

THE ROYAL BOROUGH OF KENSINGTON AND CHELSEA**CABINET – 16 NOVEMBER 2009****REPORT BY THE CHIEF HOUSING OFFICER****HOUSING STOCK OPTIONS REVIEW
PHASE 2: FINAL REPORT AND RECOMMENDATIONS**

This report proposes the work to be undertaken in the Implementation Phase of the Stock Options Review, based on the findings drawn from the Phase Two analysis, and seeks approval to proceed.

FOR APPROVAL**1. INTRODUCTION**

- 1.1 The Cabinet is requested to note the findings drawn at Phase Two of the Stock Options Review, following receipt of the final draft of a report from the Council's consultants, Tribal, and of the completed feasibility studies for regeneration in the Latimer and Edenham areas.

2. BACKGROUND

- 2.1 A review of the Royal Borough's Stock Options was originally commissioned in October 2007, although substantive work did not commence until February 2008. A formal governance structure has been in place throughout the review. A Cabinet Working Party was established as the forum for overall monitoring and approval of the work undertaken. The Cabinet Working Party has met ten times to date, including one meeting which was designated as a half-day analysis session, to ensure that detailed technical information was allocated sufficient time for effective review. Beneath the Cabinet Working Party, a Project Board, chaired by the Chief Executive, and a Housing Working Party, chaired by the Executive Director for Planning and Borough Development, have both met regularly, to ensure continuous progress, operational steer and delivery of project requirements.
- 2.2 The original consultant's brief for the Stock Options Review outlined two phases of work, the first of which completed in November 2008. Phase Two now reports on the results of the

detailed analysis and testing of those options which appeared to offer the Royal Borough the greatest potential as a workable solution to the housing funding shortfall. Phase Two work presents the Council with a detailed assessment of the financial, legal and practical viability of these following options:

- **Staying within the Housing Revenue Account (HRA) subsidy system:** a review of the options available to address the funding deficits, with a focus on redevelopment of our estates, and whether existing housing assets could be used to generate additional income.
- **Obtaining financial freedoms:** influencing the outcome of the Government's HRA review and opting out of the HRA subsidy system to become self-financing.
- **Stock transfer:** transferring our housing stock to another social landlord - a housing association or the TMO in reconstituted form.

2.3 The work on Stock Options was commissioned in response to the scale of the financial problem faced by both the HRA and the TMO capital programme, which was deemed a serious threat to the provision of quality housing services and a decent housing stock. Moreover it is unlawful to budget for an HRA deficit. The work in Phase One focused on quantifying and verifying this perception of a looming 'financial crisis', with the following conclusions drawn:

- That the HRA will go into deficit at worst case in 2011/12.

This scenario is modelled on withdrawal of the current transitional protection applied to management and maintenance allowances, in favour of a one-off adjustment to target level. There would also be an adjustment to the ALMO allowance in 2010/11. Thereafter the HRA balances would get progressively worse, mainly as a result of allowances not keeping up with projected increases in budgets.

- In Phase Two a review of projections based on updated budget information was that the worst case scenario position was in fact a deficit by 2013/14.

This change is primarily due to an increase in balances brought about by savings, and by Community and Local Government (CLG) subsidy adjustments in respect of caps and limits. Tribal's further analysis showed that the Royal Borough is amongst the ten authorities most negatively impacted upon by the change in funding of management and maintenance allowances, suffering a greater financial loss. The difference between the current and target management allowance is 136.62%, and 101.80% for the

maintenance allowance. This confirms that it is vital that the Council continues to actively plan for a solution.

- In terms of capital projections, the work undertaken at Phase One modelled an investment gap of approximately £50 million over the first five years and £170 million over 30 years (these figures exclude structural costs of Trellick, currently estimated to be around £23 million).

The capital funding gap is imminent, as the reduction in the Major Repairs Allowance (MRA), the depletion of ALMO funding, and of Supported Capital Expenditure (SCE) has caused a dramatic decline in the budget from over £17 million in 2007/08, to £11.8 million in 2009/10, to an expected £6.6 million in 2010/11. Phase Two has confirmed that the projected capital shortfall is unlikely to change and may worsen if actual cost inflation exceeds the Retail Price Index allowed for.

3. TRIBAL'S CONCLUSIONS

- 3.1 As outlined above, the Council is expected to have a deficit (which is unlawful) on the HRA by 2013/14 which is projected to get progressively worse. Analysis indicated that there would also be a capital funding gap of around £50m in the next five years and £170m over 30 years, based on the investment analysis work carried out by Ridge. Tribal have reviewed the options available to show how they address these issues.
- 3.2 **Staying within the HRA subsidy system** - The following conclusions were reached for this option of managing the capital and revenue funding deficits within the current system (including further exploration of the feasibility of **regeneration** of our estates):
- Whilst the HRA has healthy balances at present these are forecast to decline in future to a revenue deficit position by 2013/14, and the deficit will continue to get progressively worse.
 - A structural change to annual budgeting can provide the solution to this: income generation and/or financial control. This would necessarily need to be found in the form of cost reductions and/or rent increases to balance the HRA year on year.
 - There is a deficit of around £50m in capital funding compared with the investment needs identified by Ridge over the next 5 years. Limited funds from redevelopment or sales may address this but there is little or no other access to public funds for this at present outside the Major Repairs Allowance (MRA).

- To resolve the capital funding problem, it is essential that the TMO, in conjunction with the Council, agrees priorities for its capital spending plans and / or generates additional income from other sources (e.g. service charges) to pay the prudential borrowing costs on unfunded high priority items, such as lift replacements.
- Redevelopment schemes may help to generate additional revenue income and / or capital receipts in the medium to long term but will not produce a short term solution. Redevelopment could also assist, again in the medium to longer term, to resolve capital and revenue liabilities if it removes significant repair and investment costs.
- If the current HRA system remains in place for the foreseeable future, a combination of the above solutions would form an appropriate strategy to explore in the next phase, in conjunction with the TMO.

3.3 **The Government's HRA Review / Self Funding** – the following conclusions were reached for this option:

- The announcement on 30 June 2009 by the Housing Minister that he wishes to dismantle the existing HRA system follows the work carried out by Tribal and others as part of the HRA Review.
- The aim of Government proposals is to give more control to local authorities through a one off adjustment to all authorities' debt. This would no longer require a revenue subsidy system. Authorities would in future have full control of their rents and sales receipts. A consultation document has been published, with a closing date of 27 October 2009.
- Restructuring the debt will almost certainly mean the CLG paying off some of the Royal Borough's debt – but the key issue will be how much. Initial modelling carried out since our last report in November suggested that this might be around £43m. This would put the authority in a stronger position than currently, but would not be sufficient to meet all its future investment and operational needs. The CLG has indicated that there may be capital grants in future to support some investment (such as environmental improvements).
- Given the radical nature of these proposals primary legislation and extensive consultation is required to support the deal eventually put forward. This is therefore likely to take some considerable time, into which the next general election will cut. 2012/13 may be the earliest these proposals can be introduced.
- It appears from the Statement that the CLG is not proposing to allow individual authorities to opt out (using S313 of the Housing & Regeneration Act 2008). This might otherwise have been aimed

perhaps at individual high performing authorities. The CLG is instead focussing on an 'all or nothing approach'.

3.4 **Stock transfer** - The following conclusions were reached for this option:

- Revisiting the stock transfer valuation prepared last November has confirmed that a stock valuation based on traditional stock transfer principles would be around £5m. This would enable the new landlord to carry out the full investment programme identified by Ridge and provide sufficient resources to meet operational needs.
- Under these arrangements the Council's outstanding supported housing debt (£192m) would be written off by the CLG along with any debt penalties (about £50m). There would be an interest saving to the General Fund of around £1m, and scope to secure additional receipts from future sales and any VAT Sharing Agreement. Some or all of this would be needed to offset any residual corporate costs following the closure of the HRA.
- The Minister's Statement of 30 June 2009 indicated that the Government would continue to work with councils with successful transfer ballots or with transfer proposals in development. However new transfer proposals would not gain financial support beyond that provided under self-financing, and deals will be based on delivering the same standards of service at a comparable cost.
- The current financial regime is likely to change considerably if the Government follows through with the recent Statement issued by the Minister. The new proposals do appear to benefit the Royal Borough. However based on our analysis of the Government's last set of models it appears that the deal available will be insufficient to meet all the Council's operational and investment needs. Furthermore the stock transfer option is less attractive, with financial support now mirroring that on self funding.

4. **NEXT STEPS**

4.1 Based on the work done to date, and the next phase of work that is required to implement a solution, these are the suggested next steps:

- Tribal's work has been presented to the Cabinet Working Group for Housing Stock Options with this officer's report, for approval of the preferred option, and is now presented for that decision to be finalised at full Cabinet.
- The TMO Board received a report on 3 September 2009 outlining the conclusions of the Tribal study and Council officers' recommendations. The Board has offered its full support in implementing the Council's next planned steps.

- The recommendations made in section 5 (below) were presented for approval by the Members of the Cabinet Working Group, and are now presented for decision at full Cabinet.
- If endorsed, the overall findings should be formally communicated to residents after the proposed option is endorsed by Cabinet (estate feasibility study communication is addressed separately below – section 5). However, in advance of this meeting, an update of our work and findings thus far was shared through the consultation structure established with our Independent Tenant and Leaseholder Advisor, TACT@DOME, at an Insight Group meeting on 7 September 2009, accessible to all residents, and with Lead Party Councillors in attendance.

5. OVERALL PHASE 2 RECOMMENDATIONS

- 5.1 Based on the completed analysis, findings drawn at both phases of the Stock Options Review, and bearing in mind the results of the public consultation held to date, it is recommended that Executive Members approve the following work streams for the Implementation Phase of Stock Options: focusing on generating sufficient capital and revenue funding to maintain the Council's housing stock, whilst remaining within the HRA subsidy system.
- 5.1.2 **First**, it is recommended that no additional work is done on the stock transfer option at this stage. This option has been explored in detail, and although there are clear financial benefits to be gained by pursuing a full stock transfer, it is nevertheless perceived to be, at this stage, an option which also presents a number of disadvantages. The primary drawback is that a transfer would be an irreversible decision, representing a loss of future value of our assets and an associated loss of opportunity and future benefit for our residents. In addition, feedback received so far from consultation with residents indicates that a transfer would not be supported at ballot. The cost of a failed ballot would add to the pressures already on the HRA, which would appear indefensible at this stage, particularly where other options are still available. Furthermore, as Tribal conclude, the financial benefits provided by the CLG in the event of stock transfer are unlikely to remain as generous as they have historically been.
- 5.1.3 **Second**, the Royal Borough should continue to seek to influence the CLG in respect of securing financial freedoms on acceptable terms for the Council. Initial discussions with the CLG were useful and it is proposed by the CLG that a follow up meeting is held in the Autumn to further explore potential opportunities for self financing. It is worth the Royal Borough continuing to try to exert influence over the process of change, even though this does not

offer a guarantee that beneficial terms will ensue or within the requisite timeframes. To this end, Tribal's work has been framed in such a way as to enable us to bid to the CLG for financial freedoms under the existing legislation.

- 5.1.4 **Third**, a regeneration project team will be established to take forward the work in respect of development and regeneration at Freston Road and Edenham Way. The team will be multi-disciplinary and necessarily include Housing, the TMO, and Property Services; for the time being, it should remain within the current governance structure. A Project Initiation Document has been drafted on which the team can base its work.
- 5.1.5 Overall, the Latimer feasibility study has demonstrated that there is merit, clear benefit and opportunity for residents and the Borough overall in pursuing some regeneration. The consultants for Latimer looked at various options for redevelopment and regeneration. However for the time being it is most realistic to focus on the provision of new affordable housing at Freston Road, with possibilities to extend the already approved scheme to a more comprehensive approach. The Edenham Way feasibility study has demonstrated that it would be possible to build a significant number of new affordable housing units on the former Edenham residential home site, and possibly some infill development in neighbouring Edenham Way. Further work is recommended for the proposed Implementation Phase, to explore this in more detail.
- 5.1.6 The regeneration project team will start to detail how the Council can take forward these opportunities, realise the development ambitions of the Council, achieve defined benefits, and limit identified risks. A formal project planning methodology should be adopted. Within this, further work should be undertaken to identify some clear actions for limiting untenable capital liabilities – for example, a review of funding opportunities for Trellick Tower (which requires a projected estimate of just under £42 million of capital investment, as based on the Ridge analysis and separately costed structural works, over 30 years). As above, appropriate vehicles will be investigated to ensure that financial, legal, reputational and strategic risk is identified and limited.

- 5.1.7 The results of the remaining two feasibility studies will be communicated to residents at the earliest possible opportunity, in the same manner as has been previously adopted for earlier meetings and events. More critically, the team will put in place a robust structure of resident engagement. This must be addressed as a priority by the newly formed project team and covered with the project brief and work plan.
- 5.1.8 In addition to the points 5.1.4 to 5.1.7, the proposed regeneration project team must carry out full investigation of delivery vehicles for regeneration, development, disposal, and investment schemes and make reasoned proposals to take forward any scheme. Further work on regeneration and development must be planned for in detail so that timeframes, cost, contracts of work, building options, policies required to underpin arrangements (potentially including decant and Compulsory Purchase Orders) and structures for stakeholder participation are identified and fully understood, to ensure for successful delivery of required objectives. Again, all such specifics will be detailed for Members' review and approval through the appropriate governance structure.
- 5.1.9 **Fourth**, it is recommended that a finance project team should be established, including senior responsible officers from the Council and the TMO, to identify and implement financial measures to ensure that the HRA maintains a long term financial security through systematic and sustainable savings and / or income generation. Given the immediacy and scale of the forecast deficit, and the delivery limitations of options explored, the most viable and effective response has to include a target for revenue savings and a target for increasing income to the HRA. However it is recommended that before a clear target is set, the next phase must outline the impact of various target scenarios. For example, this will include modelling an increase in council rents above those prescribed as part of the rent restructuring regime, and the impact this would have on Council tenants who are in work and on a low or fixed income. In addition, a more detailed analysis will be undertaken to ensure that the potential for cost-savings is better identified and the associated impact of the various options for cost cutting is understood before a formal view is taken.
- 5.1.10 Separately, but included within the above work stream (5.1.9), the Council and the TMO should work in partnership to align their strategic objectives and priorities for asset management and capital planning. This work should include a detailed review of the stock condition review completed by Ridge, to validate results and reconcile investment needs with agreed strategic priorities. As previously recommended, further stock condition surveys should be commissioned if deemed necessary to draw robust conclusions

on investment profiles of our stock. The timeframes for delivery must align with the forecasts of the financial deficits.

5.1.11 **Finally**, it is recommended that a detailed Consultation and Communication Plan is developed for the next phase of Stock Options; this will include a distinct strategy (developed by the newly formed team, as per Recommendation 5.1.7) for any estates and property that will be involved in further work focused on progressing development schemes. In respect of communicating the decision, in addition to an information pamphlet to explain our decision-making, it is expected that the Council will arrange a number of public events to explain the decision to residents. After this, and according to the specific nature of the preferred option, it is likely that a new framework for engagement will be recommended. Members are requested to continue to take an active part in key public communication events, particularly to report back the overall decision to residents, and in the feedback to the estates involved in the feasibility study reviews.

5.2 Officers will determine the expert support and internal resources required to deliver the Implementation Phase of Stock Options. Work that necessitates external professional expertise will be identified, costed according to an agreed specification, and tendered where appropriate. Where required, contracts will be recommended for cessation and new work to be commissioned will be advised for tender. Both the main recommended further work streams, work on development and maintaining a secure, long term financial future within the HRA, will be presented for approval within the 'imps and opps' process.

6. LEGAL IMPLICATIONS

6.1 There are no known legal implications at this stage.

7. FINANCIAL IMPLICATIONS

7.1 There will be cost implications to pursuing any further stage for Stock Options. This will be further quantified and forecasted as part of the implementation phase's project planning and an appropriate bid for funding (internal and/or external where applicable) will be made where necessary. At this point, the broad outline costs and where the spend will need to be charged is shown below; please note at this stage these costs are a guide only:

- Stock transfer: £2 million (General Fund and HRA)
- Financial freedoms: £0.4 million (HRA)
- Redevelopment initiation (amalgamated): £1 - £3 million, depending on scope (HRA and GF)
- General Communications: £0.5 million (HRA)

7.2 It may be possible to capitalise some costs, although the accounting rules have been tightened up on this. Whichever option is taken forward, detailed estimates will be worked up and bids for funding will be made where necessary.

8. PERSONNEL IMPLICATIONS

8.1 There are no known personnel implications at this stage.

9. EQUALITIES IMPLICATIONS

9.1 There are no known equalities implications at this stage.

10. RECOMMENDATIONS

- (i) That no additional work is done on the stock option transfer at this stage;
- (ii) that the Royal Borough should continue to seek to influence the CLG in respect of securing financial freedoms on acceptable terms for the Council;
- (iii) that a regeneration project team be established to take forward the work in respect of development and regeneration at Freston Road and Edenham Way;
- (iv) that a finance project team be established, including senior responsible officers from the Council and the TMO, to identify and implement financial measures to ensure that the HRA maintains a long term financial security through systematic and sustainable savings and/or income generation.

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Background papers: Phase One Reports – CWG - 5 November 2008.

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