stock in trade

good practice in business planning for stock transfers

August 1999
The Housing Corporation
working to improve
people's quality of life
through social housing

The Audit Commission
promotes proper
stewardship of public
finances and helps those
responsible for public
services to achieve economy,
efficiency and
effectiveness
The transfer process
Production of the business plan is constrained by the statutory framework for stock transfer.

The business planning process
A good business plan can help the new RSL to achieve its organisational objectives and to engender stakeholder confidence.

Financial components
The financial elements of the business plan should not be regarded as the sole preserve of financial experts.

Delivering the plan
After transfer, the business plan is a vital tool in keeping the RSL's business on track.
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Introduction

1. The registration and regulation of new registered social landlords (RSLs) is an increasing part of the Housing Corporation's business – growth in the RSL sector is now led by transfers rather than by the provision of new homes. The effectiveness of the business planning that underpins such transfers is therefore of considerable importance. In March 1999, the Government approved the biggest ever programme of local authority stock transfers, involving 140,000 homes. The Government also relaxed earlier restrictions on size of transfer, and announced measures aiming to allow local authorities with negative value stock to pursue transfer. Since 1988, when large-scale voluntary transfer (LSVT) of local authority housing was introduced, over 320,000 homes have transferred to new landlords [EXHIBIT 1, overleaf]. The majority of these homes were formerly owned by councils in rural or suburban districts where values were high and stock disposal generated substantial capital receipts. These receipts were used partly to redeem debt and partly to support new capital programmes. However, the commitment of the new government in 1997 both to broaden the range of participating authorities, and to accelerate the pace of stock transfer has prompted a shift in the strategies of urban and metropolitan authorities.

2. At both central and local government levels, stock transfer is widely regarded as the principal means of securing continued investment in social housing [EXHIBIT 2, overleaf]. The Department of the Environment, Transport and the Regions (DETR) concludes that transfer:

'has brought benefits in terms of investment in the housing stock, better service, increased accountability to tenants and capital receipts for local authorities' (Ref. 1).

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1 If the tenanted market value of the stock is less than the projected cost of repairing and improving it, its value is described as negative. From 1995, such transfers were eligible for capital subsidy through the Estate Challenge Renewal Fund (ERCF). This has now ended and local authorities are expected to fund the subsidy from receipts.
EXHIBIT 1

Growth in stock transfers, 1988-1999
Since 1988, over 320,000 homes have transferred to new landlords.

* Number approved by Secretary of State.
Source: Housing Corporation/Audit Commission

EXHIBIT 2

Private sector investment in stock transfers
Stock transfer is widely regarded as the principal means of securing continued investment in social housing.

Source: HACAS
3. An organisation receiving local authority housing stock must be an RSL and the Housing Corporation, the regulatory body for RSLs, is charged with ensuring that any new organisations, including subsidiaries, set up to receive stock are subject to a rigorous assessment prior to registration. RSLs, as independent private sector bodies are not subject to the same borrowing restrictions as local authorities and are therefore able to attract private investment, both to finance the acquisition and to help improve stock condition. The Corporation neither encourages nor discourages new transfer RSLs, but has responsibility for ensuring that they are set up properly and remain viable. Scrutiny of an RSL's business plan is a key tool in testing viability. The Corporation may register only RSLs that are 'not for profit'. This means that the RSL's governing instrument must not permit distribution of profits to shareholders, trustees or guarantors. Surpluses must not be accumulated for their own sake but should be used in furtherance of the RSL's social objectives.\footnote{The constitutional form to be adopted by an RSL is set out in the Housing Act, 1996.}

**Types of transfer**

4. Of the 71 LSVTs that have taken place, 66 have involved the establishment of a new 'stand-alone' RSL. The constitution of the new organisation can vary – some are charities, some are companies, some are Industrial and Provident Societies (IPSs)\footnote{Box A, overleaf}. The model chosen in each case depends partly on the local authority's objectives – having consulted with its tenants – and partly on legal and financial constraints. Increasingly, councils are opting for the establishment of companies limited by guarantee where the governing body comprises a balance of tenants, local authority representatives and independent members. In a minority of cases, local authorities have transferred all their housing stock to an existing RSL.
Characteristics of different transfer models

<table>
<thead>
<tr>
<th>MODEL</th>
<th>MAIN FEATURES</th>
</tr>
</thead>
<tbody>
<tr>
<td>New stand-alone RSL</td>
<td>Most common model for whole stock transfers. Before 1996 these were mainly IPSs; now most are companies limited by guarantee. I Stand-alones set up to receive partial transfers are usually known as local housing companies. Both companies and IPSs may be charitable (non-charitable RSLs are liable for corporation tax).</td>
</tr>
<tr>
<td>Newly registered subsidiary of an existing RSL</td>
<td>Commonly used for partial transfers. May be IPSs or companies; charitable or non-charitable. Although controlled by another (parent) RSL, the subsidiaries will normally have their own business plan and be self-sufficient on a day-to-day basis.</td>
</tr>
<tr>
<td>Direct to existing RSL</td>
<td>Stock is directly owned by the existing RSL. May also be managed directly as with a standard development project or by an unregistered subsidiary set up for the purpose and involving tenants at committee level. RSL’s existing loan facilities usually extended. Not normally a separate business plan, but parent RSL will expect the project to be viable.</td>
</tr>
</tbody>
</table>

Source: Audit Commission

5. Since the introduction of capital subsidy towards the costs of repair and improvement – through the Estates Renewal Challenge Fund (ERCF) in 1995 – the number of partial stock transfers has increased. This has enabled local authorities to target priority estates or groups of estates for transfer. These estates usually require considerable investment to tackle decades of under-investment in maintenance and refurbishment, and their market value is therefore lower than the projected cost of the investment. This type of transfer involves the payment of a grant or ‘dowry’ to the receiving RSL to cover the shortfall. Although the ERCF has now come to an end, the Government is currently piloting a new subsidised estate regeneration programme, ‘New Deal for Communities’, which also involves transfer of targeted stock in the most deprived areas. II Local authorities can also draw on their own resources or other regeneration funds to finance dowries. Value-for-money considerations suggest that transfer is likely to be the best route for housing investment in these areas, but residents will ultimately make that decision.

I The Housing Act 1996 enabled the registration of non-charitable companies.

II This is a government regeneration initiative to tackle social exclusion, with subsidy targeted at improving job prospects and neighbourhood services as well as at stock improvement. The initiative is currently being piloted in a number of areas.
6. The choice of constitutional model for partial transfers is broadly the same, although very small transfers (fewer than 500 units) are unlikely to be able to justify a separate legal entity. Generally, partial transfers are received by existing RSLs, either directly or into a subsidiary, which might be constituted as a company limited by guarantee or as an IPS [TABLE 1].

Reasons for review

7. Any RSLs receiving a stock transfer require either a stand-alone business plan, or alterations to their existing plan, to evaluate the proposal and demonstrate its viability. It is particularly critical for organisations taking on low-value stock characterised by poor condition, and/or chronic housing management problems such as neighbour nuisance and low demand. The majority of such transfers are very new (no more than two years old) and the development of good practice in appraising and managing the risks involved is still in its infancy.

8. The focus of the Commission's study was therefore on business planning for low\(^1\) and negative value transfers. Following the issue of an exploratory questionnaire to all RSLs in receipt of ERCF and a sample of low-value LSVT, fieldwork visits were made to five positive value RSLs and eight ERCF sites (Appendix 1). The research included a detailed analysis of available business plans and discussions with a wide range of stakeholders, including tenants and funders. Although the focus of the study was on low-value transfers, the principles of good practice in business planning apply to all types.

8. The study was conducted by the Commission under the powers of the Housing Act, 1996. The study team comprised Susan Fenwick and Angie Smith under the direction of Kate Flannery with consultancy support from HACAS. An advisory group (see Appendix 1) provided valuable assistance and professional insight during the study. The Commission is also grateful for the many contributions it received on drafts of this handbook. However, the responsibility for its conclusions and recommendations rests with the Audit Commission alone.

### TABLE 1

**ERCF Transfers by type**

<table>
<thead>
<tr>
<th>Receiving organisation</th>
<th>Number</th>
<th>Number of units</th>
</tr>
</thead>
<tbody>
<tr>
<td>Direct to existing RSL</td>
<td>9</td>
<td>2,413</td>
</tr>
<tr>
<td>Subsidiary of existing RSL</td>
<td>10</td>
<td>8,432</td>
</tr>
<tr>
<td>Stand-alone</td>
<td>5</td>
<td>13,231</td>
</tr>
<tr>
<td><strong>TOTAL</strong></td>
<td><strong>24</strong></td>
<td><strong>24,076</strong></td>
</tr>
</tbody>
</table>

*Source: Housing Corporation*

\(^1\) 'Low' is defined here as having a positive value of not more than £9,000 per unit transferred.
10. The preparations for stock transfer that the local authority and the new landlord must make are both complex and challenging. A key task for the local authority is to calculate the value of the stock, which will determine the price that the new landlord must pay or, for negative value stock, the amount of dowry it will receive. This valuation is therefore critical for the new landlord and becomes a focal point in negotiations between the two parties. The new landlord’s strength in these negotiations can be greatly enhanced by the quality of its business plan and its ability to show, through a carefully constructed financial model, precisely what it can and cannot afford.

11. Both sides have clear and distinct roles and objectives in the process. Business planning is fundamental to the demonstration:
   • by the local authority that transfer is viable; and
   • by the new landlord that it is an ongoing viable business entity.

The local authority should therefore be aware that its model will eventually need to translate into a viable proposition for the new landlord. Although close co-operation and communication will improve the effectiveness of the local authority’s modelling and the new landlord’s business plan, it is vital that there is a clear separation of roles and allocation of responsibilities (Ref. 2). In the past this has often proved difficult for authorities to achieve.

12. The use of the business plan as a key document that sets out medium- and longer-term aims, and demonstrates how they will be achieved in financial and non-financial terms was not widely adopted by housing associations until the introduction of privately funded development in the late 1980s. Private sector funders, used to dealing with borrowers, who produced business plans as a matter of course, expected the same from their new housing association clients. In order to demonstrate to potential lenders that they had the capacity to deliver their objectives and repay their loans, associations had no alternative but to learn the art of business planning. The need to secure private finance has been a key factor promoting a cultural shift in housing association management towards wider acceptance of business techniques.

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**The need for business planning**

*Business plans are not fixed blue prints... (they) are a 'best present view' of the future and a basis for planning for change.*

---

I The term used to describe RSLs prior to the Housing Act 1996.

II For the purposes of this handbook, the term ‘business plan’ is used to refer to a document comprising financial projections and non-financial objectives, targets and policies.
13. While most housing associations now regard themselves as businesses as well as value-based organisations, many local authorities have been slower to make the cultural adjustment. This can be brought into stark relief when local authority officers and elected members embark on the process of transferring stock to a new business – it is unlikely that they will possess all the skills and knowledge necessary to develop and deliver the business plan [EXHIBIT 3]. Stock transfers to existing RSLs can therefore be less challenging in this respect, since the staff and board members are more familiar with business planning processes. However, business planning for partial stock transfers presents further complexities for the receiving RSL which must carefully assess the impact of the transfer on the rest of its operations. (The different characteristics of business plans for whole and partial stock transfers are developed throughout the handbook.)

EXHIBIT 3

Key business planning skills

New landlords may not possess all the skills that are necessary to develop and deliver the plan.

Source: Audit Commission/LGMB (Ref. 3)
For new organisations or operations, the business plan is a vital tool in managing performance and measuring success.

14. The benefits of business planning for any organisation – or indeed for any service, operation or project within a larger organisation – include:
   - clarifying objectives;
   - building a common sense of purpose;
   - determining viability;
   - raising funding and defining borrowing covenant ratios[^1];
   - directing detailed operational plans;
   - evidencing capacity to deliver; and
   - highlighting areas and periods of greatest risk.

For new organisations or operations, the business plan is a vital tool in managing performance and measuring success. Confidence of lenders, the Housing Corporation, tenants and other partners in the new RSL will be affected, initially, by the robustness of the business plan and, in the early years after transfer, by performance against that plan. The confidence of these key stakeholders is critical to the success of the organisation in the long term.

Handbook structure

15. The purpose of this handbook is to give good practice guidance to practitioners. It tracks the development of the business plan prior to transfer, demonstrating the interdependencies of business planning and the transfer process as a whole. It also gives guidance on techniques that ensure successful delivery of the plan. The handbook is therefore aimed primarily at the executives of existing RSLs or of newly established shadow RSLs. It may also be of interest to local authority officials involved in the management of stock transfers.

16. Each chapter begins with the key points it will address and uses case studies to illustrate good practice. The principles of good business planning apply equally to the different types of transfer but there are some important differences in application. These are highlighted in the text and also, for ease of reference, are summarised at the end of each chapter. The business plan is developed during the period between the local authority’s decision to transfer and the actual transfer of ownership to the new landlord. The process of development involves close co-operation between the two organisations, and action point summaries therefore include actions by the local authority, as well as by the RSL, in the stages before transfer. Recommendations for action by DETR and the Housing Corporation are also included in each chapter and summarised at the end of the handbook.

17. This handbook is supplemented by a short briefing which is designed to help RSL board members and local authority elected members to focus on key issues and action points for them.

[^1]: See Table 6 (page 67)
The transfer process

Organisations receiving stock from local authorities need to understand the statutory and contractual complexities of the transfer process as a whole. Both the local authority and the new landlord should formulate plans for managing the transfer as a whole project, ensuring that the different requirements of the DETR and the Housing Corporation are satisfied on time.
18. Business planning is a dynamic process which should begin at the early stages of stock transfer discussions and continue throughout the life of the new landlord organisation. The transfer process as a whole, however, has a range of statutory and contractual constraints that prescribe the timescales within which different versions of the business plan must be produced. It is therefore important that new landlords understand these constraints and ensure that their own processes link in with those of other stakeholders at all stages.

The key points to address are:
- What is the legal framework?
- What are the key government policies?
- Who are the players?
- What are the key stages?
- What guidance is available?

Legal framework

19. The principal legislation covering stock transfers relates to the requirement to obtain the consent of the Secretary of State to the disposal, and to the regulation governing the registration of RSLs [TABLE 2].

Key government policies

20. All local authorities are now expected to consider, on an annual basis, what role transfer can play as part of their housing strategy (Ref. 4) and any proposals put forward must be seen to meet the needs identified for investment and service provision. In order to win the Secretary of State's approval, local authorities must show that, in addition to the statutory requirements:
- The transfer has acceptable public expenditure costs
  DETR does not stipulate what is acceptable, nor publishes details of the net public sector costs of past transfers;
- The price is based on tenanted market value (TMV)
  The TMV is based on the new landlord's future net income from the transferred stock over the next 30 years;
- Future average rent increases are limited to the rate of inflation\(^1\) + 1 per cent
  This corresponds with Housing Corporation guidelines (Refs. 5 and 6);
- Rent levels are reasonable compared with others in the locality
  This is normally tested by referring to local housing benefit ceilings ('reference' rents), to housing corporation benchmark rents and to re-let rents of other RSLs operating in the area. It is very difficult to test in rural areas where there are no other social landlords;
- The number of dwellings transferring is not too great
  The limit has previously been defined as 12,000 (although larger numbers have been approved in a minority of cases);

\(^1\) As determined by the Retail Price Index (RPI).
### Table 2: Principal legislation affecting stock transfers

<table>
<thead>
<tr>
<th>Statute</th>
<th>Statute reference</th>
<th>Requirement</th>
</tr>
</thead>
<tbody>
<tr>
<td>Housing Act 1985</td>
<td>s32 and/or s43, Schedule 3A (as inserted by Section 6 and Schedule 1 to the Housing and Planning Act, 1986)</td>
<td>Consent of Secretary of State to disposal of land or dwellings held by local authorities for housing purposes. Duty on local authority to consult with tenants. Secretary of State must refuse consent to transfer if majority of tenants not in favour. Protects the Right to Buy for transferring tenants.</td>
</tr>
<tr>
<td>Housing Act 1988</td>
<td>s132</td>
<td>Details issues Secretary of State will take into consideration including: independence of new landlord; extent to which new landlord would become predominant in the area; terms of the disposal. Government powers to control disposals by RSLs after transfer.</td>
</tr>
<tr>
<td>Leasehold Reform Housing and Urban Development Act 1993</td>
<td>s135</td>
<td>Place on annual disposals programme required for disposals of more than 499 dwellings.</td>
</tr>
<tr>
<td></td>
<td>s136</td>
<td>Imposed 20 per cent levy on sales receipts net of HRA debt.</td>
</tr>
<tr>
<td>Housing Act 1996</td>
<td>s2</td>
<td>Extended range of bodies housing corporation could register to include non-charitable companies.</td>
</tr>
<tr>
<td>Housing Grants, Construction and Regeneration Act 1996</td>
<td>s126</td>
<td>Powers to pay ERCF grant.</td>
</tr>
<tr>
<td>Transfer of Undertakings (protection of employment) Regulations 1981 (TUPE)</td>
<td>All</td>
<td>Protects the rights of some categories of staff transferring from the local authority to the new landlord.</td>
</tr>
</tbody>
</table>

*Source: Audit Commission/DETR*

- The cost of certain dwelling improvements will be met through rent increases.
  This would typically include the installation of central heating and double glazing:

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I There is no legal requirement to hold a ballot, although no transfer has taken place without one.

II A three-year levy holiday was in effect from 1996 to 1999.
The players involved in stock transfers

21. The cost and complexity of stock transfer dictates that a large group of organisations and individuals may play a role in the process. A major difficulty for the leading players – the local authority, the new landlord and the tenants – is to decide which of the aspiring ‘bit players and extras’ are indispensable. This section lists the key players and summarises their roles. Chapter 2 describes their input into the business planning process in more detail.

Tenants

22. Tenants of the stock transferring are formally consulted and balloted. Other tenants of the local authority may have influence through authority-wide federations or forums. In the case of partial transfers, tenants of the stock that remains with the local authority should be informed about the potential impact of the transfer on their rents and services. Leaseholders of the stock transferring should also be consulted but are not balloted.

Parties to the transfer agreement

23. The formal transfer agreement is between the local authority and the RSL receiving the stock. Officers from both sides, elected members and RSL board members are involved.

Organisations that determine the framework and approve applications

24. The DETR approves applications for the disposals programme (the Secretary of State approves the transfer programme), approves ERCF funds and the terms of transfer. The Housing Corporation comments on transfer bids, approves applications for registration of new RSLs and gives consent to charging stock as security for private loans.
Funders

25. Private finance for stock purchase, capital programmes and new development (if applicable) is provided by commercial lenders, either retail lenders in the form of debt finance, or city investors in the form of bond finance, or in combination.

Consultants

26. A variety of consultants act for both sides throughout the process [BOX B]. It may appear unusual for consultants to be described as key players in their own right, since they might be expected simply to support and advise the leading players. However, it is common in transfer projects – particularly whole stock transfers – for consultants to carry out major elements of work. They may, for example, conduct negotiations, draw up business plans or liaise with statutory bodies.

---

**BOX B**

**Consultants employed in stock transfers**

<table>
<thead>
<tr>
<th>Consultants' specialism</th>
<th>Work for LA?</th>
<th>Work for RSL?</th>
<th>Work on</th>
</tr>
</thead>
<tbody>
<tr>
<td>Stock transfer process</td>
<td>✔️</td>
<td></td>
<td>Options appraisal, application to DETR, valuation model, transfer agreement, offer to tenants</td>
</tr>
<tr>
<td>Advice to tenants</td>
<td>✔️</td>
<td></td>
<td>Give tenants independent advice</td>
</tr>
<tr>
<td>Legal advice</td>
<td>✔️</td>
<td>✔️</td>
<td>Terms of transfer and legal documentation including loan agreement</td>
</tr>
<tr>
<td>Stock condition surveys</td>
<td>✔️</td>
<td>✔️</td>
<td>Information and costings on the repairs and improvements needed for the stock transferring</td>
</tr>
<tr>
<td>Valuation surveys</td>
<td>✔️</td>
<td>✔️</td>
<td>Value the stock for loan security purposes – required by lenders</td>
</tr>
<tr>
<td>Business planning</td>
<td>✔️</td>
<td></td>
<td>Business plan modelling and drafting</td>
</tr>
<tr>
<td>Treasury management</td>
<td></td>
<td>✔️</td>
<td>Advise on management of loans and investments</td>
</tr>
<tr>
<td>Business plan validation</td>
<td>✔️</td>
<td></td>
<td>Check accuracy, give a second opinion on validity of assumptions</td>
</tr>
<tr>
<td>Funding advice</td>
<td>✔️</td>
<td>✔️</td>
<td>Advise on funding options and availability, market trends</td>
</tr>
<tr>
<td>Public relations/media</td>
<td>✔️</td>
<td></td>
<td>Promote and market the transfer</td>
</tr>
<tr>
<td>Change management</td>
<td>✔️</td>
<td>✔️</td>
<td>Help to deal with role and culture change where LA staff are transferring</td>
</tr>
</tbody>
</table>

*Source: Audit Commission*
Key stages in the process

27. Little evidence was found of the local authority and new landlord formulating comprehensive plans for managing the transfer as a whole project, defining key stages and milestones at the outset and planning how to resource them. This is partly explained by their apparent failure to draw on the experience of other transfers – each new transfer appears to evolve in response to emerging issues rather than proceeding in line with a predetermined plan. The other, more fundamental reason is that the national framework presumes a clear separation of the roles and responsibilities of the parties to the transfer. An effect of this is to create a number of different projects with different aims and objectives and different timetables [EXHIBIT 4] – for example:

- tenant project to secure maximum return for their ‘Yes’ vote;
- local authority project to secure an acceptable valuation and a ‘Yes’ vote;
- new landlord project to obtain Corporation registration and a fundable business plan;
- DETR project to deliver a transfer which satisfies financial/policy criteria; and
- Housing Corporation project to deliver a new RSL/additional RSL homes which demonstrates long-term viability and satisfies statutory and policy criteria.

EXHIBIT 4
Key stages in obtaining DETR consent/obtaining Corporation registration
Different stakeholders have conflicting timetable requirements.

Source: DETR/Audit Commission
28. The lack of forward planning often means that the timetable is pushed back towards the end of the financial year and the transfer deadline. This has an impact on the availability and price of private finance.

29. In practice, there are varying degrees of co-operation and liaison between the players to ensure that everyone's objectives are more or less satisfied and met on time. In some cases steering groups are set up involving representatives from each of the key stakeholders [CASE STUDY 1]. However, a steering group is not a project team and its outputs are therefore more likely to be actions that achieve compromise rather than common objectives.

CASE STUDY 1

Kingsmead Estate Steering Group

Kingsmead Homes, a subsidiary of the Shaftesbury Housing Group, was set up to receive the transfer of the 978 homes on the Kingsmead estate from the London Borough of Hackney. Following Shaftesbury's successful bid to set up a local housing company to receive the stock, a steering group was set up to manage the transfer process. This group comprised housing management and housing finance specialists from the local authority side, Shaftesbury's regional director and group finance director and all the principal consultants from either side including the tenants' adviser. The group met every 2-3 weeks to negotiate the terms of the transfer and to receive information that helped to develop the business plan assumptions. A parallel tenants' steering group fed ideas and demands into the main steering group. The group monitored progress of the transfer against an action plan and project timetable agreed at the beginning of the process. A number of lessons were learnt during this exercise:

- tenants should not be excluded from debates about valuation and the potential risks of unviability;
- local authority representation should be at a sufficiently senior level to ensure that the data provided is timely and accurate; and
- RSLs should ensure that the skills of staff proposed for transfer match those required in the new structure.

The establishment of a steering group of the key players ensured that the Kingsmead transfer was managed as a single project and that the parties worked together to achieve common objectives.

Source: Audit Commission fieldwork
30. An early appreciation of all the activities involved in the process will enable the leading players to plan for the elements within their control around those which are governed by the statutory framework [TABLE 3]. Chapter 2 explores how dependencies within the transfer process as a whole link in with business planning processes. The other key factors to be taken into consideration are:

- how to resource pre-ballot costs in the event of a 'No' vote;
- level of detail in the formal offer document – the business plan and strategy work will need to be much more advanced if specific promises about rents and improvements are included;
- availability of private funds – (see Chapter 4);
- availability of consultants;
- availability of in-house resources;
- impact of linked initiatives – eg, some activities may need to tie in with the local SRB plan;
- political considerations – eg, level of opposition, if there is to be competition between prospective receiving organisations, also level of ongoing involvement required by elected members.

### TABLE 3

<table>
<thead>
<tr>
<th>Activity</th>
<th>Timing determined by DETR/Corporation?</th>
<th>Is activity ongoing?</th>
</tr>
</thead>
<tbody>
<tr>
<td>Local authority options appraisal</td>
<td>NO</td>
<td>NO</td>
</tr>
<tr>
<td>Consultation with DETR</td>
<td>NO</td>
<td>YES</td>
</tr>
<tr>
<td>Informal consultation with tenants</td>
<td>NO</td>
<td>YES</td>
</tr>
<tr>
<td>Consultation with housing corporation</td>
<td>NO</td>
<td>YES</td>
</tr>
<tr>
<td>Consultation with staff</td>
<td>NO</td>
<td>YES</td>
</tr>
<tr>
<td>Hold competition for new landlord (if applicable)</td>
<td>NO</td>
<td>NO</td>
</tr>
<tr>
<td>Prepare and submit outline proposal for disposal</td>
<td>YES – DETR deadline</td>
<td>NO</td>
</tr>
<tr>
<td>Determine structure and governance of new RSL*</td>
<td>NO</td>
<td>NO</td>
</tr>
<tr>
<td>Submit application for registration as an RSL*</td>
<td>YES – HC deadline</td>
<td>NO</td>
</tr>
<tr>
<td>Appoint local authority consultants</td>
<td>NO</td>
<td>NO</td>
</tr>
</tbody>
</table>

*cont.l*  

This includes: alternatives to transfer, whole or partial transfer, type of transfer vehicle, implications for retained services.
### TABLE 3 (cont.)

<table>
<thead>
<tr>
<th>Activity</th>
<th>Timing determined by DETR/Corporation?</th>
<th>Is activity ongoing?</th>
</tr>
</thead>
<tbody>
<tr>
<td>Appoint tenant adviser</td>
<td>NO</td>
<td>NO</td>
</tr>
<tr>
<td>Value the stock</td>
<td>NO</td>
<td>NO</td>
</tr>
<tr>
<td>Submit ERCF bid (if applicable)</td>
<td>YES - DETR deadline</td>
<td>NO</td>
</tr>
<tr>
<td>Second staff*</td>
<td>NO</td>
<td>NO</td>
</tr>
<tr>
<td>Set up steering group/project team</td>
<td>NO</td>
<td>NO</td>
</tr>
<tr>
<td>Plan project/agree set-up cost apportionment</td>
<td>NO</td>
<td>NO</td>
</tr>
<tr>
<td>Set up board/appoint consultants for board*</td>
<td>NO</td>
<td>YES</td>
</tr>
<tr>
<td>Consult potential funders</td>
<td>NO</td>
<td>NO</td>
</tr>
<tr>
<td>Commission stock survey</td>
<td>NO</td>
<td>NO</td>
</tr>
<tr>
<td>Prepare business plan</td>
<td>NO</td>
<td>YES</td>
</tr>
<tr>
<td>Prepare formal offer to tenants</td>
<td>NO</td>
<td>NO</td>
</tr>
<tr>
<td>Formal consultation with tenants (including ballot)</td>
<td>YES</td>
<td>NO</td>
</tr>
<tr>
<td>Negotiate terms of transfer I</td>
<td>NO</td>
<td>YES</td>
</tr>
<tr>
<td>Recruit staff</td>
<td>NO</td>
<td>NO</td>
</tr>
<tr>
<td>Prepare policy documents</td>
<td>NO</td>
<td>NO</td>
</tr>
<tr>
<td>Final bid to DETR</td>
<td>YES – DETR deadline</td>
<td>NO</td>
</tr>
<tr>
<td>Finalise pre-transfer business plan</td>
<td>YES – HC deadline</td>
<td>NO</td>
</tr>
<tr>
<td>Obtain private funding offer</td>
<td>YES – HC deadline</td>
<td>NO</td>
</tr>
<tr>
<td>Obtain Housing Corporation registration*</td>
<td>YES – HC deadline</td>
<td>NO</td>
</tr>
<tr>
<td>Finalise conveyance and obtain consents</td>
<td>YES</td>
<td>NO</td>
</tr>
</tbody>
</table>

* Timing determined by DETR/Corporation?

**Source:** Audit Commission

* Does not apply to transfers that are made direct to an existing RSL.

---

1. This includes: valuation, constitutional terms, covenants and warranties and staff transfer arrangements (including statutory TUPE provisions).
31. In 1998, DETR and the Housing Corporation issued improved and more comprehensive written guidelines on their detailed requirements, and on the issues involved in transfer (Refs.1 and 6-10). These should assist the leading players to refine their briefs to consultants and to take greater ownership of the transfer project, as a whole and of the component sub-projects.

32. The extent to which DETR and Corporation officials are consulted on an ongoing basis is very variable. In many cases, all contact with DETR is handled by the local authority consultants and a number of ERCF RSLs saw DETR merely as the provider of funds. DETR assigns caseworkers to each stock transfer applicant, and the managers of the Housing Transfers Department are available to deal with applicants' queries. Those local authorities visited, which had engaged with DETR officials, had found the advice offered helpful in guiding them through the process. The regional offices of the Housing Corporation act as contact points for local authorities/receiving organisations. While some regions have built up considerable experience of stock transfers, in others, there have been very few transfers. DETR advises local authorities to contact the appropriate regional office of the Corporation as soon as transfer is contemplated. The purpose of this early contact is to:

• enable the Corporation to identify resources to support the transfer ahead of time;
• establish dialogue and enable input from the Corporation into the authority's exploration of options; and
• clarify the Corporation's written guidance.

33. In cases where this had not happened, the quality of relationship between applicant and the region suffered – often applicants allowed insufficient time to meet the registration criteria and failed to understand the statutory requirements for independent governance. The Corporation is effectively the principal gatekeeper for viability of new transfer RSLs. As such, it is often under extreme pressure from the other players – all of whom have a vested interest in the transfer going ahead – to register organisations about which it might have grave doubts. Following a study of earlier problem cases (Ref.10), the Corporation has improved its procedures for dealing with transfer applicants and more detailed guidance is available from its regulation division to assist regions to process applications. Some regions are now managing applications through cross-functional project teams [CASE STUDY 2].
CASE STUDY 2

Housing Corporation West Midlands Regional Office Project Teams

The West Midlands region of the Corporation has dealt with 13 stock transfers. The region's Director and management team takes a proactive approach to stock transfers and will make an early approach to any local authority that is contemplating transfer. The regional office maintains regular contact with all local authorities in its area of operation through its team of planning officers.

Once the stock transfer process is put in train by a local authority, the region's Assistant Director of Regulation takes responsibility to coordinate the Corporation's input. A project team is set up which comprises a lead officer from the regulation division, a financial expert and, for some aspects, technical officers. The Director and Assistant Director receive regular progress reports and are personally involved in some meetings with the local authority and the new landlord.

The project team asks for an early meeting with the consultants appointed to act for the two sides and alerts them to any areas of particular concern. It attempts to develop constructive working relationships with all the key players so as to:

- help the new landlord understand what is required to achieve registration in a planned and considered manner;
- comment on the development of the new landlord's business plan and structures in terms of meeting registration criteria; and
- establish a framework for ongoing partnership-working after transfer.

The team is less involved with organisational issues when the new landlord is an existing RSL, but in all cases, it seeks to maintain frequent contact throughout the set-up phase, attending the majority of board and steering group meetings. Between transfer and the Corporation's formal monitoring visit at the end of the first year, the team has quarterly meetings with the senior staff of the new landlord to review progress against the business plan, and a mid-year meeting with the board.

This approach had not been in place at the time of the transfers studied, one of which had been extremely problematic. The new approach has been formulated in response to the lessons learnt by the region in dealing with earlier transfers and officers are confident that it will greatly improve the Corporation's contribution to future ones.

Source: Audit Commission fieldwork
### The transfer process

<table>
<thead>
<tr>
<th>ACTION NEEDED</th>
<th>BY WHOM?</th>
<th>MAIN DIFFERENCES FOR STAND-ALONES</th>
</tr>
</thead>
<tbody>
<tr>
<td>Before working up detailed proposals, has the local authority consulted DETR and the Corporation about different transfer options and about registration requirements?</td>
<td>LA</td>
<td>The burden of learning how the national framework works falls on the local authority until staff are seconded to the shadow RSL.</td>
</tr>
<tr>
<td>Before working up detailed transfer proposals, have the two sides familiarised themselves with all relevant statutory and national policy constraints?</td>
<td>LA/RSL</td>
<td>Initially the local authority should draw up a plan that includes actions for the new RSL. Once set up, the shadow RSL can have input into a revised plan.</td>
</tr>
<tr>
<td>Have the two sides drawn up a project plan for the whole transfer process?</td>
<td>LA/RSL</td>
<td>The creation of a new landlord will be a key early action in the process. Until staff are seconded, the local authority will manage the project alone.</td>
</tr>
<tr>
<td>Are representatives of the two sides working together as a project team/steering group to manage the transfer project?</td>
<td>LA/RSL</td>
<td>The shadow RSL will be created after the local authority has committed itself to a consultation process.</td>
</tr>
<tr>
<td>Have the two sides agreed a clear strategy for involving tenants in negotiations?</td>
<td>LA/RSL</td>
<td>Although all the resources required by both sides should be estimated by the local authority at the outset, a resourcing strategy will have to wait until after the shadow board is established.</td>
</tr>
<tr>
<td>Have the two sides agreed a clear strategy for resourcing the project (including the role of consultants)?</td>
<td>LA/RSL</td>
<td></td>
</tr>
</tbody>
</table>
The transfer process

**DETR should:**

1. Require that applications for places on the disposals programme include a project plan covering the whole transfer process and that the plan is copied to the Corporation.

2. Amend transfer guidance to emphasise that local authorities should consult the Corporation as part of their options appraisal.

3. Consider alternatives to the annual programme, such as a rolling programme, in order to reduce pressure on funding and registration timetables and give more time for considered business planning.

**The Corporation should:**

1. At options appraisal stage, provide detailed guidance on registration requirements to local authorities that are considering transfer.

2. Regularly check on the new landlord’s progress in meeting registration requirements during the set-up stages.

3. Consider appointing stock transfer specialists in each regional office.
The primary purpose of the business plan is to guide an organisation in delivering its goals while living within its means. For stock transfers, the business plan also ensures that the new landlord keeps its promises to tenants, achieves registration with the Corporation and obtains private funding.
34. A good business plan can serve both as a vital tool in achieving organisational objectives and as a means to engender confidence in stakeholders. The quality of the business plan reflects the way in which it is put together, but an effective process can also help the new landlord manage the complexities of the transfer as a whole. For new organisations in particular, the development of the business plan offers an opportunity for the leading players to develop as a team and to crystallise their thinking about the direction in which they are going.

**The key points to address are:**

- What is the business plan for and who is the audience?
- What is in it?
- How is it to be developed?
- Who should be involved and when?

### Purpose of the business plan

35. The primary purpose of a typical business plan is to guide an organisation in delivering its goals while living within its means. For stock transfers, business plans also serve to:

- ensure that the services promised to tenants are delivered at the agreed stock valuation;
- achieve registration with the Corporation (where applicable); and
- obtain private funds – a business plan would form part of a normal funding prospectus produced for potential lenders.

The period covered by the plan will be partly determined by the nature of the organisation's business and the markets in which it operates, and partly by the requirements of its funding stakeholders. In the case of stock transfers, funders expect business plans to include financial forecasts over 30 years. This is compatible with DETR's stock valuation model which also requires a 30-year projection.

36. The price the acquiring landlord pays for the stock is based on its tenanted market value (TMV) and forms part of the local authority's application to DETR. The TMV is likely to be subject to a number of revisions and is first calculated at an early stage in the process. DETR provides a spreadsheet template giving detailed guidance on the assumptions about key variables that should form the basis of the valuation (Ref. 1). The parameters that DETR sets are determined by the key government policies described above. In simple terms, the TMV is based on the future net income of the transferring stock over 30 years.¹

---

¹ Financial modelling is discussed in detail in Chapter 3.
The danger of creating and maintaining varying versions is that the key stakeholders lose track of progress against genuine targets.

37. Although the purpose of the TMV financial model is to set the sale price, its assumptions are invariably utilised by the new landlord in developing the financial elements of its business plan [BOX C]. The first version of the TMV is likely to be produced before the new landlord produces a first version of its business plan – although existing RSLs often begin their own financial modelling in tandem with the local authority’s work. It therefore makes sense for the RSL to develop the local authority’s assumptions to suit its purposes rather than to develop its own assumptions from scratch.

38. While different emphasis and presentation may be appropriate for each specific purpose, and while greater levels of detail are appropriate for internal stakeholders, RSLs should be wary about creating substantially different versions of the business plan for different audiences. One transfer RSL that experienced serious financial difficulties caused by overtrading was found to have five contradictory business plans (Ref. 10). The danger of creating and maintaining varying versions is that the key stakeholders lose track of progress against genuine targets.

### BOX C

<table>
<thead>
<tr>
<th>Financial variables</th>
<th>Included in TMV?</th>
<th>Included in Business Plan?</th>
</tr>
</thead>
<tbody>
<tr>
<td>Starting rents for new and transferring tenants</td>
<td>✓</td>
<td>✓</td>
</tr>
<tr>
<td>Level of rent increases</td>
<td>✓</td>
<td>✓</td>
</tr>
<tr>
<td>Void and re-let rate</td>
<td>✓</td>
<td>✓</td>
</tr>
<tr>
<td>Costs of backlog maintenance</td>
<td>✓</td>
<td>✓</td>
</tr>
<tr>
<td>Costs of current and future repairs and maintenance</td>
<td>✓</td>
<td>✓</td>
</tr>
<tr>
<td>Cost of improvements</td>
<td>✓</td>
<td>✓</td>
</tr>
<tr>
<td>Timing of works</td>
<td>✓</td>
<td>✓</td>
</tr>
<tr>
<td>Management costs</td>
<td>✓</td>
<td>✓</td>
</tr>
<tr>
<td>Funding costs</td>
<td>X</td>
<td>✓</td>
</tr>
<tr>
<td>Level of Right to Buy</td>
<td>✓</td>
<td>✓</td>
</tr>
<tr>
<td>Rate of inflation</td>
<td>X</td>
<td>✓</td>
</tr>
<tr>
<td>New development</td>
<td>X</td>
<td>✓</td>
</tr>
<tr>
<td>Right-to-buy receipts</td>
<td>X</td>
<td>✓</td>
</tr>
</tbody>
</table>
39. One fieldwork RSL described the business plan as the ‘final piece in the transfer jigsaw’. In others, the business plan presented was little more than a 30-year cashflow sheet, regarded as a treasury management tool of the finance department and a basis for annual budgeting. If the business plan is to achieve its primary purpose of keeping the organisation on track, it must set out the organisation’s strategic objectives and state how they are to be met. For the purpose of the TMV, the strategic objectives are those of the local authority, constrained by statutory requirements and government policy. The new landlord’s business plan is influenced by all these factors and also incorporates its own goals. These inputs, backed up by current financial information, enable income and expenditure assumptions to be developed. These assumptions are fed into a computer model, and the outputs:
- show when and how much financial resources are needed to deliver the objectives; and
- enable the development of detailed operational and service delivery plans [EXHIBIT 5].

EXHIBIT 5
Structure of the business planning process
The outputs from the process help the organisation deliver its goals.

Source: Audit Commission
40. Although the quality of the information in the business plan and the validity of its assumptions are critical to its success, the presentation of the document also merits attention. It is important that the document is fine tuned to suit the needs of different stakeholders; for example, funders will be more interested than internal stakeholders in the CVs of the RSL’s management team, while tenants want to know ‘What happens to my rent if you can’t let those empty flats?’ However, the layout of the document should follow a broadly similar pattern [BOX D].

**BOX D**

**Contents of a business plan**

<table>
<thead>
<tr>
<th>Section</th>
<th>Subject</th>
<th>Components</th>
</tr>
</thead>
<tbody>
<tr>
<td>1</td>
<td>Executive summary</td>
<td>• Purpose and highlights of the plan&lt;br&gt;• Summary of strategies&lt;br&gt;• Relationships sought with target readers</td>
</tr>
<tr>
<td>2</td>
<td>Situation analysis</td>
<td>• Short history of the local authority stock/estate&lt;br&gt;• Explanation of relevant government policy&lt;br&gt;• Likely future local/national trends</td>
</tr>
<tr>
<td>3</td>
<td>Strategic overview</td>
<td>• Mission and value statements&lt;br&gt;• Planned future structure and constitution&lt;br&gt;• Key strategies and objectives</td>
</tr>
<tr>
<td>4</td>
<td>Transfer terms</td>
<td>• Agreement with local authority&lt;br&gt;• Promises to tenants</td>
</tr>
<tr>
<td>5</td>
<td>Forecasts and budgets</td>
<td>• Summary cashflow projections&lt;br&gt;• Key financial assumptions&lt;br&gt;• Linkages to financial strategies&lt;br&gt;• Outcomes of scenario/sensitivity testing</td>
</tr>
<tr>
<td>6</td>
<td>Service development</td>
<td>• Future intended services&lt;br&gt;• Development programmes&lt;br&gt;• Marketing proposals</td>
</tr>
<tr>
<td>7</td>
<td>Action plans</td>
<td>• Scheduling and phasing of works&lt;br&gt;• Strategy implementation plans&lt;br&gt;• Monitoring and reporting arrangements</td>
</tr>
<tr>
<td>8</td>
<td>Appendices</td>
<td>• Profiles of senior staff (if appointed)&lt;br&gt;• Profiles of board members (if appointed)&lt;br&gt;• Detailed income projection scenarios&lt;br&gt;• Cash flow projection scenarios&lt;br&gt;• Financial track record (if existing RSL)&lt;br&gt;• Detailed market research results – eg, housing needs analysis, Right to Buy projections</td>
</tr>
</tbody>
</table>

*Source: Audit Commission adapted from LGMB (Ref.3)*
Development of the business plan

A project plan developed for the transfer process as a whole will help to identify the timescale for production of the business plan. The production involves a complex co-ordination of data-gathering and decision-making. Some business plan assumptions are based on historic trends or market information, some on strategic objectives and others on newly gathered data such as stock condition analysis [TABLE 4]. Key elements, such as rental income growth, are heavily influenced by government policy.

<p>| TABLE 4 |</p>
<table>
<thead>
<tr>
<th>Source of business plan assumptions (for key elements)</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Element</strong></td>
</tr>
<tr>
<td><strong>INCOME</strong></td>
</tr>
</tbody>
</table>
| Rent | • Existing local authority rents, void levels and turnover rate  
• Corporation benchmark rents and performance indicators (Ref. 12)  
• Performance of comparable RSLs  
• Government policy | Rent policy  
Marketing strategy  
Voids strategy  
Development strategy  
Allocations policy |
| RTB receipts | • Historic local authority data on level of Right to Buy | RTB strategy on sharing receipts and making previously unmortgageable property attractive to lenders |
| Service charge income | • Local authority expenditure records  
• Local authority data on charges to leaseholders  
• Projected salary costs – eg, caretakers  
• Corporation guidance | Servicedeliverystrategy |
| **EXPENDITURE** | | |
| Revenue | | |
| Management and administration | • Local authority current costs  
• RSL/Corporation benchmarks  
• Market data on office/salary costs  
• TUPE requirements | Service delivery strategy  
Human resources strategy  
IT strategy |
| Day-to-day maintenance | • Stock condition data  
• Local authority historic spend data  
• RSL/Corporation benchmarks  
• Statutory landlord obligations | Service delivery strategy  
Stock improvement strategy  
Voids strategy |
| Planned maintenance | • Stock condition data  
• Local authority historic spend data  
• RSL/Corporation benchmarks | |
| Service costs | See service charge income above | |
| Tax | • Legislation | Constitutional policies |
| Funding costs | • Market data  
• Government statistics (Ref. 13)  
• Current RSL borrowing rates | Borrowing strategy  
Treasury management strategy  
(NB – all strategies have an impact on the amount of funding required) |

cont.l
### Table 4 (cont.)

<table>
<thead>
<tr>
<th>Element</th>
<th>Source(s)</th>
<th>Strategy(ies)</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Capital</strong></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Catch-up repairs</td>
<td>• Stock condition data</td>
<td>Stock improvement strategy</td>
</tr>
<tr>
<td>Improvements</td>
<td>• Stock condition data</td>
<td>Stock improvement strategy</td>
</tr>
<tr>
<td></td>
<td></td>
<td>Rent policy</td>
</tr>
<tr>
<td>Development</td>
<td>• Social Housing Grant data</td>
<td>Development strategy</td>
</tr>
<tr>
<td></td>
<td>• Land market data (including building cost inflation)</td>
<td></td>
</tr>
<tr>
<td></td>
<td>• RSL benchmarks</td>
<td></td>
</tr>
</tbody>
</table>

*Source: Audit Commission*

42. In order to deliver the information and the decisions as they are needed, input from relevant people should be identified and planned for at the beginning of the business planning process. Equally importantly, the leading players should make a realistic assessment of the time and money needed to resource the project. Failure to do this often leads to:

- arguments pre- and post-transfer about set-up costs;
- the local authority side being under-resourced; and
- senior local authority officers having dual and often conflicting roles, attempting to represent the interests of both sides.

Recent research concluded that the 'deployment of sufficient staff with the appropriate skills to deliver the proposal' by the local authority was critical to success of the transfer (Ref.11).

43. Since 1998, DETR's guidance on the treatment of set-up costs has been explicit (Ref.1). However, a number of RSLs visited were neither aware of the guidance nor had made a proper early assessment of the resources needed. Moreover, considerable disquiet was expressed about the reasonableness of the costs involved. A breakdown of the costs incurred by fieldwork RSLs showed legal fees ranging between £123,000 and £252,000, with no clear correlation between the size or complexity of the transfer and the fees charged. Better forward planning and an understanding of what needs to be done, by whom and when, should ensure better control of set-up costs for future transfers.
Some local authorities are reluctant or unable to commit sufficient resources to the transfer process.

44. Some local authorities are reluctant or unable to commit sufficient resources to the transfer process, due to:
- a failure to understand what is involved;
- political opposition to transfer so that senior officers are reluctant to appear too committed to the process; and
- other pressures — for partial transfers in particular, local authorities often assign responsibility to staff who are too junior to exercise the necessary authority.

45. The effects of this on business planning are that the information needed from the local authority is wrong or late (66 per cent of questionnaire respondents reported difficulty with availability of data); and that decisions needed by the local authority are not made until very late in the process. However, some local authorities have taken a longer-term view, appreciating that it is in the interests of all parties for the new landlord to have as good a start as possible. They also recognise that they have a greater chance of meeting their own strategic objectives if they devote sufficient resources to negotiating the terms of transfer [CASE STUDY 3, overleaf]. In some partial transfer cases, additional staffing resources put in by the existing RSL have helped to offset the shortfall in the local authority’s contribution [CASE STUDY 4, overleaf].
CASE STUDY 3

South Staffordshire LSVT — Resourcing the transfer process

South Staffordshire District Council covers an area of 156 square miles, with many small towns and villages in 27 parishes. The Council first considered stock transfer in 1995 because of concerns about spending constraints, rising rents and the need for new homes in a number of the villages. It had not built any new houses since 1978. The decision to transfer the whole stock to a new housing association was made following an options appraisal by consultants. The Council immediately seconded the director of housing, the deputy treasurer and a resources manager to deliver the project. The original consultants were appointed to act for the new RSL and new consultants were appointed to act for the local authority. A member-level LSVT committee was also set up to oversee the transfer. The shadow board was established in 1996. As there was no formal tenant participation in the district at that time, tenant members were appointed by the LSVT committee following receipt of applications and recommendations from officers. The independent members were similarly appointed. Because of the very positive presentation and promotion of the transfer, the new RSL had no difficulty in attracting independent members with appropriate skills and experience.

Unlike many transfers, there were few disagreements about set-up costs, all of which were deducted from the capital receipt, and the new RSL was self-sufficient from the first day after transfer. Formal separation of staff, equipment and accommodation ensured that new roles and responsibilities were clear immediately after transfer. Also, unusually, the time lapse between the ballot and the transfer was almost 12 months. The benefits of this were that the new RSL had sufficient time to:
- develop its policies and satisfy registration criteria;
- obtain an attractive funding package;
- clarify staff roles and develop the new board;
- mutually agree the price paid for the stock; and
- refine business plan assumptions.

Although the transfer was not without its problems – opposition from the minority party and difficulties in fixing the valuations due to rule changes – the up-front commitment of the local authority and early separation of roles have contributed to the success of the new RSL in exceeding its promises and out-performing its business plan.

Source: Audit Commission fieldwork
CASE STUDY 4

Three Rivers Housing Association (HA) – Resourcing a partial transfer

In January 1997, Three Rivers HA received the transfer of 279 homes on the Sherburn Road estate from Durham City Council. As a principle, the Council prefers to retain its own stock and generally seeks to fulfil its statutory housing obligations through partnerships with RSLs and private builders. Ninety per cent of its housing stock is in good condition. However, Sherburn Road was an exception – the estate was poorly laid out, in an unpopular area and suffering from severe social and economic deprivation. Earlier investment through estate action programmes had failed and the Council therefore agreed to support Three Rivers’ offer to take over the estate with ERCF support. At that time the number of unlettable voids on the estate was increasing by one a week.

Three Rivers set up an interdepartmental project team of senior managers to manage the transfer. The bid to DETR for an ERCF allocation and the business plan were prepared by Three Rivers' Business Development Manager, who also took the lead in co-ordinating transfer negotiations and consulting with tenants. Although the Council paid for the stock survey, the association's Technical Services team prepared the brief. At board level, members were involved in a special committee set up to oversee the transfer. Shortly before the ballot in March 1996, Three Rivers appointed a project manager to take on a challenging brief – to prepare the Sherburn Road community for a major estate-remodelling programme; to set up an estate team and an estate office; and to attempt to assemble enough information about tenancies, voids, arrears and existing contracts to enable valid business plan assumptions to be made.

This is a highly complex and difficult transfer – the estate office has been burnt down and there have been serious contract problems. However, Three Rivers approach to the set-up phase was pragmatic and well co-ordinated. It enabled a thorough appraisal to be made of the many risks involved and helped formulate the association's strategy for ongoing management and control of those risks.

Source: Audit Commission fieldwork
There is evidence, however, that certain business plan assumptions are manipulated in order to come up with the 'right' end figure.

46. LSVTs usually involve the transfer of the majority of the local authority's housing department, including senior officers, to a new RSL. In practice, this means that the terms of the transfer are 'devised' by a group of people who are, at the same time, local authority employees and prospective RSL employees. In some cases, the local authority treasurer and solicitor act on the local authority's behalf but their involvement comes at the end of the process and is limited in scope. As one local authority treasurer put it: 'The housing committee and the housing department presented the council with a fait accompli'. One effect of this duality of interest is that the starting point for business planning is the amount of capital receipt that the local authority is seeking, rather than a zero-based exercise where financing is predicated on business objectives. To some extent this can be viewed as a pragmatic approach to getting the best deal for the local authority, without compromising the viability of the new RSL. There is evidence, however, that certain business plan assumptions are manipulated in order to come up with the 'right' end figure. The potential consequence of this for the new landlord is a perpetual juggling of resources to compensate for under provision in one element of the business plan with over provision in another.

47. Repair and improvement costs are particularly susceptible to frequent adjustment. Substantial fluctuations – over 25 per cent – in works costs assumptions were identified from one version of a business plan to the next. These were partly attributable to revised stock survey data but a number of interviewees acknowledged that costs were recast or recategorised as a means of bargaining the stock price up or down. This does not assist in the preparation of a business plan that will prove both robust and deliverable.

48. The key tasks for business planners are to gather good quality information and make informed and timely strategic decisions. The main source of data is the local authority, which needs to assemble information showing current costs and performance, and trends over time. This has proved to be particularly problematic for partial transfers, as many local authorities have traditionally kept records on a functional basis – for example, repairs – rather than using estate-based cost centres. In future, DETR’s requirements for local authorities to adopt resource accounting procedures may make estate-level data more easily accessible (Ref. 14). Strategic decisions that have an impact on the business plan require input from all the key stakeholders.

Local authority

49. In broad terms, decisions about which stock to transfer and the vehicle for transfer have an impact on the business plan. Viability is more difficult to achieve for smaller parcels of stock or estates where all the dwellings require major upgrading. Private lenders are willing to finance stand-alone transfers but may charge a premium to offset the
greater perceived risks associated with new organisations. More specifically, local authority input is required into any strategic decision that affects the terms of the transfer and the offer to tenants (the formal offer is made by the local authority). These decisions include:

- **Service delivery** – whether any related services will be retained by the local authority, where services will be delivered from, service levels, which local authority employees/contractors will transfer?
- **Rents** – level of starting rents, differentials between existing tenants and new tenants, annual rate of increase (including guarantees to tenants), cost-reflective rent increases, sale of arrears;
- **VOIDS AND ALLOCATIONS** – standard of relets, whether special tenant selection arrangements are desirable, whether intensive marketing is appropriate;
- **Stock improvement** – who should commission a stock survey, what should it contain, which work is mandatory and which optional, level of upgrading, length of works programme? Environmental works – links with other regeneration initiatives;
- **Catch-up repairs** – length of works programme, any pre-transfer or pre-ballot works;
- **Development** – number of new homes needed and where, how much subsidy? and
- **RSL funding** – warranties, financing of set-up costs, contingencies; sharing agreement on RTB sales.

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1 In the case of whole stock transfers, the new landlord is sometimes contracted to deliver homelessness services and administer housing benefit. This would not be a consideration for partial transfers.
Tenants

50. The level of tenant involvement in decision-making is very variable. There is evidence of a direct correlation between the level of tenant input and the degree of refinement to business plan assumptions before transfer. This is explained partly by the bargaining process – a powerful tenant lobby can demand very specific promises about service levels, rent levels and improvement standards, in return for a positive ballot – and, partly because tenants have considerable understanding of the causes of problems on estates and can point to solutions that are likely to be the most successful [CASE STUDY 5]. Tenant input is also clearly required for decisions about future tenant participation or management structures, resources for which will need to be earmarked in the business plan.

51. The key decisions requiring tenant input are:

- **Rents** – affordability of relet rents and proposed cost-reflective increases, sustainability of differentials, reasonableness of service charges;

CASE STUDY 5

The contribution to business planning of tenants at Limehurst Village

Limehurst Village Trust (LVT) is an LHC subsidiary of West Pennine Housing Association. It was set up in March 1998 to take the transfer of 649 dwellings from Oldham MBC. This transfer was unusual in that it was sponsored jointly by two RSLs – West Pennine HA and Portico HA. Both RSLs are represented on the LVT board of trustees and jointly hold the freehold of the properties. The transfer was initiated by tenants who were anxious to find a vehicle to bring much needed investment to the area. An SRB bid had recently failed, and tenants at Limehurst rejected the option of tenant management because it did not meet their needs. Limehurst is a close-knit and stable community and some of the tenant board members, who have lived on the estate for many years, have a good understanding of the dynamics of their community. They also had a very clear idea about what LVT’s investment priorities, both physical and economic, should be. The Chair of the board, a local authority nominee, had similar local understanding as she had been brought up on the estate.

During the transfer process, the tenants’ association, which was well established and effective, was closely involved in preparing the bid to DETR and in selecting an RSL to work with on the transfer. Tenants selected West Pennine and Portico’s joint bid ahead of three other competing RSLs.

During the set-up phase, tenants elected five representatives to serve as shadow board members, and tenant association representatives were also involved in the transfer steering group negotiations.

Both pre- and post-transfer, tenant board members took part in a range of training sessions and conferences that helped them to come to grips with the complexities of business planning. They understand the financial implications of the decisions they make to place or vary contracts. They feel that they genuinely share power with other board members and have a strong sense of responsibility for delivering LVT’s plans and promises.

Source: Audit Commission fieldwork
Effective early secondment of high-calibre staff can offer the best opportunity for informed strategic decisions to be made.

- **Service delivery** – acceptable service levels, office location, staffing structure/staff skills;
- **Voids and allocations** – standard of relets, whether special tenant selection arrangements are desirable, whether intensive marketing is appropriate;
- **Stock improvement** – extent of tenant choice, standard of specification, timing and order of works, decanting options; value of show houses, viability of environmental works; and
- **Catch-up repairs** – sample size and brief for stock survey, timing and order of works, standard of specification.

**New landlord**

52. The RSL board is ultimately responsible for ensuring the viability of its business and the robustness of its business plan. Although the board should take responsibility for all the strategic decisions that are not local authority pre-conditions, the level of its involvement is affected by the type of transfer. Transfers to existing RSLs involving subsidiaries and new stand-alone RSLs offer the opportunity for new board or committee members to build their team and their business through the business planning process. Board members of existing RSLs receiving direct transfers normally delegate strategic development to officers or, in some cases, a steering group with board representation. They are therefore involved in agreeing proposals that are already fully formulated.

53. The involvement of the new landlord’s staff in strategic decisions is much more straightforward for existing RSLs, since senior managers and other specialist staff are in post from the start. Although the establishment of a subsidiary may involve recruiting a separate management and staff team, the parent body is able to begin the process and appoints new staff as soon as it is deemed viable. For stand-alones, if staff are not seconded at an early stage from the local authority, to act as executives for the shadow RSL, then the new board’s decision-making is reliant on guidance from:

- local authority staff who have a dual and possibly conflicting interest; or
- consultants who have no practical experience of managing either the stock to be transferred or the staff.

Effective early secondment of high-calibre staff can offer the best opportunity for informed strategic decisions to be made. The staff involved have the freedom to focus on the best solutions for the new RSL while benefiting from first-hand experience of the stock, the staff and the tenants. In one partial transfer organisation visited, the local authority had decided to second most of the front-line staff from the existing estate office. This group was then drawn into the decision-making process and contributed valuable knowledge and experience.
Timing of decisions and actions

54. Some RSLs expressed the view that the deadlines and time constraints inherent in the transfer procedure created welcome pressure to resolve issues quickly, and prevented the parties disappearing in a fog of options and disagreement. Some tenants complained that key decisions, which should have featured in the formal Offer, were made after the ballot. As discussed above, high quality outputs from the business planning process demand reliable inputs. Some of these inputs are readily available; others take time to develop. Elements that are frequently squeezed – or left too late to get right – are cost assumptions for works and improvements and for management costs.

55. The capital costs of catch-up repairs, major repairs and improvements are significant, averaging £12K per unit over the first five years at the sites visited. This partly explains why they are so often the subjects of greatest debate. It is most important therefore that sufficient time is devoted to the development of the cost assumptions that are fed into the business plan [EXHIBIT 6]. Reliance on local authority stock condition data more than two years old is not recommended. In a number of transfer cases, data from two or more condition surveys – a local authority update and a new survey commissioned by the RSL – was utilised. This is not recommended unless the new survey is to provide specialist analysis of particular defects – for example, in the case of non-traditional construction. The most successful results appear to be where a single survey is commissioned jointly by the local authority and the RSL. DETR is currently developing detailed guidance on the commissioning of stock surveys and a leading consultant has drawn up a model brief for use in stock transfers [APPENDIX 1].

EXHIBIT 6
Developing capital programme cost assumptions

Sufficient time should be allowed for the development of accurate works costings.

Source: Audit Commission
56. The difficulties in projecting future management costs accurately are particularly acute for RSLs taking on stock with long-term sustainability risks. Many underestimate the number of extra staff that will be needed to provide effective links with regeneration initiatives, to support and develop the board, to facilitate tenant participation, and to resolve long-term void problems. For all transfers involving transfer of local authority staff, sufficient time needs to be devoted to deciding new structures and negotiating new roles and conditions of employment. This is normally left until after the ballot, because of:

• the risks of committing management/consultant time prior to the ballot; and/or
• the risk of appearing presumptuous about the outcome of the ballot if negotiations are at an advanced stage.

However, there is an equally powerful argument that tenants are more likely to support a transfer if front-line local authority staff are also vocal in their support [CASE STUDY 6]. The earlier that information is gathered and decisions made, the more refined the business plan can be before the new landlord takes on responsibility.

CASE STUDY 6

Ryedale HA - Agreeing staffing structures pre-ballot

Ryedale HA is a stand-alone LSVT RSL set up to receive a whole stock transfer from Ryedale District Council. The local authority ensured that both sides were well resourced during the transfer process. It was jointly agreed that securing staff commitment to the transfer at an early stage was critical. An establishment for the new RSL was agreed and a person specification drawn up for each proposed post before the ballot of tenants. Although, in most cases, jobs were not advertised externally, all local authority staff, including the management team, that wished to transfer were interviewed and had to demonstrate that they met the requirements of the person specification. Some were disappointed, but were retained by the local authority in a different capacity. The new posts were actually taken up at various points between the ballot and the transfer. The RSL believes that this enabled all staff – during the critical period between ballot and transfer – to focus on the detailed planning necessary to ensure a smooth transition from local authority to new landlord.

Source: Audit Commission fieldwork
### The business planning process

<table>
<thead>
<tr>
<th>ACTION</th>
<th>BYWHOM</th>
<th>MAIN DIFFERENCES FOR STAND-ALONES AND PARTIAL TRANSFERS</th>
</tr>
</thead>
<tbody>
<tr>
<td>Have the requirements of the different audiences of the business plan been determined?</td>
<td>RSL</td>
<td>Availability of historic data is likely to be much more problematic for partial transfers. Existing RSLs will be able to draw on past experience of managing RSL stock – stand-alones will not.</td>
</tr>
<tr>
<td>Does the business plan document contain a statement of strategic objectives together with a statement of how they will be met?</td>
<td>RSL</td>
<td></td>
</tr>
<tr>
<td>Were national policy objectives understood and incorporated into the business planning process?</td>
<td>RSL</td>
<td></td>
</tr>
<tr>
<td>Have all information sources for income and expenditure assumptions been identified?</td>
<td>RSL</td>
<td></td>
</tr>
<tr>
<td>Have sufficient resources been allocated to access the information?</td>
<td>LA/RSL</td>
<td></td>
</tr>
<tr>
<td>Is there a timed plan for the policy and strategy development needed for the business plan?</td>
<td>RSL</td>
<td>Stand-alones will need to start from scratch and will need more time.</td>
</tr>
<tr>
<td>Have the contributions to business planning required from the key stakeholders been identified and agreed?</td>
<td>LA/RSL</td>
<td></td>
</tr>
<tr>
<td>If stock condition information is more than two years old, have the local authority and the new landlord jointly commissioned a new survey?</td>
<td>LA/RSL</td>
<td></td>
</tr>
<tr>
<td>Will accurate stock condition costings be available when needed for borrowing and business planning purposes?</td>
<td>RSL</td>
<td></td>
</tr>
<tr>
<td>Have the stakeholders made adequate pre-ballot preparations to ensure that there will be sufficient time after the ballot to finalise the business plan?</td>
<td>LA/RSL</td>
<td></td>
</tr>
</tbody>
</table>
The business planning process

DETR and Corporation jointly should:

1. Issue joint guidance on their respective transfer requirements, including use of consultants.¹

The Corporation should:

1. Create a separate stock transfer peer group in the published Performance Indicators.

2. Give guidance to new transfer RSLs on sources of benchmarking information.

¹ Guidance on local authorities’ use of consultants is available in Reaching the Peak (Ref. 15) and for RSLs in Consultants’ briefs... the small print: Model for transfer organisations (Ref. 16).
Financial components

To satisfy all stakeholders the financial model must be robust and comprehensive. It is the product of intensive negotiations between the new landlord and the local authority about the value of the stock. Both sides should work together to develop prudent but reasonable assessments of future costs and income.
A good business plan blends coherent text and reliable financial calculations, and – like a well-written cheque – the words and figures must agree. Because of the need to include all elements of income and expenditure over a 30-year period, stock transfer financial calculations are complex and lengthy. Although different stakeholders require different levels of detail, it is important that the financial components of the business plan are not regarded as the sole preserve of financial experts. They should therefore be presented in a way that enables the 'lay' board member to take ownership of the figures as well as the words.

The various consultants' models differ in detail rather than in substance.

The key points to address are:
- What does a robust financial model look like?
- How does it link with the TMV model?
- How can we ensure that the inputs are reliable?
- What happens if our assumptions are wrong?
- How do we validate the outputs?

Modelling

The business plan financial model is checked by DETR to ensure that the valuation is compatible with the TMV, and appraised by the Corporation and potential lenders to ensure that the new landlord is viable, and that the transfer is fundable. For these audiences, as well as internal audiences, the model should:
- have an easily referenced layout;
- be flexible, to enable regular remodelling as circumstances change;
- have easily traceable and professionally derived assumptions; and
- show simple graphic presentations of the spreadsheet data.

Most models have traditionally been developed for stock transfers by a handful of specialist consultants – one consultancy has secured 70 per cent of the market so far. The presentation of their models is therefore familiar to lenders and to the Corporation. In most cases, lenders feed the data supplied into their own models in order to calculate the likely rate of return. The various consultants’ models differ in detail rather than in substance and the component parts should essentially be the same for all stock transfers [BOX E, overleaf]. Appendices 2, 3 and 4 illustrate how to present cashflow projections, a scenario analysis and an expenditure analysis graph.
Using the TMV

60. The process for developing the assumptions that feed into the business plan financial model involve the data gathering and strategy formulation described in Chapter 2. However, outline forecasts are often worked up by the new landlord using the data gathered for the TMV calculation. The capital value of the stock is a critical factor in determining the viability of the transfer and DETR also requires that the financial data used for the TMV and that used for the RSL’s projections are compatible. There is a three-stage process for calculating the TMV (Appendix 5 shows how typical costs should be treated at each stage):

- **Stage 1 TMV** – net present value (NPV)\(^1\) of future rental income stream allowing for repairs and renewal;

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\(^{1}\) Financial ratios such as asset cover are discussed in Chapter 4.

\(^{2}\) The NPV is determined by projecting the income and expenditure streams for the transferring stock over 30 years and then discounting it back at a stipulated rate to reflect the true cost of borrowing. For positive value transfers, the income stream exceeds the expenditure stream and the net income represents the price to be paid for the stock. Where expenditure exceeds income, the net figure represents the grant required.
...the local authority has an obligation to its council tax payers and any remaining tenants to maximise the capital receipt...

- **Stage 2 Full valuation** – As Stage 1, plus the cost of on-going improvements at the time of transfer and other works to the estate which do not attract rent increases; and

- **Stage 3 Final valuation** – As Stage 2, plus the cost of improvement works and the cost-reflective rent increases necessary to pay for them; the final valuation is the transfer price.

61. The cash-flows used to generate the capital receipt/dowry can then be converted for the purposes of the outline business plan. This is a critical exercise – the local authority has an obligation to its council tax payers and any remaining tenants to maximise the capital receipt, while the RSL has an obligation to its tenants to minimise risk and build contingency into the business plan. Although DETR is interested in maximising the receipt to the public sector, or stretching public sector support for dowries as far as possible, it is also concerned about the longer-term pressure on rents, housing benefit and the public sector borrowing requirement (PSBR). Lenders certainly feel more secure if grants are high and transfer prices low. In simple terms, if the price is too high or grant is too low, the RSL must either borrow too much or invest too little. If the price is too low, the public purse suffers and the RSL is too generously protected.

62. In Scotland, negotiation about transfer price is rare since Scottish Homes, the housing agency for Scotland, encourages competition among alternative landlords. Scottish Homes sets an indicative price for the stock based on an independent valuation. Offers are required to at least meet this indicative price. The view of Scottish Homes is that, 'As well as helping to ensure the best return to the public purse, competition usually succeeds in attracting a variety of quality proposals, thus offering tenants a greater choice of future landlord' (Ref. 14).
Evidence was found of parent RSLs providing substantial additional subsidies, and of new RSLs breaking improvement programme commitments to tenants in order to compensate for insufficient grants. Similarly, a number of LSVT local authorities felt that the level of operating surplus and/or the level of overhead generated by new RSLs indicated that the price was too low. An important distinction between grants and the purchase price is that the former are less flexible once DETR has approved them, although extensions are sometimes agreed at a later stage. The latter may be revised during negotiations until closer to the date of transfer. It is quite clear that, in order to arrive at an appropriate price/grant, the local authority and the RSL should:

- share information on financial projections/valuation cashflows;
- work together to develop prudent but reasonable assessments of key variables, in particular:
  - repair and improvement costings;
  - rate of conversion from lower transfer rents to re-let rents; and
- allow sufficient time in the project plan for constructive negotiation and a number of adjustments of the valuation [EXHIBIT 7].

**EXHIBIT 7**

**Process for calculating the TMV**

The project plan should allow sufficient time for constructive negotiation of the valuation.

Source: CIPFA (Ref. 15)
64. It is frequently argued that negotiation about the variables in the valuation has become increasingly meaningless because of the inappropriateness of the stipulated discount rate. Until the recent reduction this had been constant – at 8 per cent – since the earliest transfers in 1988. The discount factor is built into the valuation to reflect the assumed cost of borrowing private funds to finance the transfer. Some transfer RSLs, which took out loans in the early 1990s when interest rates were high, felt that 8 per cent was too low – some are still paying for long-term fixed-rate loans at over 12 per cent. But, in recent years, transfer RSLs have been able to obtain funds at a much lower cost. Negative value transfer organisations may also be under some pressure from lenders to build a greater comfort zone into their business plan assumptions because of the greater financial risks for those transfers. Negotiation between local authorities and RSLs has therefore focused on what discount on 8 per cent should be built into the business plan borrowing cost assumptions. In May 1999, DETR announced a new discount rate of 7 per cent (8 per cent will still apply to ERCF schemes already approved). 1 Although it is too early to assess whether 1 per cent is sufficient, the reduction should help both sides concentrate on debating about capital programmes and running costs.

65. Chapter 2 described the various sources of data for the financial assumptions. In practice, although the local authority’s records and its local intelligence are the main source, the data provided is often out of date, inadequate or, simply, inappropriate to the needs of the new landlord. RSLs should, wherever possible, seek alternative or additional sources of information. Then Corporation collects and publishes performance information on an annual basis on some 400-500 RSLs including stock transfer RSLs (Ref. 11). This can provide useful benchmark data for long-term assumptions, but new landlords should also refer to other sources to assist in formulating their assumptions in the early years after transfer.

66. The National Housing Federation co-ordinates two liaison groups for stock transfer RSLs – one of which is for organisations at set-up stage. These groups can offer opportunities for intelligence sharing and informal benchmarking. Chapman Hendy Associates runs a benchmarking club on behalf of 250 RSLs and has also built up a database of stock condition costings that enables them to identify appropriate benchmarks for particular types of stock. Arthur Andersen also offers benchmarking services to RSLs. Benchmarking with other RSLs generally, and with stock transfer RSLs in particular, can help new landlords to estimate income and expenditure flows that are unfamiliar to local authorities, such as:

• service charges;
• LHC running costs;

1 If the proposed transfer is not fundable at 7 per cent, valuations may continue to use 8 per cent discount rate.
If a number of the assumptions are wrong, the cumulative effect on the business plan – apart from damaging stakeholder confidence – can be serious...

Only 10 per cent of RSLs surveyed had used RSL comparators to formulate their assumptions, relying instead on officers’ estimates, Corporation allowances and local authority historical data [EXHIBIT 8].

All the LSVT RSLs in the sample had based their management costs solely on local authority performance. The existing RSLs visited also referred to the income and expenditure streams of their other stock. This provided reliable assumptions for those with experience of estate management and estate refurbishment, but less so for those whose stock comprised mainly new build estates and street properties. The assumptions which are most susceptible to substantial variation, and which would therefore benefit from additional verification, are:

- overheads/premises costs;
- voids (where local authority data is out of date and void levels during works are underestimated);
- arrears (poor data provided by local authority on housing benefit arrears; delays in housing benefit administration post transfer);
- catch-up repairs;
- repairs administration;
- reactive maintenance (change of landlord releases pent-up demand); and
- RTB sales (the effects of fluctuation are now generally neutralised via a sharing agreement between the local authority and RSL).

Risk assessment

If a number of the assumptions are wrong, the cumulative effect on the business plan – apart from damaging stakeholder confidence – can be serious, requiring a slowdown in the works programme or a reduction in service. However, there are a number of key variables where only very small fluctuations can have a serious impact on the viability of the business plan. All the RSLs surveyed and those visited had carried out some form of sensitivity testing. This involves testing the resilience of the business plan to changes in income and expenditure flows. The minimum required by the Corporation, as part of the business plan validation, is a flexing of the following assumptions to demonstrate the impact on the RSL’s debt profile:

- interest rates;
- inflation;
- rent increases;
- major works;
- management costs;
• re-let rates;
• new development programmes;
• social housing grant rates; and
• RTB/Right to Acquire Sales.¹

EXHIBIT 8

Source of void and rent loss assumptions

Only 10 per cent of RSLs surveyed used RSL comparators.

Source: Audit Commission questionnaire

¹ The Right to Acquire was introduced in 1998.
...the impact of a 1 per cent change in interest rates can increase an RSL's peak debt by 30 per cent...

69. Minor variations in some of these assumptions can have a major impact on the RSL’s peak debt (the maximum debt outstanding during the 30-year period) and the impact of a 1 per cent change in interest rates can increase an RSL’s peak debt by 30 per cent [TABLE 5].

70. In addition to this type of sensitivity test, which looks at the effect of individual adjustments, business planners might find it useful to construct a scenario analysis, involving the input of a set of assumptions reflecting certain adverse conditions. This is particularly recommended for negative value transfers, where the business plan can be very susceptible to falling demand and escalating works costs. Appendix 3 shows how adverse movements in the cost of catch-up repairs and void rates can seriously affect the viability of an ERCF transfer business plan.

71. These exercises help to identify the areas of greatest risk in the business plan and also those areas where there may be some room to minimise the impact. It is therefore vitally important that the key stakeholders, particularly tenants, are involved in the process and understand what the figures mean. Evidence indicates that board members, tenants and non-financial managers do not acquire an understanding of the financial implications of changing circumstances until after transfer, and then only if the movement is adverse and difficult decisions have to be taken. This emphasises the need to integrate the financial modelling process closely with strategy formulation, so that the RSL does not make commitments before transfer which threaten its future viability.

<table>
<thead>
<tr>
<th>TABLE 5</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Sample sensitivity test</strong></td>
</tr>
<tr>
<td>Sensitivity</td>
</tr>
<tr>
<td>Base model</td>
</tr>
<tr>
<td>Inflation +1 per cent</td>
</tr>
<tr>
<td>Inflation -1 per cent</td>
</tr>
<tr>
<td>Interest rate +1 per cent</td>
</tr>
<tr>
<td>Interest rate -1 per cent</td>
</tr>
<tr>
<td>Relet rents real growth 0 per cent</td>
</tr>
<tr>
<td>Management costs real growth +1 per cent</td>
</tr>
</tbody>
</table>

*Source: Audit Commission fieldwork*
72. Although RSLs have the capacity to negotiate more or less favourable terms of borrowing, they have no control over the general level of interest rates or over the RPI. Since movement in these areas has such a large impact on the business plan, RSLs generally make conservative assumptions about the starting point. All the RSLs visited that were in receipt of ERCF grant had assumed an inflation rate of 3 per cent a year for the full 30 years. While this rate might appear pessimistic, current forecasts would indicate that it is not overly conservative. However, as discussed earlier, borrowing cost assumptions had generally proved unduly pessimistic.

73. Since the imposition of greater rent controls, RSLs have had very little capacity to hedge against other risks through rent adjustments. They should, therefore, pay very close attention to starting rents (the level of rents for new and transfer tenants at the point of transfer). In areas of falling demand, or where there is competition from other landlords, it is important that rents are sustainable and keep within the parameters determined by government and the Corporation. In some cases the differentials are very high – up to 38 per cent – although the level of rents for new tenants are still deemed reasonable within the local context. If differentials are high but turnover slow, there is a risk that the two rent systems will not converge for many years and appear inequitable to tenants. However, prudent RSLs should seek to maximise the rent receivable at the onset, with a view to slowing down the rate of increase if they out-perform their business plans. The Corporation also expects that RSLs will reduce their highest rents if they are generating significant supplies.

74. If the assessment of risk shows that small movements in uncontrollable areas can put the business plan in jeopardy, RSLs should seek to build as much comfort as possible into their assumptions about the variables that they can influence – repair and improvement costs, management costs, voids and bad debts and turnover. This is particularly important for negative value transfers, where works programmes tend to be more complicated and more difficult to cost accurately, and where there is generally less social and economic certainty in the community. In most cases the RSLs reported that they had under-estimated void and bad debt losses, in contrast with the positive value transfers where, generally, such losses had been much lower than predicted.
Validation

75. As part of the process of registering new RSLs, the Corporation requires the RSL board to commission an independent validation of the business plan by professional auditors and gives guidance on how this should be commissioned (Ref. 6). The Corporation expects that the board will give full and serious consideration to the validator's report, which may also be utilised by private lenders. The validation serves to:

- check accuracy – the validator checks that the financial projections are consistent with the assumptions and that the arithmetic is correct;
- check sensitivity testing;
- comment on achievability of the plan; and
- provide another opinion on the reasonableness of the assumptions.

Validation should begin as soon as the ballot is complete to give the RSL sufficient time to use the findings to influence negotiations.

76. Quality assurance of the business plan is extremely important. The financial detail – involving projections over 30 years – by virtue of its volume, is susceptible to computational error. It is therefore vital that it is verified by a third party. As previously discussed, where business plan assumptions have been based largely on historic data, it is particularly important that those assumptions are challenged by an independent validator. However only one of the RSLs visited felt that the validation exercise had added value to the planning process, by challenging its assumptions and recommending substantial improvements to the business plan. Others complained that validator reports are typically full of caveats, particularly in relation to the local authority’s data, and therefore give only limited comfort to the reader. Private lenders feed the RSL's assumptions into their own funding models to check accuracy and run sensitivity tests. Some Corporation regional accountants also carry out their own analysis and in a number of cases suggested revisions that were taken on board by the RSL. But, these tests are for the lender's or the accountant's particular purposes – RSL boards should commission validation reports that assist their deliberations and improve their understanding of the key risks to their new business.
### Financial components

<table>
<thead>
<tr>
<th>ACTION</th>
<th>BY WHOM?</th>
</tr>
</thead>
<tbody>
<tr>
<td>Do all members of the board and management team understand the key elements of the financial model?</td>
<td>RSL</td>
</tr>
<tr>
<td>Is the model presented in a flexible and accessible manner?</td>
<td>RSL</td>
</tr>
<tr>
<td>Are the assumptions in the model reconcilable with the TMV?</td>
<td>RSL</td>
</tr>
<tr>
<td>Have the local authority and RSL worked together to ensure that the valuation is based on accurate costings and prudent assumptions?</td>
<td>RSL/LA</td>
</tr>
<tr>
<td>Have assumptions derived from historic data been verified by benchmarking?</td>
<td>RSL</td>
</tr>
<tr>
<td>Have the costs of any Housing Plus proposals been fully provided for in the business plan?</td>
<td>RSL</td>
</tr>
<tr>
<td>Has a rigorous risk appraisal been carried out?</td>
<td>RSL</td>
</tr>
<tr>
<td>Has this been reported to the board?</td>
<td>RSL</td>
</tr>
<tr>
<td>Have the Corporation’s minimum sensitivity testing requirements been met?</td>
<td>RSL</td>
</tr>
<tr>
<td>Have tenants, staff and board members carried out scenario analysis?</td>
<td>RSL</td>
</tr>
<tr>
<td>Has the arithmetic in the model been checked?</td>
<td>RSL</td>
</tr>
<tr>
<td>Have the business plan assumptions been validated by independent auditors?</td>
<td>RSL</td>
</tr>
<tr>
<td>Has the board received the validator’s report and given due consideration to its recommendations?</td>
<td>RSL</td>
</tr>
</tbody>
</table>

### MAIN DIFFERENCES FOR NEGATIVE VALUE TRANSFERS

Once a negative value has been established, both sides will wish to maximise the subsidy element.
Financial components

DETR should:

1. Consider requiring all transfers to be open to competing bidders, including any in-house bid.

The Corporation should:

1. Clarify its expectations regarding rent convergence.

2. Strengthen its guidance on the purpose and use of validation reports.
Delivering the plan

The RSL’s board and managers must take firm ownership of the business plan as soon as possible to ensure that they honour their commitments to tenants and other stakeholders. A flexible package of funding is critical to successful delivery of the plan. Input from key stakeholders can also help keep the new business on track.
It is critical therefore that the RSL’s new managers and board members take firm ownership of the business plan as soon as possible...

77. Before transfer, the business plan is a vital tool to help stakeholders determine the direction and priorities of the new landlord and identify key risk areas. After transfer, it is equally important as a means of keeping the business on track and providing a basis for service delivery plans and targets. For new RSLs in particular, the early stages of business planning – where a shadow organisation with no powers and no funds attempts to predict the future – can appear irrelevant. It is critical therefore that the RSL’s new managers and board members take firm ownership of the business plan as soon as possible, and understand the importance of delivering their projects and services within the parameters set. The new landlord cannot begin to run its business until after it has been registered and after the transfer of stock, but delivery of the business plan begins before transfer as the new landlord must secure an offer of private funding for the plan as a condition of registration.

The key points to address are:
- Who is responsible for what?
- How do we get the funding right?
- How do we ensure we can meet our commitments?
- How do we manage our risks?
- What are the important strategic issues?

78. The critical success factors in delivery of the business plan are:
- having the right people in the right jobs (executive and non-executive);
- effective management;
- flexible agreements; and
- clarity of purpose.

While the new landlord has prime responsibility for making these requirements a reality, input from other stakeholders can greatly help or hinder their delivery [EXHIBIT 9].

Roles and responsibilities

79. For new RSLs, it is a condition of registration that the transfer is underpinned by a viable business plan and an offer of private finance. After registration, the Corporation has statutory powers to ensure ongoing compliance with its requirements, undertaken through desktop monitoring and formal visits. All RSLs are required to submit up-to-date copies of their business plans as part of the annual performance monitoring return. It has also been Corporation policy to carry out in-depth visits to stock transfer RSLs a year after transfer. More recently, some regional offices have made brief visits after six months in order to keep abreast of teething problems and to ensure that the RSL is
addressing any shortfall in compliance that was noted at the time of registration. The Corporation is also proposing to increase the level of post-transfer monitoring in the first two years. The effectiveness of these procedures in helping to keep business plans on track is variable, depending on the skills and experience of regional staff. Although the purpose of monitoring visits is much wider than a review of financial viability, certain benefits flow from a regular and structured appraisal of performance against business plan targets:

- acting as a discipline to RSLs to carry out their own regular reviews;
- alerting the Corporation to possible future viability problems;
- enabling Corporation staff to broaden their understanding of how business plans change and of the relative impact of different factors; and
- enabling the Corporation to monitor trends in the performance of stock transfer business plans, generally and by type.

80. The Corporation administers the payment of grant to ERCF projects and monitors the RSL's performance in delivering the project against a delivery plan. This is agreed with the RSL prior to any draw-down of grant and is reviewed annually to ensure that the grant has been utilised appropriately.

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**EXHIBIT 9**

**Key elements in delivery of the business plan**

Input from other stakeholders can help the new landlord to deliver the plan.

*Source: Audit Commission*
DETR

81. The DETR has no role, after transfer, in monitoring the progress of the new landlord. It is, however, currently developing ERCF indicators that include measures of quality of life, housing stock condition and works costs. One purpose of these is to measure baseline conditions before transfer in order to evaluate change and the policy outcomes after transfer. This evaluation is likely to have an impact on business plan performance, since the RSL will need to demonstrate that the transfer has led to tangible improvements in key areas and good value for money.

82. DETR input at transfer approval stage could also affect the RSL’s capacity to deliver its business plan at a later stage, as its approval is required to the terms both of the Transfer Agreement and the formal Offer to tenants. However, very little evidence was found of DETR influencing the terms of transfer.

Local authority

83. In a number of the transfers studied, relationships between the local authority and the RSL were poor after transfer. Symptoms of this were ongoing arguments about set-up costs, exclusion of the RSL from other initiatives, ineffectual participation by local authority board nominees and a lack of local authority concern for the housing or for the community. The impact of this on the RSL’s ability to meet its commitments was negligible for LSVTs but significant for partial transfers.

Tenants

84. Tenant commitment to the objectives of the new landlord is crucial. Despite the degree of comfort RSLs may build into their assumptions about voids and arrears, the transfer may still falter financially unless tenants feel positive about their environment, and work with their new landlord to promote the improvements and deliver them on time. Evidence was found of wider tenant involvement dropping off after the ballot although, in the case of LHCs, involvement at board level was better defined. This is partly explained by the withdrawal of the tenants’ friend from the process after the ballot. While the tenants’ friend does not necessarily affect the level of tenant interest, his or her continued involvement can affect the quality of the contribution tenants can make to business planning and business plan delivery [CASE STUDY 7].

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1 The costs of the tenants’ friend are an eligible HRA cost before, but not after, ballot.
CASE STUDY 7

Adding value to the tenant contribution in South Liverpool

Following Liverpool City Council’s decision to carry out an options appraisal for the housing stock in the Speke and Garston areas, PEP consultants were appointed to act as independent tenants’ advisers. This was unusually early in the process – the tenants’ adviser is normally appointed after the local authority has decided to pursue a transfer. More unusually, South Liverpool Housing the new RSL set up to receive the stock, and the council agreed that PEP should continue to support tenants after the ballot. PEP’s role has been to provide:

- advice to tenant representatives in negotiating the terms of the Offer;
- training for tenant board members;
- information on transfer progress to all tenants; and
- a second opinion on formal documentation such as tenancy agreements and draft policies.

South Liverpool’s active tenants’ committee has developed a process for linking with tenant board members. The tenants’ adviser facilitates this by providing a summary of board papers for discussion by the tenants’ committee, before the board meeting takes place. This improves tenant board members’ understanding of the issues under debate and gives them a ‘barometer’ of tenant opinion. Equally importantly, a wider group of tenants gains the opportunity to influence board decisions (although some confidential papers are withheld from wider circulation).

The tenants’ committee is very knowledgeable about the financial structure of their stock transfer. It campaigns vociferously against measures which do not offer value for money, either for tenants or for the business. The long tenure of the tenants’ adviser, together with an effective consultation structure, has clearly contributed to the development and harnessing of that knowledge.

Source: Audit Commission fieldwork

RSL board members

85. Some of the factors which affect the capacity of the board to take ownership of the business plan were discussed earlier – inadequate preparation time, over-reliance on consultants, failure to link policy formulation with financial planning. Volunteer board members should not be expected to take control of the day-to-day implementation of the business plan and its subordinate service plans. But they must have sufficient understanding of its contents and faith in its objectives to take
ownership of it whole-heartedly [EXHIBIT 10]. The key responsibilities of board members in delivering the business plan are to:

- ensure that the organisation has the requisite business planning and business management skills at its disposal;
- secure the best possible terms in the transfer agreement with the local authority and in the funding agreement with lenders;
- ensure that the promises made to tenants are realistic and achievable;
- be aware of the key risks in the business plan;
- consider and respond to the business plan valuation report;
- identify when funds will be needed and how they will be accessed;
- set clear performance targets and regularly monitor performance against them;
- regularly monitor the impact of changing circumstances and variable performance on business plan projections; and
- refine and adapt the business plan to reflect the changing needs of stakeholders inside and outside the organisation.

### RSL staff

86. Some of the RSLs visited shared ownership of the business plan with staff at a relatively junior level. In one case, the local estate manager was fully aware of the impact on the debt profile of increasing numbers of voids; in another, an operational manager regarded delivery of the business plan as his key personal objective. Elsewhere, business plans appeared to gather dust for most of the year and were pulled out annually to update projections in accordance with funding covenants. Successful implementation of the business plan requires staff commitment as much as tenant commitment, in order to:

- keep the business plan 'live' by regularly feeding in changes and refining projections;¹
- minimise and effectively manage risk;
- understand how the financial model works and rework scenarios;
- ensure effective management of positive cashflows;
- obtain value for money in the procurement of works/service contracts;
- obtain value for money and reasonable terms from private lenders;
- secure reasonable terms of transfer; and
- build constructive relationships with other stakeholders.

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¹ As the business plan defines lenders covenants, their approval will normally be required before changes can be made.
87. The level of borrowing that the RSL requires is calculated from the 30-year cashflow projections in the business plan model. In the case of positive value transfers, the new landlord generally needs to borrow immediately, to pay the local authority for the stock. However, for negative value transfers, the borrowing requirement is usually deferred for at least 12 months since repair and improvement costs are defrayed by ERCF grant or dowry. It is possible theoretically to take a transfer of stock in good condition, without any additional borrowing. If there is no immediate need for major capital outlay, future maintenance programmes can be financed through careful management of revenue cash balances. Some of the RSLs visited had arranged further borrowing to finance improvement programmes but were outperforming their business plans to such an extent that they had no foreseeable need to make drawings. Others had made drawings simply to repay the interest. Borrowers who fail to draw down loans normally incur non-utilisation and administration fees on top of the original arrangement fee. Although the borrower should have a facility in place as a provision for possible future needs, this should be kept to a minimum. RSLs should be as precise as possible about the amount and timing of the loan sought.

88. For most low and negative value stock transfers, the major rationale for transfer is to secure long-awaited and/or urgent investment that the local authority is unable to provide. The need for substantial investment in the first few years following transfer therefore leads to a more or less typical pattern of borrowing and repayment. In the early years when borrowing is high and rental growth slow, debt increases as the RSL cannot afford to make repayments. In later years, as rents continue to increase while borrowing tails off, the debt is gradually repaid [EXHIBIT 11]. Some ERCF RSLs had drawn down some – one had drawn down the total facility – of their funds before they were required so as to earn interest while they were held on deposit.

EXHIBIT 11
Debt profiles for typical positive and negative value transfers
In the early years when borrowing is high and rental growth slow, debt increases as the RSL cannot afford to make repayments.

Source: Housing Corporation
89. The complexities of the private loans market can prove rather daunting, for new RSLs in particular, and many choose to employ specialist funding advisers to design a funding prospectus for potential lenders and to negotiate on their behalf. Most RSLs feel that funding advisers' intimate knowledge of financial markets with their impenetrable jargon is essential, and that the services they offer are good value for money. The key factors critical to securing a good funding deal are:

• a strong board and management team;
• clear organisational objectives;
• the RSL must specify its borrowing requirements very clearly;
• the business plan must demonstrate long-term financial viability and sustainable demand in the housing;
• the RSL must understand the full cost of borrowing [BOX F]; and
• the terms of the agreement should be flexible and competitive.

90. Lenders prefer new RSLs to appoint a finance director as soon as possible so that the board is not entirely reliant on the advice and assistance of the funding adviser. The RSL’s board must understand the key funding issues.

**BOX F**

**Fees and costs of borrowing**

<table>
<thead>
<tr>
<th>Cost</th>
<th>Description</th>
</tr>
</thead>
<tbody>
<tr>
<td>Lender's margin</td>
<td>Difference between interest rate paid by and that charged by the lender – typically 0.75 per cent for positive value transfer and 1 per cent – 2 per cent for negative value transfer loans.¹</td>
</tr>
<tr>
<td>Arrangement fee</td>
<td>Usually between 0.5 per cent and 1.5 per cent of total loan and is payable up front</td>
</tr>
<tr>
<td>Commitment or non-utilisation fee</td>
<td>Payable on sums available but not drawn – usually 0.25 per cent – 0.4 per cent of undrawn loan</td>
</tr>
<tr>
<td>Annual management fee</td>
<td>Fixed amount for administration</td>
</tr>
<tr>
<td>Lender’s legal fees</td>
<td>Cost of drawing up the loan documentation</td>
</tr>
<tr>
<td>Funding adviser fees</td>
<td>Some of these fees may be more appropriately apportioned to general consultancy costs if the funding adviser’s brief includes longer-term loans management advice</td>
</tr>
<tr>
<td>Valuation costs</td>
<td>For two stock valuations – one as a going concern and one open market valuation. Lenders also require an annual revaluation</td>
</tr>
</tbody>
</table>

Source: Audit Commission/Housing Corporation

¹ The margin is normally expressed as the number of basis points (100 basis points = 1 per cent) over London Interbank Borrowing Rate (LIBOR).
Evidence suggests that the issue of funding is sometimes given only scant attention until after the ballot and, sometimes is perilously close to the Corporation's registration deadline.

91. The overall cost of borrowing is a package that will be negotiated with the lender on a competitive basis by the RSL or its advisers. A lower arrangement fee may therefore result in a higher margin. For some banks, and building societies that are able to raise their funds from members, the cost of funds could be lower than LIBOR, although this may be compensated for by high fees.

92. The DETR and the Corporation advise that informal approaches should be made to one or a number of potential lenders at an early stage in the transfer process. The purpose of this is to reassure all parties that, in principle, the transfer is fundable and also to enable prospective lender and borrower to develop a closer understanding of each other's needs. However, evidence suggests that the issue of funding is sometimes given only scant attention until after the ballot and, sometimes is perilously close to the Corporation's registration deadline. For ERCF transfers, the detailed terms of any loan do not need to be worked out until a later stage if the funds are not required for the first year or so of operation. Nevertheless, the RSL, DETR and the Corporation need to know – in advance of final approvals – that someone is prepared to fund the deal and, broadly, on what terms. Some lenders are, not surprisingly, more cautious about proposals that they see for the first time in a paper prospectus, and prefer to bid for business where dialogue with the borrower has already been established. Early sight of the business plan will also enable lenders to take an initial view as to whether they wish to lend.
93. Existing RSLs receiving stock directly made initial approaches to existing lenders with a view to extending existing facilities. Where new subsidiaries were being established, however, the process of tendering was essentially the same for all types of transfer [EXHIBIT 12]. In the case of negative value transfers, lenders are interested in the wider sustainability of the community as well as the marketability of the stock and evidence of tenant commitment and involvement is usefully included in the prospectus. Because they had the necessary in-house expertise, two of the existing RSLs did not appoint specialist funding advisers and developed their own prospectuses (Appendix 6).
94. Although funders wish to see evidence of a strong link between the RSL’s plans and its financial model, they prefer a more concise version of the text than might be appropriate for other audiences. They also like the RSL to give some indication of its preferred borrowing structure. There is no ideal mix of fixed and variable funds. The typical debt profile of a transfer RSL indicates where fixed-rate borrowing may be efficiently utilised [EXHIBIT 13]. In certain market conditions it may be prudent to look for fixed interest debt during the works period because of the high level of risk and also to fix rates for different periods so as to avoid complete market exposure all at one time. Variable rates however offer greater flexibility and are often preferred for development funding. As discussed earlier, RSLs should be wary of fixing for very long periods – even when interest rates are rising. They may fall again and borrowers will wish to have the flexibility to access cheaper funds. There are also often heavy penalties associated with the early redemption of fixed-rate loans and for some RSLs refinancing is therefore not an option.

EXHIBIT 13
Sample borrowing structure
In certain market conditions, fixed rates may be prudent during the works period.

Source: Audit Commission/HACAS
95. In some cases, loans are syndicated to a number of different lenders. The mix of lenders and terms can offer flexibility but RSLs should be aware of the potential administrative burden of multiple relationships.

96. While the quality of the RSL’s proposal generally, and its prospectus in particular, influence the competitiveness of the offers it receives, the state of the market is also relevant. The market for LSVTs has probably reached maturity (Ref.19) and the growth in the programme has increased both the supply of funds and the number of lenders. Growth and the increase in competition between lenders have led to more attractive deals for RSLs in the last two years. However, some lenders are not yet as committed to negative value stock, particularly in the North where the small differentials between market and social housing rents, together with the low cost of home ownership, are depressing demand for RSL property. The major lenders look to a balanced portfolio of positive and negative value transfers and, as the number of transfers escalates, may be more selective in their bidding. RSLs taking on the more challenging estates may therefore be disappointed. Lenders are also affected by the fourth-quarter rush to complete transfers by 31 March. As discussed earlier, better planning and ground preparation by new landlords and local authorities could alleviate some of the frenetic last-minute activity. However, a rolling programme of transfer approvals, new RSL registrations and funding deals would also help to spread the workload for all the players.

Honouring covenants and commitments

97. The various legal agreements that the new landlord enters into with its stakeholders contain a wide range of covenants and commitments that are defined by the business plan. Failure to honour these commitments can:

- lead to insolvency and intervention by the Corporation;
- render the RSL liable to default proceedings;
- damage its credibility; and
- destabilise the business plan.

Conversely, the discipline of legally binding commitments helps to focus the energies of the RSL and keep the business on track. The key tasks for the new landlord are to negotiate fair and flexible terms before entering into binding agreements, and to set itself targets which ensure that it always operates within its contractual obligations.
Covenants with lenders

98. The financial covenants that lenders typically require include capital and revenue ratios. These set boundaries for the term of the loan – for the relationship between certain financial variables, and are intended to minimise the lender’s exposure to risk [TABLE 6]. The lender expects the covenants to be regularly monitored by the RSL and to receive reports detailing performance. No detailed study was made of the covenants entered into by the fieldwork RSLs but a number with negative value stock reported that negotiations about appropriate levels of asset cover had been difficult. Most negative value transfers are less than three years old and lenders will probably continue to be cautious about reducing their asset cover requirements in the early years after transfer until they have hard evidence that their exposure is short-lived. Borrowers can therefore expect that lenders will increase their margins to reflect the increased risk.

99. The loan agreement will also contain administrative covenants to facilitate monitoring by the lender. These are likely to include requirements for an annual stock revaluation, a full stock condition survey every five years and regular programme monitoring reports. Some RSLs complained that the process of negotiating the finer points of loan agreements and the attendant legal costs was out of all proportion with the basic borrowing deal. As there are only a very small number of legal specialists in the stock transfer market, lawyers representing the two sides are usually very familiar with the standard documentation and with each other. It is therefore surprising that these legal transactions have not been streamlined and made more cost efficient. A minority of RSLs had employed local solicitors, with RSL borrowing experience but limited stock transfer experience. They believed that they had secured much better value for money.

<table>
<thead>
<tr>
<th>Revenue ratios</th>
<th>Capital ratios</th>
</tr>
</thead>
<tbody>
<tr>
<td>Total income/ loan interest</td>
<td>Asset cover (valuation at existing use value/total loans outstanding)</td>
</tr>
<tr>
<td>Operating surplus/ loan interest</td>
<td>Net debt per unit/asset cover per unit</td>
</tr>
<tr>
<td>Total income/ total expenditure</td>
<td>Total loans/total reserves</td>
</tr>
<tr>
<td></td>
<td>Total loans/net worth</td>
</tr>
</tbody>
</table>

Source: Audit Commission/HACAS
Transfer agreement commitments

100. The formal transfer agreement between the local authority and the RSL contains a range of guarantees and undertakings that reflect the financial terms of the deal and provide a structure for the future roles and responsibilities of the two sides. It is also the main legal instrument that binds the RSL to the promises made to tenants by the local authority in the formal Offer document [BOX G].

101. The process of negotiating these terms had proved to be very problematic for a number of the RSLs visited. Apart from the issues concerning valuation discussed above, frequent sticking points were:
- the local authority’s stake in the governance of the new landlord;
- warranties; and
- pre-transfer works.

102. The issue of independence for the RSL has a direct impact on the capacity of the board to take ownership of and deliver the business plan. Where local authority members dominate governance of the RSL, there is a danger that the needs of the business could be subordinated to the needs of the council taxpayer. The Corporation is continuing to refine its requirements for board composition but, for a number of RSLs visited, there were ongoing concerns about the right of the Corporation to stipulate that the Chair should not be a local authority nominee. It appeared that this focus on political issues diverted the attention of the board – and, to a certain extent, the executive – away from the delivery of business objectives.

<table>
<thead>
<tr>
<th>BOX G</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Key components of the Transfer Agreement</strong></td>
</tr>
<tr>
<td><strong>Transfer terms</strong></td>
</tr>
<tr>
<td>Price/dowry</td>
</tr>
<tr>
<td>Treatment of rent arrears</td>
</tr>
<tr>
<td>Treatment of contracts in progress</td>
</tr>
<tr>
<td>TUPE and arrangements for staff transferring</td>
</tr>
<tr>
<td>Local authority stake in the new landlord – eg, nominees on the board</td>
</tr>
<tr>
<td>Warranties by the local authority – eg, in respect of land contamination</td>
</tr>
</tbody>
</table>

Source: Audit Commission
Contracts for land often include warranties by the vendor against certain future risks, such as subsidence in mining areas. Lenders in the stock transfer market often require warranties by the local authority to be in place as a condition precedent to drawing the loan. In practice, the risks to either side are mitigated by survey data or expert opinion. In one case studied, wrangling over these issues was still going on 30 minutes before the transfer deadline. In another, the local authority was obdurate in its refusal to provide any warranties – the transfer therefore went ahead without any protection for the RSL. In the majority of cases the risks involved are remote and have little impact on the business plan. In order to avoid warranties becoming a sticking point, the two sides should begin negotiations at an early stage. This will enable the RSL to estimate an appropriate contingency sum for inclusion in the business plan, should warranties be deemed inadequate. This should also prevent the two sides incurring the heavy legal fees associated with eleventh-hour stand-offs.

104. The ERCF rules allow a proportion of the grant to be spent by the local authority before transfer, either pre- or post-ballot. The DETR stipulates that pre-transfer works should be ‘limited to those absolutely necessary to achieve transfer’ (Ref. 7). The view of the RSLs visited was that such works neither offered value for money – in one case the contract was awarded to the DLO without tendering – nor benefited their own programmes. The tenants interviewed did not consider that the local authority’s pre-transfer works had had any bearing on the outcome of the ballot, save possibly to create the false impression that transfer was unnecessary. In order to optimise their ERCF allocation and their control over their programme commitments, RSLs should aim to secure as much of the ERCF allocation as possible as dowry. They should also ensure that, in the terms of the Transfer Agreement, they are indemnified against the possible negative impact of the local authority’s contract on their own delivery plans.

105. A number of RSLs had had difficulty in meeting their development commitments because of the price or availability of land. A typical response was to change the development programme by replacing newbuild units with repurchased RTB homes. Failure to meet development targets can have a serious impact in areas where the new RSL is the main or sole provider of social housing. RSL boards should also be wary of the positive effect that slow development performance can have on business plan outturn in the short term. The commitments that RSLs had made were usually for a given number of units per annum for the first three to five years. It may be more prudent for the commitments to be spread over a longer period, with any shortfall in the local authority’s need being met by other providers, if possible.
Commitments to tenants

106. Formal Offers to tenants contain more or less standard contractual terms – most of the statutory rights of secure tenants that are lost to assured tenants are restored by the new landlord through the tenancy agreement. Detailed information is also provided about starting rents and the terms of rent guarantees. However, the amount of detail in promises to tenants about repairs and improvements is very variable. Although the formal Offer document usually contains caveats that protect the RSL from being contractually bound, more specific promises are often made through other media such as newsletters or consultation meetings. Not surprisingly, RSLs which had made minimal commitments often exceeded these, while those offering more precision about what works they would do, and by when, were frequently struggling to recover time lost to contractual difficulties or unforeseen structural problems.

107. Low and negative value transfers often take place in a volatile environment, with 'No' campaigns focusing on the undesirability of transfers in principle rather than on the relative merits of the case in question. The failure of one transfer RSL to keep its promises to tenants therefore has a knock-on effect on transfers in the pipeline. The new landlord and the local authority need to strike a balance between giving tenants enough information about the proposal to enable them to make an informed judgement and tying the new landlord down to inflexible targets.

108. The ideal scenario for the RSL is to:
• negotiate contracts and agreements that are flexible in terms of output required and timescales;
• make business plan provision for a modest improvement on the minimum contractual requirements; and
• set operational targets that ensure out-performance of the business plan, and a wide buffer between actual performance and contractual obligations [EXHIBIT 14].

Managing risk

109. As well as financial risks, the plans of the new landlord are susceptible to:
• corporate failure such as breaching registration rules or malfunction of the Board;
• relationship breakdown between the RSL and key stakeholders;
• management failure to deliver the business objectives;
• treasury management failure to manage loans and investments; and
• external factors such as changes in the housing or money markets or in government policy.
EXHIBIT 14

Managing the delivery of commitments

RSLs should aim for a wide buffer between their outturn performance and their contractual obligations.

The principal financial risks are:

- cost overruns on works programmes and on management and administration;
- higher than predicted rent loss (voids and bad debts) and/or borrowing costs; and
- lower than predicted rental growth (due to low inflation or slow turnover from transfer to new tenant rent levels).

In order to manage these risks effectively, the RSL needs a strategy that contains a range of tools which deflect the threat, and minimise the impact, of any damage. Critically, the board and executive of the new landlord must have a full understanding of the risks described above so that the energies of the organisation can be directed to the management of high risk areas.
110. Ideally, risk management strategies should be in place during the set-up period. This enables the RSL to negotiate with other stakeholders, understanding how particular proposals will reduce or increase its exposure to risk. This is extremely difficult for new stand-alone RSLs, partly because of their shadow status before registration, and compounded by their lack of business experience. Before transfer, therefore, risk management is handled mainly by the new RSL's legal and funding advisers. The consequences of this can be that the board and executive take on their business without a full appreciation of the potential risks to their delivery plans. In most cases, some form of financial training was organised for board members. Before transfer, this was often limited to a single day for every aspect of financial management, and therefore gave only scant attention to business planning and risk management. In a minority of cases, the training was very comprehensive and helped board members to take ownership of their business plan and understand its key risk areas soon after transfer [CASE STUDY 8].

**CASE STUDY 8**

**Training for board members - Tonbridge and Malling HA**

Tonbridge and Malling HA was set up in 1990 to receive the transfer of all Tonbridge and Malling BC's housing stock. A training programme was organised for the shadow board of the new RSL shortly after the members had been recruited. The board comprises a mix of tenants, local authority and independent members – at the time, very few members had experience of financial management or of business planning. A number of training sessions, entitled 'Finance is fun' were run by the RSL's business plan consultants. These sessions relied primarily on simple graphic presentations of financial concepts. They were thus effective in demystifying the complexities of business planning for members at an early stage in the board's development. Members therefore felt confident about challenging or querying information presented by officers or consultants. They also took an active part in developing business plan assumptions and in agreeing the private finance package.

After transfer, the board continued to give priority to its own training and development, with numerous finance committee meetings preceded by finance training sessions.

Long-serving board members feel that the early emphasis given to developing their financial skills was invaluable in enabling them to take ownership of the business plan and, in the years since transfer, to keep the business on track.

*Source: Audit Commission fieldwork*
Where an existing RSL is involved, the balance of risks is different. While the board and executive are more likely to have the skills and experience necessary available at the onset to manage the business, the risks associated with partial transfer are greater – 'problem' estates, poor information on historic costs and tenancy details. There is a greater likelihood, therefore, that business plan projections will be wrong. For new subsidiaries, exposure to risk can be minimised through guarantees from the parent RSL.

112. Risk is partly managed through contractual tools such as insurance, guarantees and warranties, and partly by management systems that incorporate early warning systems, regular refinement of projections and simple decision-making structures. Some RSLs visited had limited arrangements in place for monitoring their business plans. Although boards received regular reports on programmes, on annual budgets and on housing management performance, reports showing the cumulative effect of these elements on the business plan as a whole were infrequent. In one case, the RSL had problems with the main works contract. Project managers dealt with this by commissioning additional work. Senior managers did not pick up the impact of this on the financial viability of the transfer until it was too late to make considered amendments to their plans. It became necessary to recast the schedule of works and renege on certain commitments to tenants. In another case, however, the RSL had developed a comprehensive set of indicators, including crime indicators, to help stakeholders gauge the overall progress of the transfer.

Strategic issues

113. Arguably, the lack of a corporate approach to business plan management is attributable more to the recurring problem of ownership than to inefficiency. Ownership in itself does not guarantee successful delivery – regular monitoring and refinement are also critical. However, if delivery of the business plan is a priority for the Chief Executive and for the Chair of the board, the chances of success are increased. All parts of an organisation need to work to the same strategic plan for achieving its goals – delivery of the business plan should therefore be a stated strategic objective of the new landlord.

114. Although RSL funding models include 30-year projections, it is not realistic for any organisation to decide its strategic objectives so far ahead. The business plan in operation at the time of transfer will normally include a statement of the RSL’s objectives for the first five years and, possibly, a longer-term vision statement. The objectives and the financial projections that flow from them should be reviewed frequently – perhaps quarterly – in the early stages, and at increasing intervals (no greater than annually) as the organisation stabilises. Any changes that flow from the review must than be discussed and negotiated with lenders before the plan can be amended. However, it will be necessary for a major review of the whole plan and the issue of a new document when the key objectives in the first five-year plan have
been achieved. In practice, service organisations do not operate in fixed blocks of time – plans and strategies evolve organically as the business matures. But the process of conducting a major review of the business plan is beneficial in:

- involving all stakeholders and possibly the wider community in a review of priorities;
- clarifying how and why objectives and delivery strategies need to change; and
- identifying how the funding package should, if necessary, be restructured to suit the new objectives.

115. The RSL also needs to consider the impact that best value requirements may have on its plans. For stock transfer organisations, there is an inevitable focus on meeting pre-transfer undertakings. However, the main purpose of transfer is to improve the quality of life for residents. While repairs and physical improvements to their estate make a significant contribution to this, tenant empowerment, community confidence and economic prosperity are equally important. Clearly, the RSL alone cannot meet these tough challenges. It needs to work in partnership with other agencies, both public and private, but it can make an impact through the strategies it adopts for running its business and spending its surpluses.

**Continuous improvement**

116. In a number of the LSVTs visited, the transfer had been 'sold' to tenants on the basis that the housing management service they would receive from the new landlord would be the same as had been provided by the local authority. This was to allay general fears about the impact of change among tenants who were essentially satisfied with council services. This is clearly incompatible with best value principles; all RSLs should be aiming, year on year, to:

- improve the quality – the responsiveness, helpfulness, professionalism – of their services; and
- reduce the cost of providing the services.

Understandably, where services to tenants are provided by the same staff before and after transfer, there may be more difficulty in achieving the change in behaviour and output necessary to meet these aims. Some tenants reported that, although transfer had created a different management style, front-line services continued to be delivered by the same individuals to much the same standard as before.
Tenant empowerment

117. In the three cases studied where stock had been transferred directly to an existing RSL, none of the tenants transferring was involved at board level – although there was general tenant representation. In all other cases, tenants were formally involved in the governance of the RSL. In practice, many of the tenant board members serving in the first year after transfer had been co-opted rather than elected. This was an inevitable effect of the time pressure on the transfer process and the need to establish a shadow board before tenants had sufficient time and support to organise elections. However, the constitution of new RSLs, particularly LHCs, requires the tenant board members to stand down after the first year, with new members appointed via a tenant ballot. There is tremendous potential for this democratic process to deliver the widest possible tenant participation. In order to maximise that potential, the RSL needs to commit sufficient resources to:

- provide training and support to board members to improve their contribution to running the business; and
- enable the wider tenant population to develop collective bargaining or participative structures.

Regeneration initiatives

118. Most negative value transfer RSLs are making a small contribution to economic regeneration by stipulating that their contractors should employ a quota of tenants on repair and refurbishment projects. This has provided work for unemployed skilled tenants and also training opportunities for unskilled people – mainly young men. Other RSLs have also honoured their commitment to provide job opportunities for tenants within the RSL. Kingsmead Homes, for example, has employed a number of tenants in front-line roles, including that of receptionist. This has considerable business benefits – the RSL is able to draw directly on the local knowledge and experience of their tenant employees, and tenants see real evidence of the RSL’s commitment to investing in their future.
Investing surpluses

119. The early signs for negative value transfers are that – as with positive value transfers – new landlords will out-perform their business plans, although the margins will be narrower. RSL boards therefore need a clear strategy to re-invest the surpluses they generate. The Government believes that rent control in the subsidised sector, by reducing benefit dependency, is an effective tool to encourage people back into the jobs market. The Corporation also expects that RSLs that outperform their business plans will defer planned rent increases. However, RSLs might consider it prudent in the longer term to accelerate the repayment of their loans, or – if market conditions are favourable – to bring forward development plans. Earlier research noted the concerns of traditional RSLs that cash-rich LSVT bodies were pushing up the price of private land (Ref. 20). It is clearly unwise to pay above the going rate for land, but a number of transfer RSLs have, sensibly, used their surpluses to acquire brownfield sites adjacent to their estates for the purpose of meeting future development needs.

120. RSLs will wish to be flexible about the treatment of surpluses but current trends in over-performance emphasise the need for a strategic approach to business plan management. Because boards and management teams did not review business plan performance on a regular basis, there was a tendency for finance departments to take responsibility for managing the surpluses – perhaps by making short-term investments. Although this may ultimately have been in the best interests of the business, it was notable that decisions about the treatment of surpluses were not taken at a strategic level. If business planning is seen as a process which is both corporate and dynamic, the transfer RSL will have a better chance of doing everything it promised, doing it on time and doing it within its means.
### Delivering the plan

<table>
<thead>
<tr>
<th>ACTION</th>
<th>BY WHOM</th>
<th>MAIN DIFFERENCES FOR NEGATIVE VALUE AND TRANSFERS DIRECT TO EXISTING RSLs</th>
</tr>
</thead>
<tbody>
<tr>
<td>Has the RSL identified inputs required from other stakeholders to help deliver the business plan?</td>
<td>RSL</td>
<td><strong>Negative value transfer RSLs</strong> have a more structured relationship with the Corporation as there is regular monitoring of grant payments.</td>
</tr>
<tr>
<td>Has the board formally taken responsibility for ensuring the plan is delivered?</td>
<td>RSL</td>
<td><strong>For transfers direct to existing RSLs</strong> there may be no separate business plan – however, the board should receive separate reports which show project performance against targets and ongoing viability.</td>
</tr>
<tr>
<td>Does the board receive regular reports showing overall performance against the business plan?</td>
<td>RSL</td>
<td></td>
</tr>
<tr>
<td>Are business plan projections automatically refined as circumstances change?</td>
<td>RSL</td>
<td></td>
</tr>
<tr>
<td>Are business plan objectives and projections reviewed at least quarterly during the works period and 6-monthly thereafter?</td>
<td>RSL</td>
<td></td>
</tr>
<tr>
<td>Have business plan objectives been cascaded down to service plan and individual work plan levels?</td>
<td>RSL</td>
<td></td>
</tr>
<tr>
<td>Has the RSL secured expert funding advice?</td>
<td>RSL</td>
<td></td>
</tr>
<tr>
<td>Have early approaches been made to potential lenders?</td>
<td>RSL</td>
<td></td>
</tr>
<tr>
<td>Have loan facilities been secured at a competitive price?</td>
<td>RSL</td>
<td></td>
</tr>
<tr>
<td>Does the RSL have a comfort zone between its formal commitments and covenants and its internal assessment of what is achievable?</td>
<td>RSL</td>
<td></td>
</tr>
</tbody>
</table>

*cont.*
### Delivering the plan

<table>
<thead>
<tr>
<th>ACTION</th>
<th>BY WHOM</th>
</tr>
</thead>
<tbody>
<tr>
<td>Does the RSL have a risk management strategy?</td>
<td>RSL</td>
</tr>
<tr>
<td>Does it have an early warning system?</td>
<td>RSL</td>
</tr>
<tr>
<td>Is there a strategy for carrying out comprehensive reviews of business plan objectives?</td>
<td>RSL</td>
</tr>
<tr>
<td>Is there a strategy for increasing tenant participation in business planning?</td>
<td>RSL</td>
</tr>
<tr>
<td>Does the business plan demonstrate how best value will be achieved?</td>
<td>RSL</td>
</tr>
<tr>
<td>Is there a clear strategy for investing surpluses?</td>
<td>RSL</td>
</tr>
</tbody>
</table>
Delivering the Plan

**DETR should:**

1. Ensure that its requirement that pre-transfer works should be limited to those absolutely necessary to achieve transfer is rigorously enforced.

2. Produce indicators for monitoring the effects of transfer – ie, value for money, quality of service, tenant involvement, socio-economic improvements.

**The Corporation should:**

1. Strengthen requirements for new RSLs’ financial expertise at board/executive levels.

2. Ensure that performance against business plan targets is given high profile in post transfer visits to transfer RSLs.
DETR should:

1. Require that applications for places on disposals programme include a project plan covering the whole transfer process and that the plan is copied to the Corporation.

2. Amend transfer guidance to emphasise that local authorities should consult the Corporation as part of their options appraisal.

3. Consider alternatives to the annual programme, such as a rolling programme, in order to reduce pressure on funding and registration timetables and give more time for considered business planning.

4. Consider requiring all transfers to be open to competing bidders, including any in-house bid.

5. Ensure that its requirement that pre-transfer works should be limited to those absolutely necessary to achieve transfer is rigorously enforced.

6. Produce indicators for monitoring the effects of transfer – i.e., value for money, quality of service, tenant involvement, socio-economic improvements.

The Corporation should:

1. Provide detailed guidance on registration requirements to local authorities that are considering transfer at options appraisal stage.

2. Regularly check on the new landlord’s progress in meeting registration requirements during the set-up stages.

3. Consider appointing stock transfer specialists in each regional office.

4. Create a separate stock transfer peer group in the published Pls.

5. Give guidance to new transfer organisations on sources of benchmarking information.

6. Clarify its expectations regarding rent convergence.

7. Strengthen requirements for new RSLs' financial expertise at board/executive levels.

8. Ensure performance against business plan targets is given high profile in post transfer visits to transfer RSLs.

DETR and Corporation jointly should:

1. Issue joint guidance on their respective transfer requirements, including use of consultants.
Appendix 1: Advisory group members and fieldwork sites

Advisory group members

Julian Ashby  Managing Director, HACAS
Teresa Bray  Director of Finance, Poplar HARCO
Stephen Duckworth  Housing Finance and New Initiatives Director, National Housing Federation
John Green  Assistant Director, Regulation, Housing Corporation
Roger Jarman  Head of Housing Management, Housing Corporation
Keith Sobey  Audit Manager, District Audit
Stephen Stringer  Housing Transfer Manager, DETR
Diane Taha  Formerly Director of Finance, Ealing Family HA

Fieldwork sites

Bentilee Community Housing
Kerrier Homes
Kingsmead Homes (subsidiary of Shaftesbury Housing Group)
Limehurst Village Trust (subsidiary of West Pennine HA)
Partington HA (subsidiary of Manchester and District HA)
Ryedale HA
Samuel Lewis Trust (2 sites)
South Liverpool Housing
South Staffordshire HA
Three Rivers HA
Tonbridge and Malling HA
Vange Community Housing (subsidiary of Anglia Housing Group)
Appendix 2: Sample stock survey brief

Outline of brief used by 3 Rivers Housing Association for a partial stock transfer

Contents

1. Introduction
   • Background to the transfer
   • What the survey information is for/how it will be used
   • Statistical confidence level required

2. Duty of care
   • Surveyors’ duty of care to the local authority, to the new landlord and to the private funders
   • Requirements for professional indemnity and other insurances (value and duration)

3. Limitations
   • Requirement for the tenderer to stipulate the limitations on the scope or reliability of the survey
   • Confidentiality required of the contractor
   • Copyright of the survey report and rights of access by third parties

4. Survey sample and method
   • Types of survey required – eg. external and internal
   • Basis of sampling
   • Basis for costing repairs

5. Tendering process
   • Stages
   • Fee structures
   • Options for bidding
   • References
   • Contents of the submission, including estimated timescales

6. Survey stages

   Whole stock impressionistic survey
   • Purpose
   • Classification of properties
   • Survey report requirements

   Sample survey
   • Scope
   • Sample size
   • Void inspections
• Data collection methods: definitions – eg, catch-up repairs; data levels – eg, estate, block, unit
• Compliance with British Standards
• Survey report

**Related housing assets**
• Definitions – eg, garage blocks, play equipment
• Scope
• Sample
• Reporting requirements

**Leasehold property**
As above

**Non-traditional stock**
As above, plus:
• Mortgageability
• Rebuild costs

7. **Categories**
Full description of and required standards for:
• Catch-up repairs
• Improvements
• Planned, programmed repairs
• Cyclical maintenance and servicing
• Responsive and void property maintenance
• Contingent major repairs that are not specifically foreseeable

8. **Reporting and output requirements**
• Timing
• Content
• Presentation
• Number of copies

9. **Liaison and conduct of survey**
• Communication with tenants
• Access arrangements
• Treatment of urgent repairs
• Progress reporting

**Appendices**
Fee analysis
Stock profile
Unconventional construction types
Description of existing computer systems
### Appendix 3: Sample summary

#### 30-year cashflow model

<table>
<thead>
<tr>
<th>Year</th>
<th>Income</th>
<th>Expenses</th>
<th>Surplus/Deficit</th>
<th>Interest Receivable</th>
<th>Interest Payable</th>
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<td>38,700</td>
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</table>

#### Notes:
- The above table represents a simplified cashflow model for a 30-year period, focusing on income, expenses, and surplus/deficit metrics for planning and financial forecasting purposes.

---

**Total income**:
- Year 1: 22,202
- Year 30: 334,401

**Total expenditure**:
- Year 1: 23,383
- Year 30: 1,302,952

**Surplus/deficit**:
- Year 1: 0
- Year 30: 1,302,952
Appendix 4: Sample scenario analysis

Illustration of the effect on debt of adjusting three key variables – staff costs, maintenance costs and improvement costs.

<table>
<thead>
<tr>
<th>Adjustment</th>
<th>Increase/ (decrease)</th>
</tr>
</thead>
<tbody>
<tr>
<td>Reduce staff costs by 10 per cent</td>
<td>(1,874)</td>
</tr>
<tr>
<td>Increase maintenance costs by 5 per cent</td>
<td>2,475</td>
</tr>
<tr>
<td>Increase stock improvement costs by 1 per cent</td>
<td>15,330</td>
</tr>
<tr>
<td>TOTAL CHANGE</td>
<td>15,931</td>
</tr>
<tr>
<td>Cumulative impact on interest</td>
<td>601</td>
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<table>
<thead>
<tr>
<th>CURRENT PLAN</th>
<th>AMOUNT OF PEAK DEBT £</th>
<th>YEAR OF PEAK DEBT</th>
<th>YEAR DEBT REPAYED</th>
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<tr>
<td></td>
<td>36,842,000</td>
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<td>27</td>
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<table>
<thead>
<tr>
<th>REVISED PLAN</th>
<th>AMOUNT OF PEAK DEBT £</th>
<th>YEAR OF PEAK DEBT</th>
<th>YEAR DEBT REPAYED</th>
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<tbody>
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<td></td>
<td>53,374</td>
<td>21</td>
<td>30+</td>
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</table>

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Appendix 5: Sample expenditure analysis graph

Source: HACAS
Appendix 6: Treatment of typical costs in TMV

Extract from DETR’s Housing Transfer guidelines (Ref. 1)

**TMV**
(Net present value of future rental income stream allowing for repairs and renewal)

- catch up repairs
- routine maintenance & response repairs
- future major work, planned maintenance
- contingent major repairs and preliminaries

(See Part 2, Section 10 for definitions.)

**Plus**
Some unusual and extensive works where they represent the most effective technical solution which reduces repair and maintenance costs on NPV basis and is the only sensible way of carrying out repair/replacement.

eg,
1. Reconfiguring dwelling layout where health and safety legislation requires it.
2. Over-cladding where it is technically the most appropriate and cost-effective way of dealing with condensation, damp and water penetration.
3. Over roofing because of water penetration or because flat roof is at end of its life.

**FULL VALUATION**
(On-going improvements programme at time of transfer, works to block and environment of estate which do not attract rent increases)

Improvements already programmed at the time of transfer where rents were not planned to increase.

**Block**

1. Elaborate reconfigurations of dwellings not for health and safety or other legislative reasons.
2. Recover-cladding to rectify inadequate thermal insulation or improve poor external appearance.
4. New lift towers.
5. Improved lift security.
6. New staircases against blocks.
7. Provision of new reception.

In the very worst blocks where poor security is a major issue this could help solve the problems of poor image and difficulties in letting. It might also reduce vandalism related maintenance costs.

**FINAL VALUATION**
(Improvement works and cost reflective rent increases necessary to pay for them)

Includes:
1. Works which increase the utility of the dwelling to the tenant, e.g. installation of central heating where none existed before: measures which increase energy efficiency and so reduce expenditure or increase comfort.
2. Improvement works already programmed at the time of transfer where works had been related to rent increases.
3. Replacement of kitchens and bathrooms well before the end of their expected lifetime with facilities of modern standard; increasing the provision of facilities e.g. second WC; addition of shower.
4. Replacement and upgrading of electrics well before the end of their expected lifetime.
5. Replacement of doors and windows with modern fitments (including double glazing) well before the end of their expected lifetime.
TMV
(Net present value of future rental income stream allowing for repairs and renewal)

FULL VALUATION
(On-going improvements programme at time of transfer, works to block and environment of estate which do not attract rent increases)

8. New security measures (doors and windows) which reduce landlord repair and maintenance costs and improve dwelling security and, thereby, lettability.

9. Installation of new entry phone with reduced expenditure on repair of vandal damage and greatly improved lettability and block image.

10. Provision of tenants' clothes drying areas within the block.

11. Bin area/refuse areas. A case should have to be made that a number of factors added together produce a significant local housing issue amongst tenants, or where the problem resulted in an exceptionally poor image to prospective tenants, landlords and funders. Factors such as disgusting paladin chambers and chutes immediately adjacent to block entrance/chutes to small even normal refuse bag/paladin chambers susceptible to arson.

FINAL VALUATION
(Improvement works and cost reflective rent increases necessary to pay for them)

Other items directly charged to users:
1. Garages and other related income and expenditure, and leaseholder works covered by service charges.
2. Income and expenditure related to assets such as shops.
APPENDIX 6 • TREATMENT OF TYPICAL COSTS IN TMV

**TMV**
(Net present value of future rental income stream allowing for repairs and renewal)

**FULL VALUATION**
(On-going improvements programme at time of transfer, works to block and environment of estate which do not attract rent increases)

**FINAL VALUATION**
(Improvement works and cost reflective rent increases necessary to pay for them)

**Environment of estate**

1. Alteration of road layout. Could a case for readjustment of roads from 'Radburn' to conventional layout to bring benefits in security, lettings and sales and counter joy-riding/rat-running through estate. Could, however, be very expensive particularly since utilities' services would probably have to be relocated.

2. Traffic restriction signs. May be a case if policy/emergency services find it difficult to navigate estate, also if estate has a maze-like layout. Is the crime rate so bad that it would warrant measures to reduce length of time visitors spend trying to find right address?

3. Reduction of road layouts (e.g. increased space for parking)

4. In-curtilage parking to reduce commuter parking and car crime/damage which leads to visual evidence of 'disorder' and spiral of decline.

5. Grouped parking. Would need a strong case on grounds of visual disorder and improved lettability.

6. Additional footpaths.
TMV
(Net present value of future rental income stream allowing for repairs and renewal)

FULL VALUATION
(On-going improvements programme at time of transfer, works to block and environment of estate which do not attract rent increases)

7. Provision of road barriers. Strong case would need to be made. Justification might include fact that estate is a racetrack with bad joy-riding problem.

8. Vehicle speed restrictions. May be a case on grounds of persistent joy-riding, high number of pedestrian accidents or to make a route across the estate for schoolchildren safer.

9. Creation of private gardens to reduce ground maintenance, vandalism, crime and to improve the perception of the estate and its lettability.


11. Communal gardens.

12. Planting and natural landscaping to improve visual quality of estate tenant satisfaction, and lettability with some security benefits.

FINAL VALUATION
(Improvement works and cost reflective rent increases necessary to pay for them)
<table>
<thead>
<tr>
<th>TMV</th>
<th>FULL VALUATION</th>
<th>FINAL VALUATION</th>
</tr>
</thead>
<tbody>
<tr>
<td>(Net present value of future rental income stream allowing for repairs and renewal)</td>
<td>(On-going improvements programme at time of transfer, works to block and environment of estate which do not attract rent increases)</td>
<td>(Improvement works and cost reflective rent increases necessary to pay for them)</td>
</tr>
</tbody>
</table>

13. Fixed play areas and equipment. A case could be made if the works improved the lettability on estates with lots of young children. We would, however, expect to see provision for, and encouragement of, parental supervision (e.g. integral seating nearby, planting and landscaping).

14. Community centres. Case could be made where it increased tenant satisfaction and involvement in the estate and its future and thereby improved the potential landlord and funders’ views of the estate.

15. Improved estate lighting to improve security/lettability.


17. Closed circuit TV. A case that it is essential could be made for very bad blocks for monitoring parking areas, inside lift carriage and trouble spots.

(Works which radically change the nature of the dwelling mean that the original dwelling’s TMV stops because dwelling ceases to exist or has changed so much that it is no longer sensible to view it as the original dwelling. The cost of such works should be set against the net rents which are charged for the dwellings which result from these works).

Examples of such works include:

1. Demolition. Any demolition proposals would require strong justification against proposed benefits.
2. Decapitation of blocks. This is often very expensive, even more so than demolition and rebuild.
3. Conversion of flats/maisonettes to single flats.
appendix 7: example of in-house funding prospectus

summary of funding prospectus produced by west pennine and portico housing associations

covering letter to prospective funders

dear

£8.3/£9.8 million facility for a regeneration project

west pennine housing association (wp ha) and portico housing association (pha) have been successful in a joint bid for the transfer of 649 properties on the limehurst estate from oldham metropolitan borough council. the project involves the regeneration of the estate through major improvements – involving expenditure of approximately £15m in the first two years of the project – together with intensive housing management and community initiatives.

we are writing to you to establish whether you are interested in providing a loan facility for this project and working with the partner associations on this project. the partner associations will jointly establish limehurst village trust (lvt). lvt will be a 53.6 per cent owned subsidiary of wp ha the remainder will be owned by pha. the properties will be owned by wp ha and pha and leased to lvt. the loan requirement is £8.3m and there is a loan requirement by the partner associations of up to £5m for their investment in the project.

the total funds required for the project are £15m the details of which are set out in the following table

<table>
<thead>
<tr>
<th></th>
<th>£m</th>
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<tbody>
<tr>
<td>ercf – dowry</td>
<td>4.9</td>
</tr>
<tr>
<td>ercf – other</td>
<td>0.3</td>
</tr>
<tr>
<td>wp ha/ portico investment</td>
<td>1.5</td>
</tr>
<tr>
<td>wp ha/ portico loans</td>
<td>8.3</td>
</tr>
<tr>
<td>total</td>
<td>15.00</td>
</tr>
</tbody>
</table>

we invite you (along with other funders) to quote rates and fees and propose one or more funding structures. in preparing your indicative proposals you may like to bear in mind that both associations will also be tendering in the near future for facilities in addition to the limehurst project amounting to approximately £10m each.

we have appended a schedule that sets out some features on which comparison between proposals will be evaluated. we have also appended some key loan agreement clauses and sections to be included in the loan facility agreement which reflect terms acceptable to us and on which we do not expect to negotiate. the objective is to reduce the time taken to complete facility arrangements and to standardise the form of our loan documentation.

we enclose the following:

- an extract from the bid document that provides detailed information on the structure, business plan, housing management, regeneration and property stock.
- annual report and accounts for each association.
- the business plans of each association.

we would like to receive initial expressions of interest within 7 days of receipt of the letter, with formal quotations submitted by august 8 1997.

yours sincerely

finance directors
Loan features that should be addressed in the proposal

Loan Structure, for example

- Annuity
- Low start
- Variable loan repayment
- Fixed and variable rate options
- Unsecured borrowing
- Flexibility - providing a range of options within the facility

Loan costs

- Rates for 3, 5 and 10 year fixed margin above benchmark guilt
- Variable rate basis
- Margin and MLA
- Facility charges
- Arrangement fees

Drawing availability

- The date by which all funds will be fully drawn
- Access to funds
- Restrictions on drawings

Security

- Form of security
- Withdrawal of security
- Effect of right to buy/VPG – eg. substitution
- Loan cover EUV – SH circa 110 per cent, TOMV circa 125 per cent

Covenants

- Gearing – defined as borrowings to the historic cost of housing assets – circa 60 per cent
- Income cover – surplus on operations before interest – circa 110 per cent

Comments

- The phasing of the draw down of funds is driven by the major repairs spend. We therefore need to mitigate cash holding by drawing down frequently from the facility for variable amounts.
- As we need to maximise the use of our asset base we will consider mechanisms to release charges as the life of the loan progresses.
- We believe in the partnership approach to provide social housing and we are looking for a funding partner that will work closely with us on this project to provide the best funding solution so that we can deliver the extensive regeneration programme outlined in our bid.
- We are looking for an innovative and cost effective structure with the mitigation of interest rate exposure at least in the first few years of the project.
Key loan agreement clauses

Security
- No negative pledge will be available to restrict the rights of the Borrower to enter into floating charge arrangements.
- Security cover has been dealt with in appendix 1.
- If on revaluation the value is greater than the agreed cover surplus properties will be released from charge at the borrowers request. Conversely if on any revaluation of the properties the value is less than the over required additional properties will be charged within 90 days otherwise at the end of that period the borrower shall repay a sufficient proportion of the loan or make a lodgement into a charged account pending additional property security.

Valuation
The initial valuation will be at the cost of the borrower. Thereafter the lender may require new valuations at intervals and if aggregate advances and any deferred interest exceeds 80 per cent of the last valuation. The costs of such valuation shall be borne in the first instance by the Borrower but shall be for the account of the lender if the valuation establishes there was and is no breach of covenant.

Covenants
- Financial covenants have been dealt with above.
- It is anticipated that there will be no covenants that restrict operational activities.

Legal Expenses
Both parties to account for their own legal expenses in relation to completion of the facility (lenders expenses in relation to security to be for the account of the borrower but a maximum cost to be provided in advance).

Prepayment
For variable rate funding at the borrower’s option provided 7 days notice is given, no penalties will apply. If the date of prepayment is not the interest date payment date there will be further payment to compensate for any loss of interest which will be calculated by reference to the reinvestment rate.

Cancellation
The borrower may cancel the facility at any time by written notice in respect of:
- undrawn amounts: or
- amounts prepaid.
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In March 1999, the Government approved the biggest ever programme of local authority stock transfers, involving 140,000 homes. At both central and local government levels, stock transfer is widely regarded as the principal means of securing continued investment in social housing. The effectiveness of the business planning that underpins such transfers is therefore of considerable importance.

An organisation receiving local authority housing stock must be a registered social landlord (RSL). Any RSLs receiving a stock transfer require either a stand-alone business plan, or alterations to their existing plan, to evaluate the proposal and demonstrate its viability. It is particularly critical for organisations taking on low-value stock characterised by poor condition, or chronic housing management problems such as neighbour nuisance and low demand. The majority of such transfers are very new (no more than two years old) and the development of good practice in appraising and managing the risks involved is still in its infancy.

Stock in Trade provides analysis and good practice guidance to practitioners. It tracks the development of the business plan prior to transfer, demonstrating the interdependencies of business planning and the transfer process as a whole. It also gives guidance on techniques that ensure successful delivery of the plan. The handbook is therefore aimed primarily at the executives of existing RSLs or of newly established shadow RSLs. It should also be of interest to local authority officials who are involved in stock transfers, particularly those about to embark on it for the first time.

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