ALMOs – a new future for council housing

National Federation of ALMOs

Chartered Institute of Housing

HOUSEMARK

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Since 2001, a massive change has been taking place in council housing. In many parts of the country, arms length management organisations (ALMOs) have been set up to take over the running of the housing service. Some 49 ALMOs have so far been established, managing 740,000 homes. Soon they will cover half the remaining council housing stock in England.

ALMOs are already delivering better services for tenants. Most have achieved a two-star or three-star rating from the Audit Commission. Performance in services for tenants, such as lettings and repairs, has significantly improved. Tenant satisfaction levels are running much higher than for council housing generally. And ALMOs are on target to deliver the government's Decent Homes Standard.

Despite this success, ALMOs are not necessarily here to stay. They have temporary contracts with local councils, aimed at completing the decent homes programme, and could then be wound up. But many councils, tenants, and ALMOs themselves would prefer the new bodies to have a long-term future in reshaping the way council housing is run. To achieve that, the local authority housing revenue accounts need to be put on a sounder basis financially. ALMOs need to become more flexible and sustainable organisations, able to address the varied needs of the places and tenants they serve, and help contribute to wider local authority priorities.

Why new research?

This paper is about the ways in which this might be done. It is a summary of more extensive research carried out by the National Federation of ALMOs, the Chartered Institute of Housing and HouseMark, who have a shared objective of helping ALMOs to build a sustainable future and have been working jointly to help bring this about. Six ALMOs, ranging in size from under 4,000 to over 20,000 units, have acted as case studies.

None of the options put forward here is seen as 'the answer' to the future of ALMOs. More detailed work will be required, but in any case we would prefer the outcome to be a 'menu' of different options available to local authorities, some of which might be immediately attractive and others at a later stage, with councils in different places choosing different futures for their ALMOs.

What are we aiming for?

The proposals are aimed at ensuring long-term financial viability for ALMOs and providing stability and security for councils. They will allow ALMOs to continue to be effective organisations that will help achieve central and local government priorities. They will promote greater tenant involvement and control. The proposals do not require primary legislation and could be put in place before the decent homes target is met. This would allow ALMOs to carry out wider regeneration of their areas, delivering decent and sustainable neighbourhoods, as well as decent homes.

ALMOs are already doing some of these things. Derby Homes is planning to commission new housing, linked to a local housing association. Kensington & Chelsea TMO is tackling anti-social behaviour by running a mentoring service for youngsters. Leeds West Homes, like other ALMOs, is considering demolishing and replacing unpopular houses instead of bringing them up to the Decent Homes Standard. First Choice Homes in Oldham hopes to be part of a consortium delivering Housing Market Renewal Pathfinder programmes.

But the ALMOs are the first to recognise that this activity is much more limited than it should be (box 1). They need to be able to raise more resources, have more certainty about their resources and gain more flexibility in how they use them. Then they can contribute much more to the wider regeneration of their areas.

Box 1: Limitations on ALMOs that need to be addressed

- restrictions on the range of services they can manage for the local authority
- losing properties through the right to buy and having no means of replacing them
- not being able to undertake cost-effective asset management
- very limited powers and finance to respond to the on-going needs of community sustainability
- unable to meet tenants' higher expectations of service from their landlord as properties are improved

The starting point

All the options considered in the research depend on breaking the link between the local finance system for council housing (the housing revenue account, or HRA) and the national system (the HRA subsidy system). At first this may not seem an obvious step for councils with an ALMO to take. But although HRA subsidy is worth around £1 billion each year, much of this money is recycled between councils. This makes the system complicated and – over anything more than a year or two – unpredictable. It also means that councils and ALMOs find it difficult to create new sources of income without losing it to the national 'pot'. Breaking the link to the subsidy system is a key step in making their finances more dependable.

ALMO finances would need to be self-sufficient – based on rental income. How could this be done? The main reason for still having subsidy is to deal with the costs of old debt. All the options we have looked at are based on the principle of 'remodelling' each council's HRA, so that the housing service no longer needs outside subsidy and can 'come out of' the subsidy system. The government would need to take over enough of the old debt so that the remainder can be financed from rents. The remodelling would also have to take account of future investment needs, to give councils and ALMOs sufficient scope to finance the wider regeneration they need to carry out.

Although there are clear advantages to 'breaking the link', there is also a price to be paid. The costs to the government will vary according to the further options that ALMOs might pursue, and we deal with those later. The risks, alongside the benefits, are set out in box 2.

Box 2: Breaking the link between the council's HRA and the national HRA subsidy system

Benefits
- greater certainty
- greater control and more flexibility
- less dependency and greater performance incentive
- debt repaid over 30-year business plan

Risks
- no subsidy 'safety net'
- no protection against interest rate rises
- greater chance of 'business failure'
- possible adverse effect on authorities still in subsidy system

The four main options

Four main options have been developed, all of them taking the 'self-sufficient HRA' as their starting point.

If all four were developed and agreed by the government, there would be a 'menu' of options that councils could voluntarily opt into over time. The extent to which a council pursues any one of them would depend on local circumstances. Each council would need to have confidence in the ALMO's capacity to deliver local objectives and in its own ability to manage the arms length role effectively. Tenants would need to be convinced of the advantages of ALMOs taking on greater risks. Each option provides for a greater degree of independence for the ALMO – but without losing the council's shareholding, ownership of the housing or the vital role of tenants in the ALMO's governance.

The four main options are:

- **option 1a: Self-sufficient HRA controlled by local authority** with sufficient investment to maintain the housing at the Decent Homes Standard in the future
- **option 1b: Self-sufficient HRA controlled by local authority**, as above, but also with sufficient investment to deliver long-term sustainability, including environmental and community works
- **option 2: Self-sufficient HRA managed by ALMO** with the HRA debt becoming ALMO debt, secured on the ALMO's income, but still within public sector borrowing controls. A longer contract period for the management agreement would be required. The local authority would be the regulator and exercise control through the management agreement
- **option 3: Self-sufficient HRA managed by an ALMO – no longer majority local authority owned.** The council could have a minority share. The ALMO could have a tenant majority. The local authority would manage the HRA through a long-term service contract with the ALMO. Borrowing would be private sector and off the balance sheet of the authority.

All four options could include receipts from future right to buy sales in the HRA remodelling calculation. Alternatively, they could be subject to a sharing agreement, as happens with stock transfer.

The financial framework in options 1a, 1b and 2 is similar to what happens with stock transfer, with the crucial difference that the council continues to own both the stock and the ALMO.

In option 3 the council owns the stock but does not fully own the ALMO. As with PFI (Private Finance Initiative) projects, borrowing would be outside public sector borrowing controls.

In all options the tenants remain council tenants and their statutory rights are unaffected. The choice of option must be a joint council-ALMO decision freely entered into on both sides, and supported by government.

We now look at the options and their consequences in more detail.

Options 1a and 1b: Self-sufficient HRA

In the first option, the local authority would keep control of the HRA. The housing service would be financially self-sufficient, and no longer part of the HRA subsidy system. Under **option 1a** it would have enough resources to achieve decent homes and maintain the houses to that standard in future, but not to carry out wider regeneration.

Going further, **option 1b** would ensure that the ALMO authority did have these extra resources, which would go a long way to ensuring community sustainability (and protect the investment in the housing stock). The extra resources would enable the ALMO to carry out:

- community safety measures and improved security
- remodelling of unpopular properties to improve marketability
- upgrading common parts of flats (e.g. lift renewal)
- a higher standard of home facilities (e.g. bathrooms)
- wider community regeneration measures appropriate to each locality.

Options 1a and 1b – how would they work?
ALMOs would have the same relationship with their councils as they do now. The HRA business plan would be re-worked following similar principles to those used in stock transfer (but, obviously, without the transfer). The local authority, working closely with the ALMO, tenants and leaseholders, would do this. It would require the government to restructure the local authority's housing debt (reducing it in most cases, but increasing it for some others), so that the debt could be serviced and repaid over the 30-year life of the business plan, together with new borrowing needed to finance the investment included in the business plan.

The new business plan would either be limited to keeping houses up to the Decent Homes Standard (option 1a), or would go further to embrace the wider regeneration activities in the bullet points above (option 1b).

The re-worked HRA business plan would then be used as the basis for a negotiation with government, for the local authority to 'come out of' the HRA subsidy system permanently. The most significant financial implication of this option is the replacement of HRA subsidy with an affordable level of HRA debt. The HRA would then keep all the income from tenants' rents, to pay for services, debt and the costs of new investment.

Under this option the regulatory regime for ALMOs would stay as it is now. The management agreement between the council and the ALMO sets out what will happen if the ALMO fails to meet its delivery plan, and this would still apply.

Options 1a and 1b – advantages

- the change would be a straightforward exercise for ODPM
- councils would have more control over their income and not suffer uncertainty about future subsidy arrangements
- under option 1b, councils would be able to invest in works such as the remodelling of estates
- councils would have more control of their investment decisions, allowing them to take a longer-term view
- they would also have greater certainty about their finances, helping the ALMO to plan more realistically and provide better services for tenants
- the options provide an incentive for ALMOs to continue to improve and create a more challenging operating environment.

Options 1a and 1b – disadvantages

- option 1a would have the disadvantage that ALMOs might still be investing in stock that would be better demolished and replaced
- councils would be limited in how much investment they could take on, by the government's borrowing rules – ALMOs would have no control over this
- the ALMO would still need the agreement of the council to any changes to the delivery plan, which can cause delays
- no housing subsidy payments would be available to protect against rising interest rates.

Option 2: Self-sufficient HRA managed by ALMO

In this option, the finances would be taken over by the ALMO and no longer run by the council. Taking over the HRA would require the ALMO and the council to have a longer-term management agreement than most now do. In effect, the relationship shifts so that the ALMO 'runs its own show' but through an agreement with the council and – as before – with an annual delivery plan. The council's main role is now to regulate a financially-independent ALMO.

In other respects, option 2 is very similar to option1b.

Option 2 – how would it work?
The HRA would be financially self-sufficient and outside the HRA subsidy system. The significant difference compared with options 1a and1b is that the HRA is 'arms length' from the local authority and managed by the ALMO.

This makes the ALMO responsible for all decision-making for the remodelled HRA, within a framework agreed with the local authority and set out in an HRA management agreement. An annual delivery plan would still be agreed each year.

The newly-restructured HRA debt could become ALMO borrowing, secured on the ALMO's income, rather than being direct council borrowing. This would put responsibility for the debt in the same hands as responsibility for managing the housing service.

There are two different ways of remodelling the HRA with the ALMO taking on the HRA debt. In option 2 the ALMO borrowing would still be classified as public sector borrowing. The council would retain control of the ALMO, as it does now, and it would be possible for the ALMO to borrow from the council. The council would still be the regulator of the ALMO, making sure that the ALMO's borrowing is within the council's borrowing rules.

Option 2 – advantages

- the ALMO gains greater independence, especially financial independence, and can more easily make decisions about spending priorities
- it has more incentive to improve efficiency, as it keeps any savings it generates and can reinvest them in service improvements
- running the housing service and running the finances for it are in the same hands
- the ALMO has control of its own 'overheads' – the costs of back-up services like legal advice and computer services
- the council's role as regulator is clearer, as it is no longer involved in day-to-day financial details
- managing the financial operation is likely to be more efficient, needing staff in one organisation (the ALMO) rather than both (although the council would still have a 'client side')
- the ALMO could bid for grant to build new homes (Social Housing Grant).

Option 2 – disadvantages

- the ALMO is operating the HRA itself but still has to follow the council's rules about borrowing
- any borrowing is still subject to public sector borrowing controls
- the ALMO takes on more risk itself, with no access to subsidy
- if it gets Social Housing Grant, it can't borrow privately for the rest of the cost of the development, like housing associations can
- the council loses what the ALMO gains – control of all HRA income – and it may be funding other services from this.

Option 3: Self-sufficient HRA, managed by ALMO – no longer majority local authority owned

Option 2 provides the ALMO with a good deal of financial independence, but it is still subject to overall public spending controls. Option 3 changes this by allowing the ALMO to borrow privately from banks and building societies, as housing associations do.

Option 3 – how would it work?
If the ALMO's borrowing is to be treated as private finance under present rules, the ALMO would have to show that it was not majority-owned or controlled by the public sector. There would be three tests (box 3).

Box 3: Three tests of whether borrowing by the ALMO is outside public sector controls

1. the day-to-day operations of the ALMO are not controlled by the council (or any other public body)
2. except for any safeguards in the management agreement, the council has no control over the ALMO
3. if anything goes wrong, it's not the responsibility of the council (or any other public body) to sort it out

How would these tests be met? A combination of changes would be needed:

- First, the ALMO must not be majority-owned by the public sector, so the ownership and control would have to change in many cases. A 51% community ownership would be possible, as long as the local authority with 49% ownership retained no controlling interest.

  Kensington & Chelsea TMO is a private company which is 100% owned by tenants. So it would not need a change of constitution to raise private finance: it could be a model for others.
- Second, the council would have a long-term (35-year) contract with the ALMO, to include investment in the housing. The ALMO would be responsible for all day-to-day decision-making, within a framework agreed with the council in the contract. An annual 'delivery plan' would still be agreed each year.
- Third, the ALMO would raise private finance on the strength of the contract fee, which would be linked to its performance. The fee would be set at a level that could be paid from rents. The level of the fee, and the ALMO's track record of managing the stock, would determine what the ALMO could borrow. The ALMO's loans would be secured on its income.
- Fourth, the risks of managing the properties and borrowing money would have to rest with the ALMO. This means that in accounting terms the assets (the houses) would be on the ALMO's balance sheet not the council's. Legal ownership would remain with the council and properties could not be sold except as agreed in the contract. All the financing risk would be with the ALMO and lenders would have no recourse to the council or its assets.
- Fifth, if the ALMO were to get into financial difficulties or fail under the contract, lenders would take responsibility for sorting things out. If the ALMO could not repay its loans, lenders would contact the council and jointly consider bringing in a new contractor. The council would have no controlling say in sorting out the financial affairs of the ALMO, although they would of course take responsibility for any contract negotiations.

Although the ALMO would no longer be local authority owned, legal ownership of the housing would stay with the council and the tenants would still be secure council tenants. The ALMO could be either a 100% privately-owned company, like the Kensington & Chelsea TMO, or have a minority local authority ownership, probably with a community or tenant majority. In most cases the ALMO would continue to have a board membership of one-third tenants, one-third council nominees and one-third independents.

Option 3 – advantages

- The ALMO would be outside public borrowing controls, like housing associations. In many cases, this would allow it to invest more.
- It gives more financial certainty to the council and the ALMO, with less financial risk to the council than with other options.
- The ALMO would make its own decisions on spending priorities for the HRA. This should allow it to make savings to compensate for higher borrowing costs (compared to local authority borrowing).
- The ALMO would have to act in a business-like way to keep to the performance-related contract. There would be incentives for the ALMO to focus on tenants' needs, improve performance, manage the assets well and respond quickly to changes in demand.

Option 3 – disadvantages

- As with option 2, the ALMO would be running the finances with no housing subsidy payments to protect it against rising interest rates. The ALMO would need to protect itself against this risk.
- Borrowing would be more expensive than the public sector borrowing in the previous options. The cost difference would get smaller as the ALMO develops a successful track record, or if it later refinances its borrowing (like stock transfer bodies do).
- This option would have to lead to efficiencies not available in options 1 and 2, to show value-for-money. Otherwise, because the costs of the private finance are higher than the public borrowing in other options, the government would have to write-off more HRA debt. But this could be a price worth paying to get all the HRA debt off the public sector balance sheet.
- For some councils it will be a disadvantage that (in this option) all HRA income would be kept by the ALMO, except for a small amount to fund the local authority client side. Currently, some authorities use HRA capital receipts for their wider expenditure. An agreement about sharing right to buy receipts could be used to ensure that the council is no worse off.

Other options

This briefing paper summarises the four main options from our research. We also looked at other options, including the possibility of the council leasing or selling the stock to the ALMO. However, there was little support for such an approach and they had no significant advantages compared with option 3. As a result, they are not being considered any further.

What would be the cost of making these changes?

There are many different factors to take into account in assessing the costs of the different options, especially because (as with stock transfer) it involves forecasting trends in factors such as rents and subsidy payments, which is not a simple process. As mentioned before, we asked six ALMOs to act as case studies to help us assess the costs.

The results will be given in fuller detail in the main report. The key points are:

- most ALMO councils *would need debt repaying*, to be able to pursue the options; some would need a *dowry* or *capital grant*
- the amount involved in each case is *less than with stock transfer*
- in some cases government would *save money* by allowing these options to go ahead
- the picture does *vary from place to place* – in some councils, there would be no savings to the government
- ALMOs and councils need to *retain more right to buy receipts* than the government now allows, meaning there would be less money for the government investment 'pool'
- we have assumed that government *would continue to support some new borrowing* by the councils concerned, beyond the 2010 deadline for meeting the Decent Homes Standard.

What do these changes mean for councils?

Many of the implications of these changes for councils have been included in the advantages and disadvantages of the different options. Here are some wider issues:

- **ALMO outside local authority control** – Unlike an LSVT, over which the local authority has no regulatory control, the ALMO must deliver its council's priorities if it is to survive. The better service the ALMO delivers the more likely the council will be to take up one of the options, and this may well change over time according to local circumstances.
- **Local authority funding of strategic housing role** – the extent to which councils retain rental income to fund their strategic housing roles must be down to local negotiation. Some councils have delegated wider housing functions to ALMOs. Others have delegated only the landlord role. But the HRA is a landlord account while the strategic housing role is properly paid for by the General Fund. In reality all HRAs contribute to General Fund housing functions, but this must be demonstrably reasonable. Creating ALMOs has made the split between the HRA and the General Fund more transparent and the proposed options will not significantly alter that.
- **Adverse impact on local authorities without ALMOs** – If necessary ODPM could control the process of change through a bidding programme. This would ensure only a certain number of authorities could take up the options in any one year, to ensure sufficient resources remain for those still within the subsidy regime.

Conclusions from our research

Everyone – especially tenants – wants to build on the success that ALMOs have had. But ALMOs are concerned that without freedoms and flexibilities from government for well-performing ALMOs, contracts with councils will be ended, or allowed to expire, when the Decent Homes Standard has been achieved. Tenants will not want to relinquish the greater involvement they have now come to expect, nor to see an end to incentives for good performance.

Councils will need good reasons to renew their contracts with ALMOs. The options set out in our research – and summarised here – show how these can be put in place.

ODPM should publicise the fact that councils must consult tenants (under s105 of the Housing Act 1985) before changing the current management arrangements.

All the options we have looked at start with the council coming out of the HRA subsidy regime – if they have a well-performing ALMO. This would mean the government restructuring the council's housing debt (reducing it in most cases, but increasing it for some others). The debt could then be serviced and repaid over the 30 year life of the business plan. There would also be scope for new borrowing needed to finance more investment.

Option 1a, where the HRA business plan is remodelled to meet the Decent Homes Standard and the local authority keeps control of the HRA, is the most basic option. It may not have enough advantages for the local authority or its ALMO to be attractive.

Option 1b, where the HRA business plan is remodelled on the basis of delivering sustainable communities and the council retains control of the remodelled HRA, would provide a significant incentive for councils to keep their ALMOs in place after decent homes have been achieved. It would provide more financial certainty, and would ensure adequate investment for long-term viability.

Option 1b might be sufficiently attractive in itself to encourage other local authorities to set up ALMOs.

Option 2 is likely to involve considerable discussion and negotiation between the local authority and the ALMO before a decision is made to go ahead. This is because it involves all the business planning and remodelling of the HRA as does option 1b – but in addition the local authority puts the remodelled HRA at 'arms length' to the authority, and delegates management of housing finances to the ALMO. Some functions currently retained by the authority may need to be included in the new management agreement, involving a minor reorganisation.

Option 2, where the council's housing debt is replaced with ALMO debt, would avoid the need for outside lenders as the ALMO could borrow from the local authority. The potential problem is that this option could involve significant increases in local authority borrowing which the Treasury might want to limit.

This is why we have developed option 3. This aims to get the ALMO borrowing outside public spending constraints – but without transferring the stock. Tenants would need to be sure about the need for, and benefits of, substantial changes to the ownership and control arrangements that would be necessary. Council members may see their loss of majority ownership of the ALMO as a step too far. But if this option were chosen, it would offer the most financial certainty possible without stock transfer.

Other options considered in the research explored the benefits of transferring the housing stock to the ALMO. They are dismissed at this stage as the disadvantages outweigh the advantages.

The options are not necessarily mutually exclusive. The ideal outcome would be that all four options are endorsed by government and allowed to be developed for high-performing ALMOs. This would give a degree of choice to councils, their tenants and ALMOs. One option could be a 'stepping stone' to another as the local authority becomes more comfortable with the ALMO having greater autonomy.

Next steps

To prevent the early ALMOs being wound up as their management agreements expire, government needs to act now. All four options represent viable ways forward. Not only is action necessary to safeguard existing ALMOs, but developing these options would further encourage authorities which have not yet gone down the ALMO route, to do so.

The more detailed research report on these proposals and the case studies will be made available on the CIH, HouseMark and NFA websites in due course. All three organisations welcome comments – especially from ALMOs, their councils, and tenants, on the options that are being developed.

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