required to be paid over even if it is not collected.
- Administration costs of the system.
- Will this increase the void rate if people choose to move out rather than pay market rent – and thereby increase the number of voids available to sell?
- Will this increase the Right to Buy sales? – people choose to pay a mortgage if they have to pay a higher rent (might as well own as rent).
- Whether there will be tiered system so that it is not an automatic jump from social rent to market rent on a single salary trigger.

The Detailed Stock Transfer Options

Main stock transfer – to a new stand alone company

6.49 This option would involve setting up a new housing company made up of the majority of existing Council Housing Service (which was formed on the closure of the ALMO), The new company would be formed as Registered Provider (RP) which would then on transfer date take ownership of the main housing stock which excludes the 538 properties in the West Kensington and Gibbs Green scheme and be able to invest in the properties. The new company would be stand alone and not-for-profit and would usually operate under charitable rules in order to take advantage of the VAT Shelter Scheme. The RP would need to be registered by the Homes and Communities Agency (HCA) for regulatory purposes.

6.50 The majority of existing staff employed by the Housing Service would transfer to the new company (TUPE) and possibly some employees of the Council that provide housing services centrally. An exercise to determine how the corporate services within the Council's General Fund might be affected has been carried out as part of this appraisal.

As this option requires the Council to maintain a retained HRA to manage the 538 remaining properties, the Council will need to keep a small number of staff to manage the retained service and maintain the HRA business plan. On a day-to-day basis it may choose to buy in the management and maintenance services from the new landlord or an alternative Registered Provider.

6.51 The Council would no longer own the main housing stock and related assets such as garages and shops on the estates, the new housing association would own the properties. All decisions with regard to ownership, management, maintenance and investment in the land and property transferred would be the responsibility of a Board of Members of the new company. The Board need not be structured as equal numbers of members within the groups (Tenants (with Leaseholder representation if desired) / Councillors / Independents), but often initially it is easier to set up an equal proportion of voting. Some boards have more tenant representatives than the other categories, others may feel that having more Independents on the Board gives a better commercial edge. The make-up of a board can change over time. In the UK's only Mutual housing association, employees are also represented in the decision making process and all tenants have the right to become Members of the Mutual and can choose the level of involvement that they have in the running of the company.

6.52 As a stand-alone company that only owns Hammersmith & Fulham stock, then all decisions made and resources are dedicated to that stock and the Board have full control over what happens on the estates. There is no group structure to fit into with set policies that could be applied to these properties.

6.53 Performance standards would be those of the existing service at least, which may be developed as part of the structuring of the new company, rather than those existing in another housing association. However, there are fewer opportunities to make savings from economies of scale and to rely on the borrowing capacity of a group. The Cost Sharing Group may be an option however to allow a stand-alone company to achieve some economies of scale without being part of a group in terms of the ownership of the homes.

6.54 The number of strategic partners in Hammersmith & Fulham would be increased under this option. The new stand alone landlord would also be an additional company which could form a member of a Cost Sharing Group. The transfer option to a stand-alone new company maximises the involvement of tenants and leaseholders in how the homes are managed. It does not however deliver the maximum access to other sources of borrowing or funding.

6.55 The table below sets out a summary of the pros and cons of the option for the Council to transfer ownership of the housing stock to a new stand alone housing association:

Option	Pros	Cons
New stand alone RP – e.g. set up a new housing company from the current housing service	• Members of the Board would have complete control over what happens on these estates. Control over decision making is strengthened as Council no longer owns stock and all decisions transfer to the new RP • Tenant representation on the Board could be increased subject to agreement • A stand alone RP for 11,600 units is likely to be financially viable having sufficient stock to be able to deliver economies of scale whilst being a comfortable enough level of stock for a single operator to manage • Registration would be fairly simple concentrating mainly on financial viability and governance and the existing performance of a housing service that has previously had	• A new stand alone RP is unlikely to have any cash reserves with which to support additional investment in the stock. Recent stock transfers have included HRA debt write off by the Government, but only to support a level of investment in the housing stock to the Decent Homes Standard. Without additional Government support to achieve a standard above the level of investment to maintain the stock to a reasonable standard as advised by Savills, such a standard could not be achieved without additional resources from for example reserves, the Council or the VAT shelter • The economies of scale achievable may not be as great as those that could potentially be achieved by joining an existing provider and sharing management and back-office costs • There would be no

	ALMO experience • Less disruption to staff during transition to a LSVT than moving to an existing housing association, so service standards can be maintained • Tenants are familiar with Council staff managing their stock. A ballot is easier to sell to the tenants and leaseholders as they feel they are voting for what they already have, particularly if they are satisfied with the service they get • All of the recent large stock transfers have been to a single new RP (albeit these all involved ALMOs) • Financing options are not affected by banking relationships or funding structures that would exist within an established RP • Value for money considerations can be potentially mitigated via a Cost Sharing Group • Current service standards could be maintained or	opportunity for cross-subsidy support from other, areas of the country (assuming an existing RP has a diverse client base) • Council membership on the Board could reduce be less than a third subject to agreement. • Set up costs would higher than those for the conversion of an existing ALMO to RP. The key costs for set up would be accommodation and IT systems which the Council may be able to provide assistance with.

	improved. Whilst joining another provider may provide additional investment support, it may compromise the service standard. This could adversely affect a ballot result • Decisions and investment of resources would relate to Hammersmith & Fulham properties only – there would be no issues of cross-subsidy to other areas of the country for example, e.g. taking advantage of the more higher property prices in the borough to fund less affluent areas • Possible capital receipt available (or VAT shelter savings) against which to offset set up costs • Council will only need to manage the HRA debt in relation to the West Kensington and Gibbs Green scheme properties in future • Borrowing to fund new build (or VAT shelter income) would be available if the business plan can	

	demonstrate that it can be supported. This may lever in additional Government funding • This is likely to provide the fastest route to transfer as tenant consultation groups are in place, new group structures are not required and registration considerations would relate to the new business only and not the impact on an existing association's business plan • Best option for set up of a Mutual organisation and inclusion of employees in the running of the business	

Main stock transfer – form a new group and create two subsidiaries

6.56 Initially, this option would involve setting up a new housing company made up of the majority of the existing Council Housing Service in the same way as described above for the stand alone new RP option. Rather than stand alone, the company could form a group with an existing stand alone RP. The group would also need a Parent Company establishing which would be non-registered with the Regulator and would not be stock-owning. An example is the Stockton ALMO, Tristar, which joined Housing Hartlepool to form a new group on transfer of the Stockton stock in 2011 and has subsequently recently become part of an even larger group of five housing associations following further mergers in the North East.

6.57 Both the new housing company and the existing RP would be subsidiaries of the new group. Each would be managed by a Board of Management. The Boards' roles are to direct the work of their subsidiary including determining strategic direction, delivering the Management Agreement between the subsidiary and the group and approving policies and overall expenditure. The two organisations would retain their own distinct identities and continue to operate as separate organisations with their own homes, working within local communities.

6.58 The day-to-day running of the companies would be delegated to a single Executive Management Team (shared management team reduces costs of having two sets of management). Members of the Board of both subsidiaries would be elected to the Group Board which would determine the strategic direction of the group as a whole. A new group of two RP's would be able to share some back office costs and senior management team expenses. Strategically, if there are two RP's in an area, it may make sense to have them jointly managed so that there is a common focus and economies of scale may be achieved in terms of purchasing contracts. There does need to be a good business case for the Board of the existing RP to consider forming a group. There does need to be a "what's in it for our tenants" otherwise there is no point in making a change. This may mean that the existing RP could access more funds for its properties or to share its costs over a wider base.

6.59 From Hammersmith & Fulham's point of view, there would be savings to be made through sharing an Executive Management Team, but additional costs in terms of administration of more than one Board. The Council would need to be sure that the RP forming the group has performance standards that meet the expectations of its own tenants and leaseholders so that the Council's performance is not put at risk. In financial terms, joining a group may give access to unused reserves and/ or extra borrowing capacity through the value in the existing RP's properties (to raise bond finance for example).

6.60 This option would not increase the number of strategic partners in Hammersmith & Fulham, and as savings are achieved from sharing an Executive team and some back-office functions, there is less scope for making savings in a Cost Sharing Group. The number of Members available to join the CSG is less than that of the stand alone option.

6.61 In order to generate reserves or have borrowing capacity in their properties, an RP, in particular one which may have been a LSVT transfer RP originally would have to have completed its major property works that have been promised to its tenants and have reached the peak debt of their funding facility. Headroom to borrow usually occurs once

the company is past its peak debt (often around year 10 after transfer). The risk to the existing RP is that in order to provide finance to support a new transfer, they will have to have their own finance facility reviewed by their funder – this may increase their own borrowing rates depending on when they last refinanced.

6.62 The set up costs of a group would be higher than the stand alone option as this would require additional administrative and legal arrangements to be put in place to form the group in addition to those to set up the new company initially. Financially, individual company business plans would be required and a consolidated group business plan. The plans would need to show that the existing RP was no worse off by forming the group. Registration of the new housing company as an RP would require consideration of the performance of the existing RP as well as its own performance and the new governance structures would need to be approved. All business plans would need to be approved.

6.63 The transfer option to a new group with two subsidiaries provides a fair level of involvement of tenants and leaseholders in how the homes are managed, but not complete control. The Group Board would have overall strategic control. It delivers some cost savings through shared management and may offer additional borrowing capacity depending on the financial status of the existing RP that the new housing company partners with.

6.64 The table below sets out a summary of the pros and cons of the option for the Council to transfer ownership of the housing stock to a new group made up of a new housing company and an existing housing association:

Option	Pros	Cons
Set up new RP and form a group (non-registered parent) with another single RP	• Tenant membership on the Board could be increased subject to agreement. • Opportunities for tenant and leaseholder involvement are increased beyond that of the retention options.	• Registration would need to cover both the new RP and the existing RP, but could still rely on existing inspection reports and concentrating mainly on financial viability and governance • Set up costs would be higher than the stand alone option. Both

	• 11,600 units is likely to be attractive to an RP of a similar size or smaller looking to increase the size of their business to take advantage of economies of scale • Savings in senior management and back-office service costs may be achieved • There may be opportunity for cross-subsidy (assuming an existing RP has a diverse client base) • A local RP may be prepared to invest more in the stock in order to gain a strategic advantage in London, by increasing their coverage of the City, which may deliver strategic and economic advantages being in the same City (see cons) • Some disruption to staff during transition to a LSVT, but not extensive, so service standards can be maintained • Possible capital	companies would be already set up, but a new Parent Company and group structure and reporting lines would need to be set up. Business plans for the transfer organisation and the group would need to be prepared, validated and potentially all stock valued for loan purposes • Financing options may be affected by banking relationships or funding structures that would exist within an established RP. Existing loan arrangements may prevent an RP from taking on a new transfer without renegotiating their funding rates (usually to a higher level) or occasionally re-financing completely to reflect the new risks. • Current service standards may be maintained or improved. However, joining another provider may provide additional investment support, it may compromise the service standard. This could adversely affect a ballot result. • Members of the Board may have complete

	receipt available (or VAT shelter savings) against which to offset set up costs • Council will only need to manage the HRA debt in relation to the West Kensington and Gibbs Green properties in future • There is a greater ability for Hammersmith & Fulham representatives to retain control over decision making on their estates, than perhaps there would be in a larger group or as part of a larger single RP. • Borrowing to fund new build would be available if the business plan can demonstrate that it can be supported. This may lever in additional Government funding • The existing RP may already have gone through the transfer process previously and as such would be aware of the input required to successfully complete	control over what happens on these estates, however may not have control over the group decision making • Council membership on the Board could be reduced to less than a third subject to agreement. • Care needs to be taken that the group does not become too big that it becomes unmanageable • The existing RP may not have gone through the transfer process previously and as such may not be aware of the input required to successfully complete a transfer • The existing RP's Board will need to be assured that in moving to a group structure, that there is benefit to them as well as to the new transfer organisation. Economies of scale would need to be shared • More recently, group structures are being "collapsed" in housing associations– a costly operation, if you have only just set one up. • Risk of identity loss if a

	a transfer • The set up of a Mutual organisation may be possible subject to the legal status of the group.	group structure is collapsed.

Whole stock transfer – join a group as one of several subsidiaries

6.65 Again initially, this option would involve setting up a new housing company made up of the majority of the existing Council Housing Service in the same way as described above for the stand alone new RP option. Rather than stand alone, or set up a new group structure, the company could join an existing RP group as a new subsidiary. An example is New Charter Housing Trust Group (based in Tameside). In 2008, Gedling Homes was formed as a new company to take the housing stock and staff from Gedling BC. The company became a subsidiary of the New Charter Housing Group and has its own Board and representation at Group level. New Charter Housing Group consists of 3 RP's and a building company. The Together Group is another example of a number of LSVT and traditional housing associations being run within one group organisation.

6.66 As with the new group option, the new company subsidiary could have its own Board of Management and then would hope to have some representation on the Group Board. The representation on the Group Board would be less than that of a group of two subsidiaries and would depend on the size of the group. There is benefit in joining a larger group – "safety in numbers". This may particularly be the case if the existing group members have been RP's for some time and the group stock can be used to provide security for borrowing. Many larger groups in the last three years or so, have undertaken bond financing deals using their stock which is at decent homes standard or above and are now simply being maintained on a standard refurbishment programme. They are then using this finance to build new homes. This long term loan finance can also be used to support the group where there are significant pressures on the business plan by scaling back development programmes. Similar savings in management and back office costs would be seen as with the two subsidiary group, although the costs could be spread over a larger stock base. Much would depend on the offer made by the group.

6.67 The location of a potential partner group of associations will determine whether the number of strategic partners will increase in Hammersmith & Fulham or not. Similarly, it may not increase the number of Members available to join a Cost Sharing Group. Larger housing association groups may be less tempted to join a CSG as they already consider they minimise costs within their group structure and maintain more control over the service provision by being the employer.

6.68 The same principles apply with respect to set up costs and registration considerations as the two-subsidiary group. Previous legal advice suggested that the option to set up a Mutual organisation is more difficult as it may require the group to change its constitution to allow this. Further more current legal advice would be required if this option is chosen.

6.69 The transfer option to a group with many subsidiaries provides some level of involvement of tenants and leaseholders in how the homes are managed, but a produces further dilution of overall control. The Group Board would have overall strategic control and the members of Hammersmith & Fulham board would have a limited number of representative seats on the Group Board. This option delivers some cost savings through shared management and is likely to offer additional borrowing capacity depending on the financial status of the existing RP and the size and nature of the stock.

6.70 The table below sets out a summary of the pros and cons of the option for the Council to transfer ownership of the housing stock to a group made up of Hammersmith & Fulham as a subsidiary in an existing housing association group:

Option	Pros	Cons
Set up new RP and join existing RP group structure as a subsidiary	• 11,600 units is likely to be attractive to a group looking to increase the size of their business to take advantage of economies of scale • Opportunities for tenant and leaseholder involvement are increased beyond that of the retention options.	• Hammersmith & Fulham's identity may be diluted subject to the Group structure. • Registration would need to cover both the new RP and the existing RP, but could still rely on existing inspection reports and concentrating mainly on financial viability and

	• Savings in senior management and back-office service costs may be achieved • An existing group may have accrued reserves capable of supporting a higher investment standard than the advised level of investment to maintain the stock to a reasonable standard An existing group may have reserves to help resource set up costs • There may be opportunity for cross-subsidy support from other areas of the country (assuming an existing RP has a diverse client base) • A local RP may be prepared to invest more in the stock in order to gain a strategic advantage in London. RPs from neighbouring authorities may be interested in consolidating stock whilst having a fairly local presence for providing the head office base. • Possible capital receipt available (or VAT shelter savings) against	governance • Set up costs would be higher than the stand alone option, but perhaps less that the new group option. The new subsidiary would need to be set up, but the Parent Company would already exist. However the group structure and reporting lines would need to be amended. Business plans for the transfer organisation and the group would need to be prepared, validated and potentially all stock valued for loan purposes • Financing options may be affected by banking relationships or funding structures that would exist within an established RP group. Existing loan arrangements may prevent a group from taking on a new transfer without renegotiating their funding rates (usually to a higher level) or occasionally re-financing completely to reflect the new risks. • Current service standards may be

	which to offset set up costs • Council will only need to manage the HRA debt in relation to the West Kensington and Gibbs Green properties in future • Tenant membership on the Board could be increased subject to agreement. • There is the ability Hammersmith & Fulham representatives to retain control over decision making on their estates, this is more diluted than being part of a small group, but is more beneficial than being part of a larger single RP. • A group which has undertaken stock transfers in the past will be aware of the level of resources (time as well as money) required to complete a successful stock transfer and ensure the business develops • There is strength in numbers and risk and costs may be shared • Borrowing to fund new build would be available	maintained or improved. However, joining another provider may provide additional investment support, it may compromise the service standard. This could adversely affect a ballot result • Members of the Board of the subsidiary may have complete control over what happens on these estates, however will not have control over the group decision making • Council membership on the Board could be subject to agreement. • The existing group Board will need to be assured that in extending the group structure, that there is benefit to them as well as to the new transfer organisation. Economies of scale would need to be shared but more widely across the whole group • A large group may be perceived as more risky (the bigger they are, the harder they fall) • More recently, group structures are being

	if the business plan can demonstrate that it can be supported. This may lever in additional Government funding. In certain circumstances access to bond finance over longer term than 30 years may be available to fund affordable housing	"collapsed" in housing associations – a costly operation, if you have only just set one up • Risk of an identity loss if a group structure is collapsed • The Mutual model may not be attractive to an existing group • Cost Sharing Groups may not be attractive to an existing group

Whole stock transfer – transfer stock to existing RP without subsidiaries

6.71 This option would not require the setting up of a new company as a Registered Provider. Ownership of the properties would be transferred to an existing RP as landlord but with no distinct Board of Management of Hammersmith & Fulham stock. The stock would be subsumed into the general stock of the new landlord and there may be only one Board of the company. As an existing RP, it would be likely to be not-for-profit and would usually operate under charitable rules in order to take advantage of the VAT Shelter Scheme. Alternatively, it may have tax losses that can be utilised to take advantage of the VAT savings. The RP would already be registered by the Homes & Communities Agency (HCA). The new landlord may be of any size and may or may not have taken in transfer stock previously. An example of this could be the Sanctuary Housing Association although there may also be others.

6.72 Unlike the previous group options discussed, the former Hammersmith & Fulham Council Housing Service would not be a subsidiary and is unlikely to have its own strategic Board of Management. There may be some opportunity for representation on the Group Board, but this would be subject to the agreement of the existing group. This may also provide issues for existing Council staff whose roles may not be required in the group. There is benefit in joining a larger existing RP. A large group may or may not

introduce a new strategic partner to Hammersmith & Fulham. It is unlikely however, that they would be interested in being a Member of a Cost Sharing Group. Additional savings in management and back office costs could be seen as there is less administration in the non-group structure. Set up costs would be less than the previous options as there is no new company to form. The existing landlord would need a letter of comfort from the Regulator to agree to the transfer of stock, would need to undertake due diligence and prepare a new business plan.

6.73 Tenants and leaseholders could expect some involvement in how their homes are managed, but this would be through arrangements made for the association as a whole. The Mutual Model would not be an option here. The transfer option to a new landlord with no subsidiaries provides the lowest of involvement of tenants and leaseholders in how the homes are managed, with no overall control. It delivers some cost savings through shared management and is likely to offer additional borrowing capacity depending on the financial status of the existing RP and the size and nature of the stock.

6.74 The table below sets out a summary of the pros and cons of the option for the Council to transfer ownership of the housing stock to an existing housing association or group, without setting up a new subsidiary for Hammersmith & Fulham. The stock would be absorbed into the existing portfolio of the existing landlord:

Option	Pros	Cons
Stock is transferred to an existing RP with no defined company (all stock combined)	• 11,600 units is likely to be attractive to an RP of a similar size or larger looking to increase the size of their business to take advantage of economies of scale • Savings in senior management and back-office service costs may be achieved • An existing group or association may have accrued reserves	• Hammersmith & Fulham's identity will be lost • Delivery of the transfer in regard to winning the ballot may be at risk if the stock is completely subsumed within an existing organisation • Registration would need to cover both the new transfer business plan and the existing RP, but could still rely on existing inspection reports and concentrating mainly on

	capable of supporting a higher investment standard in Hammersmith & Fulham • There may be opportunity for cross-subsidy support from other, areas of the country (assuming an existing RP has a diverse client base) • A local RP may be prepared to invest more in the stock in order to gain a strategic advantage in London. RP's from neighbouring authorities may be interested in consolidating stock, whilst having a fairly local presence for providing the head office base. • Possible capital receipt available (or VAT shelter savings) against which to offset set up costs • Council will only need to manage the HRA debt in relation to the West Kensington and Gibbs Green properties in future • A group which has	financial viability and governance • Set up costs would be similar to that of the stand alone option. The existing company would be already set up, a new company for the Hammersmith & Fulham housing service business would not be necessary, but business plans for the transfer organisation and the group would need be needed. • Financing options may affected by banking relationships or funding structures that would exist within an established RP. Existing loan arrangements may prevent an RP from taking on a new transfer without renegotiating their funding rates (usually to a higher level) or occasionally re-financing completely to reflect the new risks. • Current service standards may be maintained or improved. However, joining another provider may provide additional investment support, it may compromise the service standard. In being subsumed into a ready-

	undertaken stock transfers in the past will be aware of the level of resources (time as well as money) required to complete a successful stock transfer and ensure the business develops • There is strength in numbers and risk and costs may be shared • Borrowing to fund new build would be available if the business plan can demonstrate that it can be supported. This may lever in additional Government funding	made company, then it is likely that the existing company policies and procedures will prevail and the this could adversely affect a ballot result • Hammersmith & Fulham representatives will have a minimal representation on the Board, Councillors are unlikely to have any • The existing RP Board will need to be assured that in expanding the company, that there is benefit to them as well as to the new transfer organisation. • A large RP may be perceived as more risky (the bigger they are, the harder they fall) • The Mutual Model is not an option

Partial stock transfer – transfer individual estates to new landlords

6.75 This option would only really be considered if there were certain estates that would benefit from transfer and would leave the Council's HRA in a better position as a result of the loss if the stock. From our initial discussions with officers at the Council, the intention is to protect the assets for the whole of the community rather than certain area. There were no obvious estates identified for transfer rather than the main stock. This option therefore has not been considered any further at this time.

Housing Stock Transfer Valuation and Business Plan Outputs

6.76 The stock transfer valuation and business plan includes the main housing stock of 11,722 properties as at 31 July 2015. The 538 properties on the West Kensington & Gibbs Green estate that are part of the re-development scheme are included in a retained HRA that the Council would need to maintain after transfer. The business plans also include the costs and income associated with managing 4,693 leaseholder units. The valuation (or purchase price) does not need to include the leaseholder properties as these are not sold, the management responsibility is passed over. The assumptions used are those set out in section 4 above, with the annual savings.

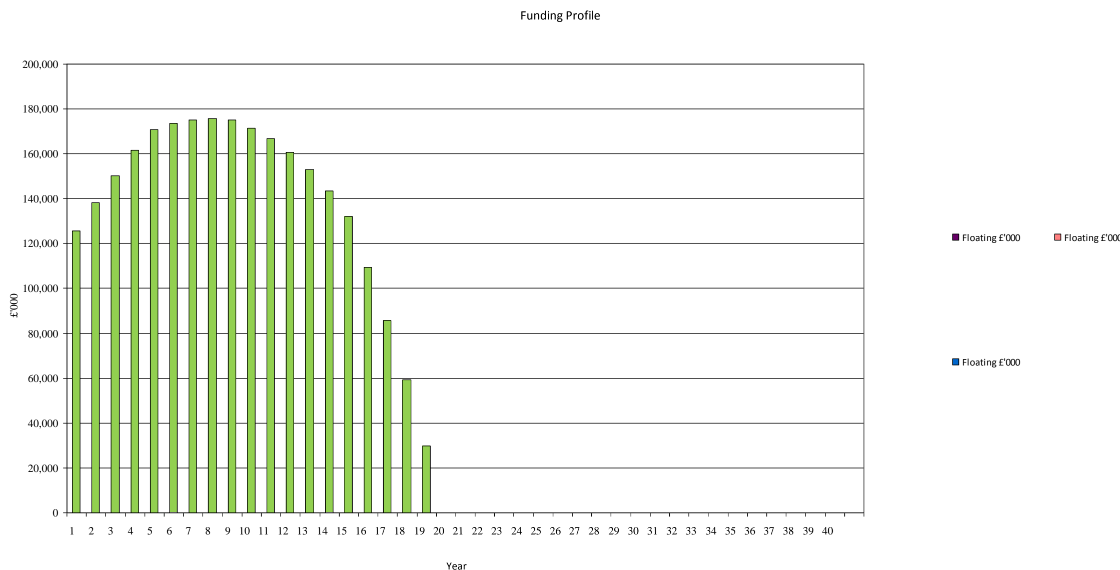
6.77 The results of modelling a 40 year business plan for the HRA on the basis of the Council's retention of the stock are set out below and termed T1, T2, T3 and T4 as explained in Section 3 above. The models are shown on the assumption of a stand alone new company only. As can be seen from the pros and cons of the various structures above, the savings to be had from group structures may be outweighed by the additional set up costs. If a group structure is preferred, then there will need to be a bidding process for existing landlords and this may drive out efficiencies but these cannot be modelled with accuracy at this stage.

T1 Valuation and Business Plan Model Outputs

6.78 T1 is the scenario that assumes the current assumptions on expenditure and other income (as the Council housing service now), but assumes that the rent in future would be based on the former rent guidance, i.e. increasing by CPI + 1% + £1 convergence. It essentially replicates R1 for the HRA as if it were a stock transfer organisation from April 2015, but includes the Savills survey from year 1 and includes the cost of VAT where it is deemed irrecoverable. A 50% VAT shelter is assumed.

6.79 The valuation, or the amount a new landlord might be expected to pay, based on the Tenanted Market Value (TMV) at April 2015 for T1 is £**110.123 million**. On that basis and with some fixed interest funding would show that the landlord would need to borrow a maximum of £176 million by the 8th year after transfer. Given the strength of the income cashflows compared to the expenditure required, the loans could be repaid by year 20. A borrowing facility of that level would require up to three banks to work as a syndicate to provide the funding.

6.80 This means that all of the works required to maintain the 11,722 properties in the main stock could be completed at the right time. The homes would maintain the Decent Homes Standard and all structural works required as a minimum to protect them could be completed. The borrowing and repayment curve is shown below:



6.81 The transfer would be reliant on debt write-off from the Government. The calculation of the amount required would be:

Debt outstanding: £220 million
Less debt re WK/GG: (£12 million)
Less purchase price (£110 million)

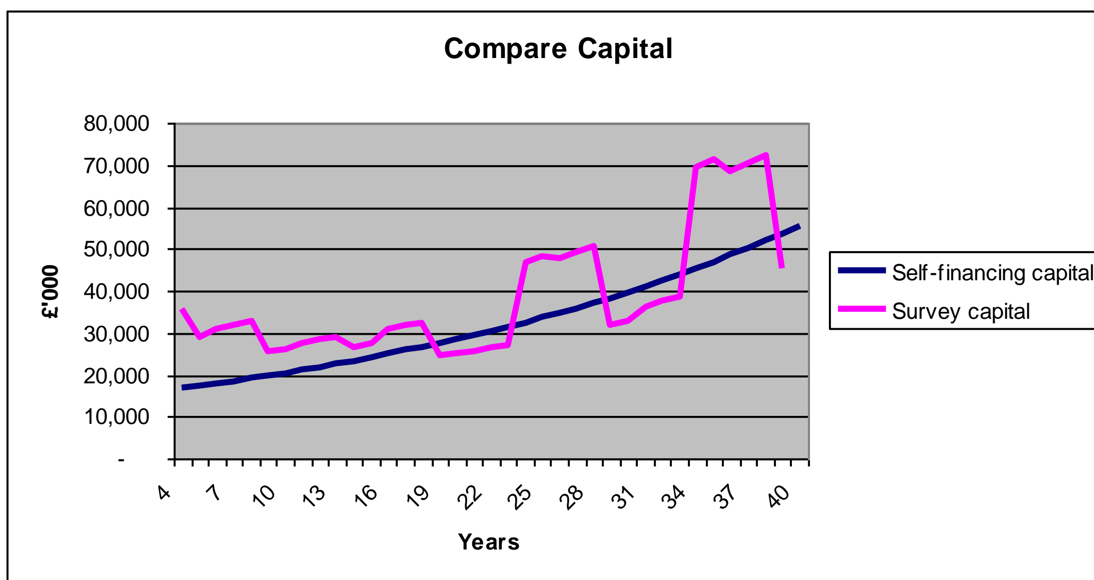
Leaving £98 million plus early debt repayment premia to be paid off by the Government. Monetarised benefits to the value of the total debt write off would need to be identified as part of a business case for transfer.

6.82 One of the key differences which gives rise to the difference between the self-financing debt valuation of £254.617 million and the valuation here of £110 million is the cost of VAT on day-to-day management and maintenance and all capital investment costs not subject to the VAT shelter savings. Additional costs such as VAT push the valuation down

6.83 A second contributing factor is the difference in the profiling of capital investment required. The self-financing valuation assumed that other than inflationary rises, the capital spend would be the same amount every year. It did not take into account the profile of works required and the lifecycles of re-occurring work according to that which had been completed by with ALMO funding.

6.84 The graph below shows the self-financing capital investment assumption rising steadily with inflation only (blue line) compared to the recent survey requirement (pink line). Where the pink line is above the blue line more expenditure is required in reality. The

important thing to note is that the pink line is above the blue line in the next few years and higher costs in early years have a larger depressing effect on the valuation (i.e. net present value).



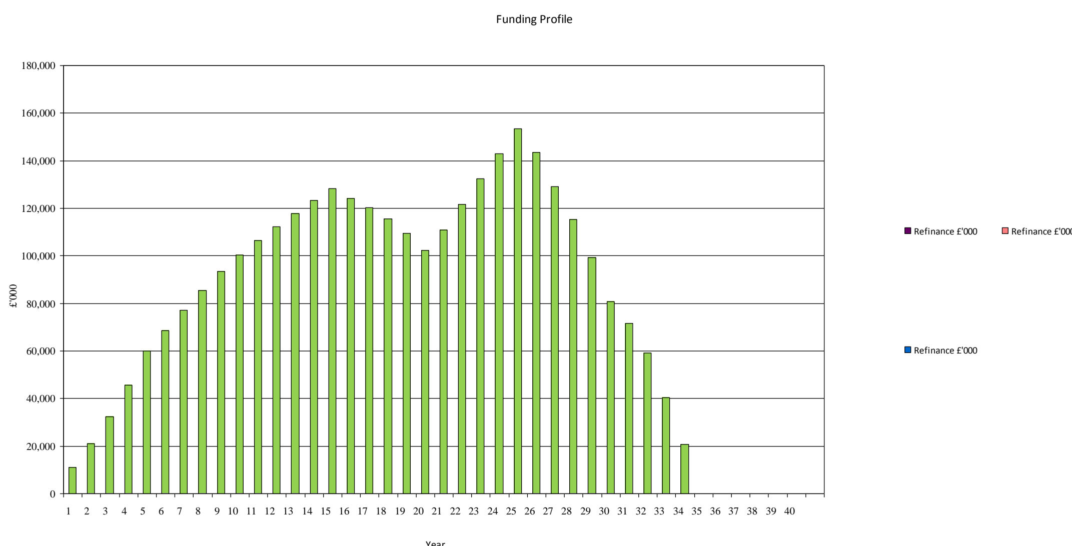
T2 Valuation and Business Plan Model Outputs

6.85 T2 is the scenario that assumes the current assumptions on expenditure and other income (as the Council's Housing Service now), but assumes that the rent in future would be based on the the new rent reductions announced in the 8 July 2015 Budget. After four years the rents are assumed to rise by CPI + 1% but not converge, so are rising by a lesser amount than the HRA. It essentially replicates R2 for the HRA as if it were a stock transfer organisation from April 2015, but includes the Savills survey from year 1 and includes the cost of VAT where it is deemed irrecoverable. It has a 50% VAT shelter included in it.

6.86 The valuation, or the amount a new landlord might be expected to pay, based on the Tenanted Market Value (TMV) at April 2015 for T2 is no longer a positive figure – the valuation is **minus £29.963 million**. This means that the income cashflows over 30 years do not exceed the expenditure cashflows and so in reality a landlord might be expected to receive a grant to take this stock on, rather than pay for it. The effect of assuming a four year rent reduction is to reduce the valuation of the stock on a TMV basis from £110 million to minus £30 million, so a movement of £140 million in total.

6.87 Around 10 years ago, the Government supported negative transfer valuations with "gap funding" in addition to overhanging debt write-off. This has not been available for some time. T2's business plan assumes that the new landlord will not make payment for the

stock, but will not receive any assistance towards the pressure on the business plan of the negative cashflows. On that basis and with some fixed interest funding it shows that the landlord would need to borrow a maximum of £155 million by the 25th year after transfer. The loan could not be repaid until year 35 which is beyond the typical pay back period for most banks. A borrowing facility of that level would require up to three banks to work as a syndicate to provide the funding.

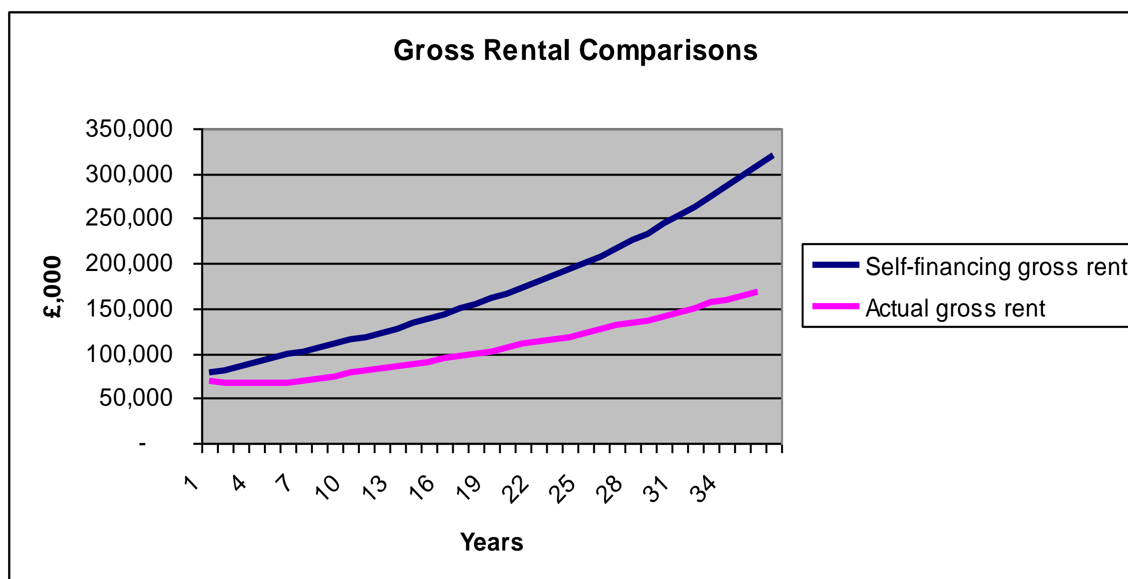


6.88 The transfer would be reliant on debt write-off from the Government. The calculation of the amount required would be:

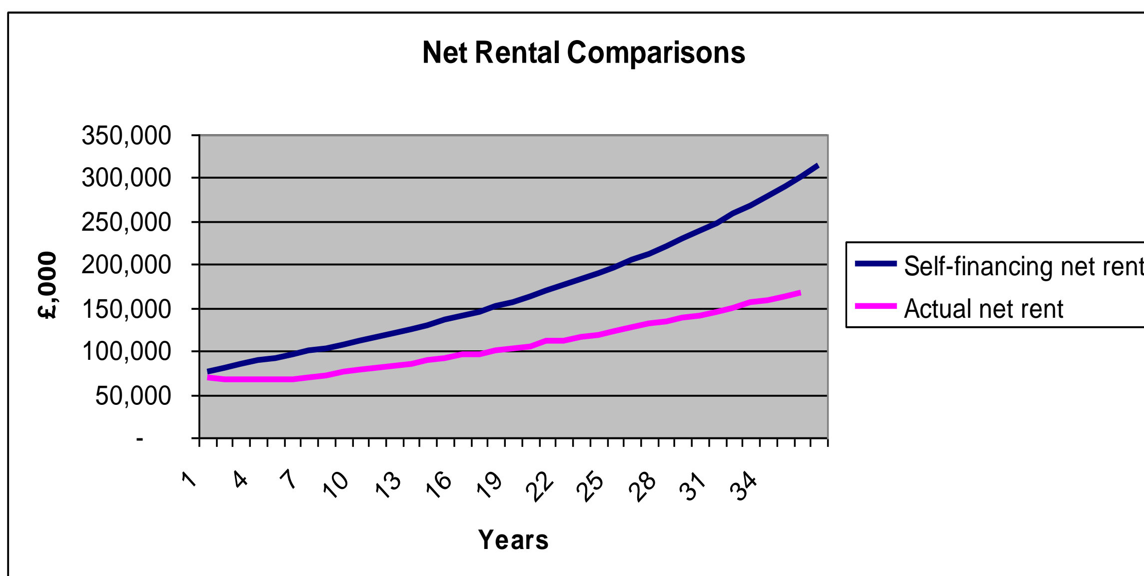
Debt outstanding: £220 million
Less debt re WK/GG: (£12 million)
Less purchase price nil

Leaving £208 million plus early debt repayment premia to be paid off by the Government. Monetarised benefits to the value of the total debt write off would need to be identified as part of a business case for transfer.

6.89 Here we now have the combination of VAT, a different capital investment profile and rents that are less than the self-financing assumption. The graph below shows the rental income expected in the self-financing valuation (blue line) compared to the current expected rent levels (pink line):



6.90 The net rental difference graph below shows how this is made worse by the assumption that the void and bad debt loss would be 2% in total in the self-financing valuation, whereas the policies of welfare reform introduced mean that the Council predicts total losses from voids and bad debts of 6.3% per annum.

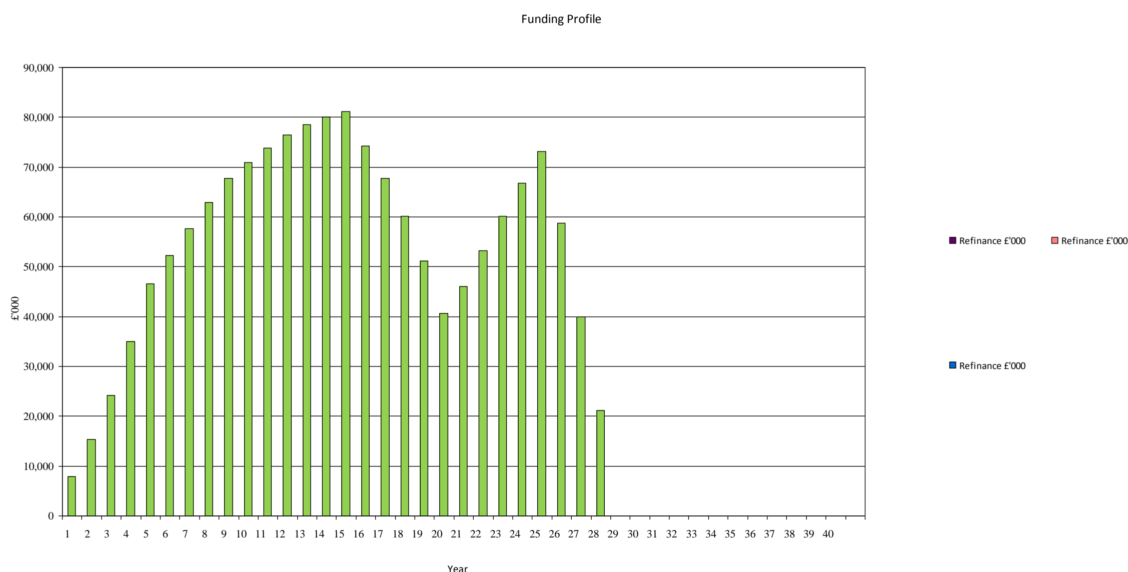


T3 Valuation and Business Plan Model Outputs

6.91 T3 replicates T2, but to see if the business plan repays within 30 years by improving the valuation, it is assumed that 75% of the VAT shelter is used to support the business plan rather than 50%.

6.92 The valuation, or the amount a new landlord might be expected to pay, based on the Tenanted Market Value (TMV) at April 2015 for T3 is still a negative figure – the valuation is **minus £15.38 million**. The addition of more VAT shelter income has

improved the value by £15 million, but it would have a long way to go before becoming positive. On that basis and with some fixed interest funding would show that the landlord would need to borrow a maximum of £82 million by the 15th year after transfer. The loan could be repaid by year 29. A borrowing facility of that level could require one or two banks to provide the funding.



6.93 The debt write off required would be the same as in T2 above at around £208 million plus early debt repayment premia.

T4 Valuation and Business Plan Model Outputs

6.94 T4 takes the assumptions that were modelled in T3 which were based at April 2015 and rolls them forwards by adding inflation to the financial year 2017/18 which is more likely the year in which a transfer would occur. The transfer model contains the main stock of 11,622 properties (11,722 as at July 2015 less an assumed 100 propertied sold under RTB in 2 years) and there is a HRA retention model of 538 held tenanted properties/replacement properties that are part of the land sale agreement (see section 7 below). The valuation of the stock needs to be measured in reality as close to the transfer date as possible, as once a deal is done with regard to the payment of any debt write off, then this will not be able to be changed. The calculation at this point is on the most reasonable and relevant assumptions available at this time, but would be honed as part of any transfer application. The business plan includes the existing stock only at this point as any development opportunities would need to be built in separately with additional private funding facilities as part of a business case if transfer is chosen as the option.

6.95 The valuation, or the amount a new landlord might be expected to pay, based on the Tenanted Market Value (TMV) at April 2017 for T4 is still a negative figure – the valuation is **minus £16.533 million**. The addition of rolled forward inflation, together with two years of a rent reduction, with a further two more post transfer has increased the negative value slightly. A new landlord would still not be prepared to pay anything for the stock on this basis. Appendix D(i) to D(iii) show the valuation cashflows, net present values and business plan cashflows that are based on the assumptions in this model.

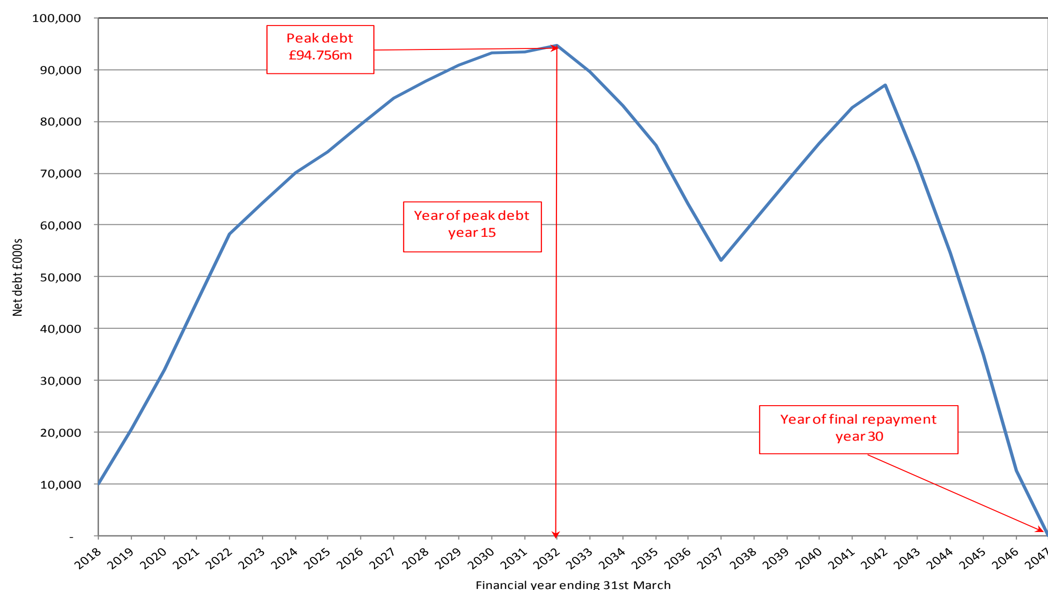
6.96 The valuation would vary if the assumptions are changed, but it would only improve if either income is increased (this is capped in reality by constraints on rent increases and service charges only able to recover the cost of the related services); or expenditure is reduced. The valuation assumes the lowest level of investment recommended, so any of the higher standards would push the valuation down further, unless savings could be made in management and maintenance to pay for a higher investment standard.

6.97 One variation that can be considered is the discount rate applied. It has been assumed that the cashflows are discounted at 6.5%, which is a value accepted by DCLG for transfer valuations. Reducing the discount rate to 6% would give a valuation of **minus £14.283 million**, so this change contributes very little to the negativity of the value.

6.98 The detailed funding assumptions are set out in section 4 above. On the basis of these assumptions, the business plan projects a debt profile which peaks at just under £95m 15 years following transfer and achieves full repayment by the end of year 30 as illustrated in the chart below. The expenditure required to maintain the stock to a reasonable standard could be achieved at the right time even with the reduced rent assumption.

6.99 This profile is considered to fall within the bounds of what is likely to be acceptable to lenders, although it would be preferable to do some further work to try to bring the year of peak debt in and smooth the profile if possible. At £95m the requirement is possibly within the reach of a number of lenders in their own right, and certainly for two banks working on a syndicated basis.

T4 Base business plan – debt profile



6.100 The debt write off required would be the same as in T2 above at around £208 million plus early debt repayment premia. Indications of the cost of debt premia at this time are £72.5 million on £192 million of debt redemption.

Sensitivities

6.101 The debt profile produced by the base business plan is driven by the assumptions built into the plan, and the profile will be affected by changes in actual conditions that differ from the assumptions made. Given the very long term covered by the business plan, and the unpredictable nature of many of the factors about which assumptions have to be made, it should be evident that many differences and changes are likely to occur, all which will have potential implications for the organisation's ability to service and repay the debt that it will need to raise to deliver its business plan and the promises made to tenants.

6.102 The approach taken in constructing the business plan is to seek to ensure that the assumptions made are robust enough to ensure that the organisation will have a reasonable chance of being able to work within them. There can, however, be no guarantees of this being the case, and it is important for the board of the new landlord to establish a sound understanding of the business plan and the key factors affecting this, identify the key areas of risk to which it is exposed, and in due course formulate systems for monitoring such risks, and strategies for mediating any adverse changes that do occur.

6.103 A key tool in establishing such understanding, and identifying and quantifying the risks to which the business is exposed, is sensitivity and stress testing. This entails flexing the assumptions built into the plan so as to identify the potential impact of changes on the organisation's debt requirement. To some extent the sensitivities run at this stage reflect an artificial position, in that they assume that the changes in assumptions run throughout the life of the plan, and that no mitigating action is taken. In practice changes in economic and operating conditions are more likely to be cyclical in nature, and of course the organisation would seek to take action to offset adverse changes as and when these arise. As the model is developed and progress is made toward transfer, further more sophisticated testing will be undertaken, including stress testing based on 'multivariate' analysis identifying the potential impact of changes in a number of different factors, this now being a standard requirement of the HCA as the regulator for social housing providers.

6.104 The sensitivities run at this early stage, are however useful in highlighting the key vulnerabilities of the plan. Appendix E provides a table showing the results of a series of standard sensitivities run by Capita on the business plan model. The results of the testing show that the model is reasonably robust under many of the scenarios run, but that the debt requirement does becomes unviable in some scenarios, i.e. the level of debt continues to escalate throughout the plan, and it is never possible to repay debt. Similar patterns are shown by all new transfer plans.

6.105 As might be expected, the most damaging sensitivities are those where the relationship between income and expenditure is disturbed either by income falling below, or expenditure increasing above, expected levels. This can result from:

- Future rent increases being lower than expected (as would be the case if rent policy is not allowed to revert to CPI+1% following the Budget reduction period)
- A widening gap between CPI and RPI in a position where costs are driven by RPI and rents by CPI
- Management and repair and maintenance costs being either higher than expected and/or suffering higher rates of increases than rents

6.106 The sensitivities do, however, also indicate the potential scope that the organisation will have for managing its position if necessary, by seeking efficiencies and economies in its management and maintenance costs. The organisation would need to monitor its costs and income on an ongoing basis and exercise control over these, so as to ensure that it can operate within the limits of the loan facilities put into place.

7 Headline Option – LSVT – Retained stock business plan

7.1 As discussed in section 3.1 above, if the Council decides to transfer the housing stock to a new landlord, it will not be able to immediately transfer the properties within the West Kensington & Gibbs Green estates that are part of the re-development scheme with Capco. As the there are more than 50 properties, the Council will be required to keep open its HRA account and collect rents and manage and maintain the properties.

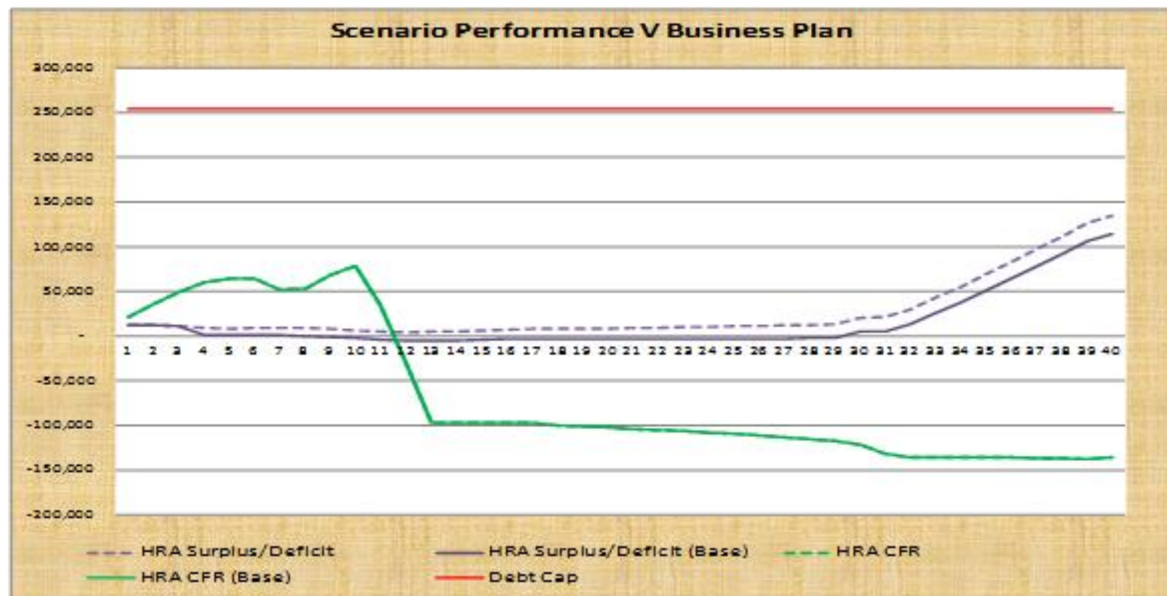
7.2 A HRA business plan model which contains only these properties with their respective rental income (by specific address no pro-rata to the main stock); the associated investment and maintenance expenditure (as determined by separate stock condition surveys of the properties concerned) and an assumption of management for a reduced HRA has been prepared.

7.3 The Council will be required to retain housing debt which is attributable to these properties and manage that debt within its retained HRA. The debt can be calculated on the basis of the individual archetypes of the properties using a DCLG worksheet and this method is accepted as a reasonable estimate of the attributable debt. The debt calculated on this basis is £11.8 million. The HRA business plan produced for the retained stock assumes that this amount of debt is retained and that the associated loans are a pro-rata of the portfolio of loans that the Council has at present.

7.4 Any retained HRA must be viable and as well as managing the debt and delivering the required standard of investment, it must also maintain a positive HRA revenue balance, as it is illegal to have negative HRA reserves. The Council will be able to retain the HRA working balances at transfer to support the plan, as the HRA cannot be closed and has assumed that a sufficient level of Major Repairs Reserves could be retained to keep a positive HRA working balance.

7.5 The debt cap remains at £254.617 million despite the transfer. However, it would not be possible for the Council to borrow up to that limit in future as it could not afford the interest repayments without income to support the borrowing. If it has transferred all of its land other than these estates then it does not have anywhere to build new properties either.

7.6 The business plan outputs show:



7.7 The retained HRA model can be seen to be managed with a positive HRA revenue balance (the blue line) to deliver the west Kensington and Gibbs Green scheme and generate capital receipts post year 10. It can be seen by the green line that the scheme requires a high level of borrowing up to year 10 (£79million) but then cash receipts are generated after year 12. This is shown by the green line falling below zero which would appear to be "negative borrowing". What this means in reality is that capital receipts are being generated, however, capital receipts for the Council can only be used to fund capital spending and not revenue spending. Here the Council is generating capital in future (in the event of a transfer) that it cannot use as it properties do not require any additional investment and it has no room on the land available in the HRA to build.

7.8 This partial HRA business plan is actually a part of the full HRA business plan, but we are able to see the effects of the individual cashflows for these properties in isolation. When incorporated in the full HRA retention business plan, the high level of borrowing over the first 10 years required for the West Kensington & Gibbs Green scheme (and in order to generate future capital receipts) is contributing to the Council's need to borrow up to its debt cap. So within the overall HRA without transfer, this scheme could be affecting the Council's ability to deliver Decent Homes Standard for all of its properties.

7.9 If a stock transfer for the main stock can be made to work and also the retained West Kensington & Gibbs Green HRA can be viable then by separating the stock, both Decent Homes for the main stock and the redevelopment can be achieved without impacting upon each other.

7.10 The generation of capital receipts from the scheme post year 10 may be able to be utilised in some way to support the transfer and debt write-off. This would need to be explored further, but there may be options for the Council to:

- Retain more than the calculated attributable debt for the 538 properties if the debt can be repaid later from capital receipts;
- Release capital receipts at a later date to the transfer organisation to support new build;
- Release capital receipts to other organisations to provide new homes.

8 Benefits of Transfer

8.1 In the sections above, it has been seen that to achieve a stock transfer, the Council will need to provide a business case that shows that the Government could benefit from writing off the debt for the Council. This was a new requirement introduced post self-financing. The three recent transfers in 2015, were required to under take a cost/ benefit analysis to identify benefits from transfer that DCLG economists could place a value on over time.

8.2 Typical benefits that were accepted were:

Benefit of Transfer	Saving Generated to Government
Irrecoverable VAT on costs to housing association	Any VAT not reclaimable by an HA is additional revenue to Government over time
Avoidance of long term empty homes (esp blocks of properties)	Tenants are placed in private rented homes if Council cannot maintain social homes – Local Housing Allowance (LHA) for a private rented home> Housing Benefit (HB) for a social rented home. Government save the difference between the two if voids are avoided
New build homes	Moving tenants from private rent to social rent saves Government value of LHA-HB. Government saves from new homes. Benefit calculated based on weekly rent values
Additional jobs / avoid lost jobs	Increased tax revenue / reduced benefits costs / economic impact on local area
Additional apprenticeships	Increased tax revenue / reduced benefits / social welfare increased
Energy efficiency / structural & thermal works (non-traditional build)	More cash in tenants' pockets - positive mental health effect / reduced health costs
Newly arising non-decent homes being able to be brought to decent standard	Avoids private letting costs
Additional investment in the stock / area	More sustainable homes / better neighbourhoods / lower ASB costs
Regeneration of areas	Attraction of investment to areas generates economic benefits from employment and private investment in

	community initiatives / schools
Council includes land in transfer that could be deemed to attract additional private funding for new build	New build benefits as above

8.3 These benefits have not however so far ever had to cover debt write-off relating to an assumed cut in rents. The level of debt write-off relating to the rent cut is estimated to be £110 million (the amount assumed to reduce the valuation to nil rather than minus £16.533 million), with the additional £98 million (excluding debt premia) relating to costs of works that need to be done in the early years rather than on an average basis and irrecoverable VAT. The rent effect will require a conversation with GLA / DCLG as to how the difference in the valuation can be addressed because of this new assumption, separately from benefits to address any other differences.

Other areas to consider to bridge the gap

8.4 The amount of debt-write off is assumed to be around £208 million plus debt premia. To reduce this sum there are several areas that could be considered and have been discussed in detail above:

- Increase the valuation – either by reducing expenditure assumed, or by increasing income
  It should be noted that income arises mainly from rents which are controlled by Govt legislation and also that the valuation is minus £16.533 so before the £208 million is reduced, the valuation would need to become positive.
- Assume that the retained HRA can keep more debt than the £11.8 million attributable to the retained stock and still maintain a positive HRA.
- Look to include land in the transfer agreement that GLA/ DCLG agree is a contribution to the valuation.
- Seek to utilise capital receipts post year 12 from the retained HRA to deliver development potential either to the new landlord or other housing associations in the area to deliver wider economic benefits.
- Identify the support of the negative value of £16.533 million as being private investment in the stock.

These areas would need to be explored further if the option of transfer is chosen to be pursued.

9 Funding for Stock Transfers

9.1 Large scale voluntary stock transfers have primarily been funded by banks, although a small number of financial institutions have shown interest in providing, and have submitted bids for, funding for the most recent batch of transfers. A number of banks are likely to have a strong appetite for lending to a new stock transfer which is able to present a viable and appropriately robust business plan, although their individual appetites are likely to be limited to around say £90 million. Larger requirements will require the participation of a number of banks, which will reduce the potential competition for funding, but on the basis of banks' expected appetites could probably support a total funding requirement of between £200 million and £300 million.

9.2 Loans from the banks are likely to have a maximum maturity of 10 years, which will require the transfer association and its regulator to be prepared to accept an element of refinancing risk. The quantum of funding that could be supported and the competition to provide funding could be increased if institutional investors can be successfully attracted, and certainly in last transfer round two institutional investors bid for participations in transfers alongside bank funding partners, and another submitted a bid as sole funder. The involvement of institutional investors would also extend the maturity period of the available funding, such investors generally seeking longer term investments to match their liabilities. Institutional investors tend to favour index linked loans, and the availability of index linked income streams, such as rents, is attractive to them. However, their appetite for funding will need to be tested in the light of the announcement of rent reductions in the recent Summer Budget.

Procuring funding

9.3 The key to procuring funding on the best possible terms will be the generation of the strongest possible competition between potential lenders. The first step in ensuring such competition will be to ensure that the transfer presents an attractive investment opportunity for potential lenders and investors. This will be achieved through the construction of a sound, financially viable and robust business plan incorporating credible assumptions about future cost increases and funding costs and demonstrating a funding requirement which falls within the parameters acceptable to lenders. This will include a peak debt requirement and year within acceptable bounds, the ability to achieve full repayment within 30 years, and to meet appropriate financial covenants.

9.4 The business plan and funding model will form the core of a funding prospectus which funding advisers will prepare for agreement by Hammersmith & Fulham and distribution to potential lenders. The prospectus will provide potential lenders with all of the details that they require to consider lending to Hammersmith & Fulham and will present the

organisation in the best possible light. The prospectus will set out clearly Hammersmith & Fulham's expectations of its lending partners and also a timetable for the submission of proposals and completion of the funding exercise.

9.5 The prospectus will be distributed to all potential lenders and investors known to have a genuine and active interest in providing funding for stock transfer. Recipients of the prospectus will be invited to visit Hammersmith & Fulham to meet members of the senior executive team and possibly board members, and to view a selected sample of the transferring stock. They will also be encouraged to ask any additional questions and request any additional information that they may require and is not covered by the prospectus.

9.6 Lenders will be invited to submit written bids in accordance with the identified timetable. Written bids will be fully analysed and assessed so as to identify their respective costs and benefits, and a presentation of the analysis made to Board members. Depending upon the number of bids received, either all lenders or a selected shortlist will be invited to attend interview by either the Board or an appropriately constituted funding panel. At the interviews lenders will be given the opportunity to expand on their proposals and answer any questions that members have in relation to them, and to make any improvements that they may be able to make. Following the interviews, a preferred lender will be selected, and detailed Heads of Terms negotiated for agreement and signature by Hammersmith & Fulham. The Heads of Terms will form the basis for the formulation and negotiation of detailed loan agreements, which will be completed in time for funds to be drawn upon the day set for transfer.

Treasury management

9.7 Funding costs are likely to represent one of the largest single elements of expenditure within Hammersmith & Fulham's business plan.

9.8 In the absence of any action by Hammersmith & Fulham, loans from the banks will run on a variable rate basis, linked to LIBOR. LIBOR is set for short term periods, typically of either 3, 6 or 12 months, and the rate payable by Hammersmith & Fulham under such loans would therefore be subject to change on a continual basis. Because the level of LIBOR in future years is uncertain, lenders will require that reasonably conservative assumptions are made about the level of LIBOR in future years. This in turn will impact upon the debt repayment profile generated by the business plan, pushing peak debt up and the date of final repayment out. Hammersmith & Fulham will, however, have the option to lock into fixed rates of interest on the whole, or just part of their loans. Such loans convey certainty of cost at rates inside the assumptions that are likely to be

acceptable to lenders on variable rate loans, and therefore improve the projected debt profile.

9.9 Care needs to be exercised in relation to fixing interest rates as typically these are, over the longer term, more expensive than floating rates loans (notwithstanding that the opposite has to be assumed as a matter of risk management). Additionally long term fixed rates can result in a severe loss of flexibility, with the break costs attaching to them often proving a very substantial barrier to any future refinancing should this become desirable. We would advise that Hammersmith & Fulham adopts a balanced and well reasoned treasury management policy, with a mix of fixed, floating and possibly index linked loans in the light of the respective costs of these, the impact upon the debt profile and the risk parameters demonstrated by the business plan.

9.10 Fixings with bank lenders are likely to have to be limited in term to the maturity of the loan facilities, i.e. 10 years, but mechanisms are available to enable borrowers to take advantage of longer term fixed rates through the use of standalone swaps. Hammersmith & Fulham would, however, need to be fully briefed upon the use of such instruments, and the risks and benefits attaching to these.

9.11 Funding from financial institutions will naturally take the form of either fixed rate or index linked funding and if these can be secured at competitive rates, these could make a valuable contribution to the business plan, but will clearly impact upon the range of treasury management options that would be available to Hammersmith & Fulham.

10 Summary

10.1 In summary, the retention solution comprising of an HRA for all stock will mean that some properties may not receive the investment they require at the right time, which will lead to further repairs costs and/or increased void properties. It is the high level of borrowing in the early years to support the West Kensington and Gibbs Green scheme combined with the immediate rent reduction and structural works to tower blocks which is causing the Council to hit its debt cap. However, if the main stock and the West Kensington and Gibbs Green stock are separated by means of a transfer, then it would appear that both the main stock investment and the West Kensington and Gibbs Green estates could be achieved at the right time without either scheme's investment requirements impacting upon the other.