



Cynulliad Cenedlaethol Cymru  
The National Assembly for Wales



# Local Government and Housing Committee

## Final Report

### Policy Review of Housing Stock Transfer



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## Foreword



The Local Government and Housing Committee attaches a high priority to ensuring that everyone in Wales has a decent home. Good housing is vital for promoting better health, helping to combat social exclusion and encouraging the development of vibrant and confident communities.

If we are to achieve this objective, we have to tackle one of the most deep-seated housing problems, that is the poor condition of much of our council housing stock. After years of under-investment, we need a massive injection of expenditure to get our council housing up to an acceptable standard. The focus of this review has been the policy on stock transfer and whether there are alternative approaches which could generate the finance necessary to overcome the backlog of repair and modernisation work.

As the report makes clear, the Committee feels that the most straightforward option would be a change in the local government finance system to allow councils to borrow on the same terms as housing associations. In the absence of such a change, the Committee's view is that stock transfer, with appropriate safeguards for tenants, should continue to be an option available to local authorities for modernising their housing stock.

There are a number of themes which run through the report. These include the need to devise local solutions for local problems, the need to involve tenants and staff at an early stage in the options appraisal process and the need for better information on the condition of the stock.

I am sure that the Assembly Cabinet will be considering the Committee's report carefully, and that it will be looking to take forward the recommendations in the context of the emerging National Housing Strategy.

I am grateful to past and present Members of the Committee – Peter Black, David Davies, Janet Davies, William Graham, Janice Gregory, Alison Halford, Brian Hancock, Edwina Hart, Peter Law, Dai Lloyd, Tom Middlehurst, Janet Ryder and Owen John Thomas – for their work on the review. I would also like to thank Judy Wayne, the Committee's expert adviser, the Secretariat and all those who submitted their views to the Committee or otherwise contributed to the review.

A handwritten signature in black ink that reads "Gwenda Thomas". The signature is written in a cursive, flowing style.

GWENDA THOMAS AM  
Chair, Local Government and Housing Committee

May 2001



# Contents

|                  |  |
|------------------|--|
| <b>Chapter 1</b> | Introduction   |
| <b>Chapter 2</b> | Background   |
| <b>Chapter 3</b> | The options available to local authorities   |
| <b>Chapter 4</b> | General issues   |
| <b>Chapter 5</b> | The options appraisal process  |
| <b>Chapter 6</b> | The stock transfer process   |
| <b>Chapter 7</b> | Post stock transfer issues   |
| <b>Chapter 8</b> | Summary of recommendations   |
| <b>Annex 1</b>   | Consultation letter inviting submissions for the review  |
| <b>Annex 2</b>   | Organisations consulted in the policy review   |
| <b>Annex 3</b>   | Policy statement by the Minister for Finance, Local Government<br>and Communities on housing stock transfer, 1 November 2000 |
| <b>Annex 4</b>   | Estate transfers in Wales  |
| <b>Annex 5</b>   | Technical note on capital financing and securitisation   |



# Chapter 1 - Introduction

**1.1** At its first meeting in April 2000, the National Assembly's Local Government and Housing Committee confirmed that it wished to proceed with a policy review of housing stock transfer which had been planned by the previous Local Government and Environment Committee.

**1.2** The Committee subsequently agreed the following terms of reference for the review:

*To consider the policy on the transfer of local authority housing stock into Community Ownership, and in particular:*

- *the emerging model for Community Ownership and the extent to which the model can be tailored to meet the needs of local communities (including disabled people and others with particular requirements);*
- *whether there are alternative approaches which could generate the finance necessary to overcome the backlog of repair and essential modernisation for council housing.*

## The Committee's approach to the review

**1.3** In line with its standard working practice, the Committee undertook the review in an open and participative manner. It decided to seek a wide range of views on stock transfer, through a written consultation exercise, oral consultation sessions, briefing sessions and visits. A copy of the initial consultation letter is at **Annex 1**, with a full list of the bodies which contributed to the review at **Annex 2**.

**1.4** The Committee appointed Judy Wayne as an expert adviser to provide independent advice during the review. Judy Wayne is a Senior Manager with HACAS Chapman Hendy and leads their services in Wales. Prior to that she was an Executive Consultant with KPMG, and she was the Director of the Chartered Institute of Housing in Wales from 1988 to 1993. She has also been a Committee member of the Tenant Participation Advisory Service in Wales, Chair of the Newydd Housing Association and a member of the Board of Tai Cymru (Housing for Wales).

## Chapter 2 - Background

### The existing housing stock

**2.1** The total housing stock of Wales is approximately 1.25 million. By tenure, owner occupied homes make up some 71 per cent of the total and privately rented homes account for a further 8 per cent. Local authorities own and manage some 200,000 homes, representing around 16 per cent of the total. The remaining 4 per cent of dwellings are owned by housing associations.

### Resources for housing

**2.2** During the second half of the 1990s there was a downward trend in local authority capital expenditure on housing, from nearly £260 million in 1996-97 to around £200 million in 2000-01 and 2001-02. The recent budget has reversed this downward trend, with provision increasing to £214 million in 2003-04.

**2.3** Within this total, local authorities invested some £70 million in council homes in 1999-2000 (the latest year for which information is available), with the balance being set aside for private sector renovation work. This split of the available resources reflects local authorities' priorities.

**2.4** Local authority revenue expenditure on housing is funded through the Housing Revenue Account (HRA) subsidy. Expenditure on management and maintenance was £208 million in 1998-99, £206 million in 1999-2000 and an estimated £219 million in 2000-01.

### Development of a national housing strategy

**2.5** This policy review took place against an evolving policy background, with work under way to develop a national housing strategy. This work has its origins in the National Consultative Forum on Housing, which presented *A Framework for a National Housing Strategy* to the National Assembly in July 1999. Following publication of this Framework, four independently-chaired, multi-agency task groups were established to develop more detailed policy proposals for consideration by the National Assembly.

**2.6** The four Task Groups reported in April 2000. Following consideration of these reports, the National Assembly is currently undertaking a consultation on *Better Homes for People in Wales*, a set of proposals for a national housing strategy. The plan is to publish the national housing strategy later in 2001, taking account of this consultation exercise.

**2.7** *Better Homes for People in Wales* sets out how the national housing strategy relates to betterwales.com, the National Assembly's strategic plan. In particular the strategy contributes to all of the National Assembly's key action areas as well as embracing the three key themes of sustainable development, tackling social disadvantage and equal opportunities.

**2.8** The Local Government and Housing Committee, as well as the previous Local Government and Environment Committee, has been closely involved in the process of developing the national housing strategy. The Committees have considered *A Framework for a National Housing Strategy*, the four Task Group reports and *Better Homes for People in Wales*.

## **The scale of the problem with the council housing stock**

**2.9** The condition of much of Wales' council housing stock is poor and it fails to provide acceptable homes for many families, often in deprived communities. There is no definitive estimate of the backlog of improvement and repairs for the 200,000 council houses in Wales, but most estimates are in the range £750 million to £1 billion.

**2.10** The Welsh House Condition Survey is of limited use in estimating the size of the backlog, and an alternative approach is an analysis of the information in local authorities' Housing Strategies and Operational Plans. Work undertaken by the Chartered Institute of Housing in 1998 using this approach suggested an average disrepair of £1,500 and modernisation needs of £2,200 per dwelling. These estimates, which must now be regarded as very conservative, imply an overall backlog of some £750 million.

**2.11** The pilot stock condition surveys which five local authorities have recently undertaken will provide another source of information. The limited results currently available do suggest that the backlog could be larger than the estimates above. These results do however need to be treated cautiously as they are not necessarily representative of Wales as a whole.

**2.12** As noted above, local authorities' capital expenditure on council housing was some £70 million in 1999-2000. The Working Party on Securing Additional Investment in Local Authority Housing through Private Finance (see below) estimated that an additional £80 million annually, on top of current levels of capital expenditure and revenue maintenance, would be needed simply to prevent further deterioration.

**2.13** One final point is that all of the various estimates of the backlog of repairs and maintenance relate directly to the cost of improving the council housing stock. They take no account of the significant costs which would be involved in securing environmental improvements to council housing estates.

## The policy on housing stock transfer

**2.14** The origins of the Assembly Cabinet's policy on housing stock transfer go back to the Working Party on Securing Additional Investment in Local Authority Housing through Private Finance, which was established by Welsh Office Ministers in January 1999. The Working Party reported in September 1999 and the main conclusion was:

*Large scale voluntary stock transfer into Community Ownership is the only option currently available which would be capable of delivering additional investment in the local authority housing stock on the scale necessary to fully overcome the identified backlog of repair and modernisation,*

The Assembly Cabinet accepted this conclusion.

**2.15** Following her appointment as Minister for Finance, Local Government and Communities, Edwina Hart reiterated the Cabinet's policy on housing stock transfer in a statement to the Local Government and Housing Committee on 1 November 2000. This statement emphasised that the policy was to encourage local authorities to improve the council housing stock from the range of options available to them, with stock transfer simply one of the available options. The full text of the statement is reproduced at **Annex 3**.

**2.16** Better Homes for People in Wales confirms the policy on stock transfer. The consultation paper (Section 10.5) sets out the following detailed proposals:

- There should be no timescale and no target should be laid down about the number of houses to be transferred.
- The levy on excess capital receipts over the attributable housing debt (which is set at 20 per cent in England) to be suspended for a period of three years.
- Assistance to be given to local authorities with overhanging debt, either by a one-off grant to clear the debt, or by continuing to pay Housing Revenue Account (HRA) subsidy.
- The removal of the requirement on local authorities to complete the transfer of their housing stock within one financial year.
- The development of criteria for Tenants' Advisers and a Tenants' Stock Transfer Charter, for integration into the Stock Transfer guidelines.
- The development of good practice guidance on tenant relations in major works projects.

**2.17** The Assembly Cabinet has undertaken a consultation on a set of draft guidelines on housing stock transfer. The Minister for Finance, Local Government and Communities has informed the Committee that she does not intend to issue the final guidance until after the completion of this review. The Committee has welcomed this decision.

**2.18** To date there have been no whole stock transfers in Wales. There have however been a number of estate transfers and these are detailed at **Annex 4**.

## **The position in England**

**2.19** The stock transfer process is well established in England. Since 1988 over 440,000 homes have been transferred from around 100 local authorities to registered social landlords. This process has attracted over £6 billion of private finance for investment to improve the homes that have transferred and has yielded over £3 billion in capital receipts for local authorities.

**2.20** Initially stock transfers in England took place in 'shire' counties, although by the mid-1990s inner city estates were being transferred with deficit funding through the Estates Renewal Challenge Fund. More recently consideration has been given to the transfer of the whole council housing stock in cities like Birmingham and Coventry. There seems no doubt that the transfer programme has been successful when viewed from the tenant's perspective. Recent research commissioned by the Department of the Environment, Transport and the Regions has shown that transferring tenants are more satisfied with their landlord and the services they provide than local authority tenants as a whole.

**2.21** The recent Department of the Environment, Transport and the Regions policy statement *Quality and Choice: A Decent Home for All* makes it clear that they will support the transfer of up to 200,000 dwellings a year. This compares with the total stock of around 3.2 million council houses in England. With transfers increasingly taking place in urban areas, there have been some changes to the key criteria for future stock transfers. These now place more emphasis on community regeneration and greater competition within the transfer process.

## **The position in Scotland**

**2.22** To date most stock transfers in Scotland have involved Scottish Homes and New Towns stock, or small-scale transfers of council estates to community based housing associations or co-operatives. However, the Scottish Executive has adopted a policy of promoting stock transfer and a number of large-scale transfers are known to be under active consideration (Glasgow is the best known example, with almost 100,000 homes).

## Chapter 3 - The options available to local authorities

**3.1** Three main options are currently available to local authorities for modernising their housing stock. These are to continue with the existing financing arrangements (the status quo), to transfer the stock to a registered social landlord or to pursue a Private Finance Initiative scheme. Two other options – arms-length companies and the Major Repairs Allowance – are being made available in England. These options are currently subject to consultation in *Better Homes for People in Wales*.

### The status quo

**3.2** One of the options available to local authorities is to retain their social housing and continue to invest in repairs and maintenance using both their own resources and those made available by the National Assembly.

**3.3** This approach undoubtedly provides a mechanism for tackling the backlog of repairs and modernisation work, provided sufficient resources can be made available. The Minister's policy statement on stock transfer (see **Annex 3**) warns of the need to be realistic about resources, and it seems unlikely that many authorities in Wales would be able to modernise their housing stock with the resources available to them. In practice, for many authorities this option is likely to mean a continuing deterioration of their housing stock.

### Stock transfer

**3.4** The transfer of the housing stock to a registered social landlord, as described in Chapter 2, is one of the options available to local authorities. Following the transfer, the registered social landlord would be able to borrow in order to fund the investment necessary to modernise the housing stock.

### The Private Finance Initiative

**3.5** The Private Finance Initiative (PFI) is an approach to procurement which transfers responsibility and risk to the private sector and ensures that capital expenditure is 'off balance sheet' and not treated as public expenditure. The PFI contract would need to be serviced by revenue payments over its lifetime, which could be 25 to 35 years.

**3.6** Local authorities are permitted under the capital finance regulations to enter into PFI contracts to raise money for investment in social housing. The main PFI housing refurbishment models involve either a service contract or a long lease. The advantage of the service contract approach is that the authority retains ownership of the housing stock and the tenants remain local authority tenants.

**3.7** Alternatively, under the ‘stock leasing’ model the stock would be transferred to a new landlord under a long-term lease, who would then manage and maintain the properties on behalf of the council. The freehold would remain with the local authority, allowing them to retain an interest in the stock. However, because for the purposes of the stock transfer legislation the grant of the lease would have the same legal status as a transfer of the freehold, the same regulatory requirements would need to apply. Providing the new landlord was structured on the same principles as a conventional stock transfer landlord, borrowing would not count against the Public Sector Borrowing Requirement. The lease would be subject to a break clause which would allow the stock to revert to local authority control after perhaps 25 to 35 years.

**3.8** Authorities can meet the revenue payments for PFI contracts from their own resources or by seeking support from the National Assembly, which would be delivered through the award of a PFI credit. The allocation of a PFI credit would in effect reduce the amount which would otherwise be available to support revenue expenditure by local authorities. With PFI contracts some local authority staff may have to transfer to the private sector.

**3.9** *Better Homes for People in Wales* proposes that the PFI should be considered as a credible option for social housing. It makes it clear that the eight PFI pathfinder schemes being taken forward in England are being monitored.

## **Arms-length companies**

**3.10** The housing policy statement *Quality and Choice: A Decent Home for All*, issued in December 2000, states that the Department of the Environment, Transport and the Regions would be encouraging local authorities in England to set up new arms-length management arrangements for council housing. Additional funding in the form of borrowing will be made available to authorities which have demonstrated excellence in the delivery of services to tenants.

**3.11** There is nothing to prevent local authorities in Wales from setting up arms-length companies to manage their housing. However, any funding made available to such companies would fall within the Public Sector Borrowing Requirement rules and hence score as public expenditure. *Better Homes for People in Wales* makes it clear that the creation of arms-length companies on the same basis as that in England would in effect top-slice the available resources for the best-performing local authorities. The consultation document states that there are no plans to introduce arms-length management companies in Wales, although the situation will be kept under review.

## **The Major Repairs Allowance**

**3.12** *Quality and Choice: A Decent Home for All* confirms that a Major Repairs Allowance is to be introduced in England as part of the Housing Revenue Account subsidy. The Major Repairs Allowance reflects the resources necessary to maintain the condition of the stock in the medium term.

**3.13** The introduction of the Major Repairs Allowance is part of a wider package of reforms to the Housing Revenue Account. These include the introduction of a form of resource accounting, together with the removal of rent rebates from the Account. Resource accounting is designed to measure on a consistent basis the resources used over the lifetime of authorities' assets, rather than simply the cash spent on them.

**3.14** Resource accounting does not create any additional resources for local authority housing finance. Unless funding of the overall housing programme is increased, any resources earmarked for a Major Repairs Allowance could be met only by a corresponding decrease in other housing programmes.

**3.15** *Better Homes for People in Wales* is seeking views on the possible introduction of these changes in Wales. The consultation document makes it clear that the introduction of a Major Repairs Allowance, at much above the current level of Housing Revenue Account credit approvals, could have an impact upon the resources for other housing activities.

## Chapter 4 - General issues

**4.1** Better Homes for People in Wales emphasises the National Assembly's strong partnership with local authorities, as well as the community leadership role of local authorities. It brings out local authorities' key strategic role in ensuring that people in their area have access to a decent home in a sustainable community. The consultation document makes it clear that consideration is being given to how best to achieve a separation of authorities' strategic and landlord responsibilities for housing, as part of a review of the housing strategy and operational planning process.

**4.2** The Committee supports strongly the general thrust of these policies. In particular it feels that local authorities, with their democratic mandate, are uniquely placed to carry out both strategic and operational functions in relation to housing. They can establish consultative mechanisms, develop partnerships at the local level, identify strategic opportunities and ensure the delivery of services which meet the needs of local communities. Furthermore, council housing is subject to democratic control and accountability, which is valued by many tenants.

**4.3** Against this background, the Committee feels that the ideal solution to tackling the backlog of repairs to the council housing stock would simply be to allow local authorities access to the capital markets on the same basis as registered social landlords. Councils would then be able to retain ownership and control of their housing and borrow to finance the investment necessary to modernise their stock.

**4.4** At present this approach is ruled out by the Public Sector Borrowing Requirement (PSBR) rules. The Committee has noted the evidence provided by the Chartered Institute of Housing and others about the restrictive nature of United Kingdom's public sector accounting conventions and the case for moving away from the PSBR as the main measure of public finances towards the General Government Financial Deficit (GGFD). This would allow local authorities to borrow for productive investment and create a level playing field between the public and private sectors. It would also bring the United Kingdom into line with the conventions adopted in the rest of Europe.

**4.5** The Committee is aware that Assembly Ministers have already raised this point with H M Treasury, but feels that the Assembly Cabinet should continue to press vigorously for this change. The ongoing discussions over the future of the local government finance system may provide a suitable opportunity to reiterate this point.

**Recommendation 1:** *The Assembly Cabinet should continue to bring pressure to bear on H M Treasury to change the rules governing local government borrowing so that authorities are free to borrow on the same terms as registered social landlords.*

**4.6** The Committee regards this recommendation as paramount, in the sense that the remaining recommendations are relevant only in the context of the existing public sector accounting conventions.

**4.7** Within the existing financial policy framework, the Cabinet's policy is that it is for local authorities to decide the best way of improving their housing stock from the available options, including stock transfer. The Committee supports the view that it is for local authorities to decide how best to modernise their housing stock, and it is conscious of the limited range of options available to them as discussed in Chapter 3. In the circumstances, the Committee feels that stock transfer should continue to be an option available to local authorities, provided that there are adequate safeguards for tenants.

**Recommendation 2:** *Stock transfer, with appropriate safeguards for tenants, should continue to be an option available to local authorities for modernising their housing stock.*

**4.8** The Committee is concerned about the absence of reliable information on council housing, both in terms of the size of the backlog of repairs and modernisation work and the value of the stock. As noted above, estimates of the backlog are generally in the range £750 million to £1 billion. The value of the stock has been estimated at around £1.5 billion, although this valuation has involved some heroic assumptions.

**4.9** The Committee feels that reliable information on the council housing stock is needed. This is necessary to help the Cabinet to frame its policies and, over time, to ensure that those policies can be properly evaluated.

**4.10** Funding has already been provided to some local authorities to enable them to undertake pilot stock condition surveys, and this funding will continue for the next three years. The Committee considers that all local authorities should be encouraged to undertake these surveys, which should ideally use a similar methodology.

**4.11** The Committee is also aware that *Better Homes for People in Wales* makes it clear that there will be consultation on a proposal to introduce local authority housing stock business plans from April 2002. The intention is that these business plans will help to develop a more rigorous and structured planning regime for investment in the local authority stock. An assessment of the condition and value of the stock would be an essential part of the development of the business plan.

**4.12** The introduction of local authority housing stock business plans provides an opportunity for the National Assembly to collect consistent and reliable information on the condition and value of the council housing stock. The guidance for these business plans should define a common methodology for stock condition and valuation surveys, so that the National Assembly can collate the information in the plans. In due course this would make it possible to produce a definitive assessment of the cost of essential repair and modernisation work, built up from reliable data at the local authority level.

***Recommendation 3:** The Assembly Cabinet should ensure that the proposed local authority housing stock business plans can be used to produce a definitive assessment of the size of the backlog of repairs and modernisation work, as well as the value of the council housing stock.*

**4.13** The Committee feels that it is important that investment decisions on council housing should not be taken in isolation. These decisions should be consistent with the community strategies which local authorities will be required to prepare. Furthermore, any proposals for stock transfer or Private Finance Initiative housing projects which require the National Assembly's approval should be consistent with the Assembly's broad policy framework, as set out in its strategic plan *betterwales.com*. In particular they should be consistent with the three major themes underpinning *betterwales.com*, that is sustainable development, tackling social disadvantage and the promotion of equal opportunities.

***Recommendation 4:** Local authorities should be encouraged to ensure that any investment decisions on council housing are consistent with their community strategies.*

***Recommendation 5:** The Assembly Cabinet should ensure that any proposals for stock transfer or Private Finance Initiative schemes should be consistent with the policy framework set out in *betterwales.com*.*

## Chapter 5 - The options appraisal process

**5.1** The Committee was concerned that local authorities are unsure about exactly which options are available to them in terms of modernising their housing stock. This is particularly true in relation to the financial implications of some of the options, such as capital financing and securitisation, where there are few precedents in the public sector (a technical note on capital financing and securitisation is at **Annex 5**). Local authorities need clear guidance on how these approaches would be treated in accounting terms, as this will determine whether or not the options are viable.

**5.2** The Committee feels that there is a need for definitive strategic guidance which would set out in a single document the options which are available to local authorities for modernising their housing stock. This guidance would need to be updated regularly given the rapid rate of change in capital financing options. It is envisaged that the high level guidance would be supported by more detailed guidance on each option.

***Recommendation 6:** The Assembly Cabinet should prepare strategic guidance to set out the options available to local authorities for modernising their council housing stock, including the financial implications.*

**5.3** The Committee was concerned that the range of options available to local authorities for modernising their housing stock, as described in Chapter 3, is limited. Without a massive injection of new resources, the most realistic options for securing the investment necessary to modernise the council housing stock are stock transfer and Private Finance Initiative (PFI) projects. To date there have been no whole stock transfers in Wales and no housing PFI projects are being taken forward.

**5.4** The Committee feels that the Assembly Cabinet should promote the full range of options available to local authorities for overcoming the repair and modernisation backlog for council housing. However, it should also consider how best to advise local authorities which are interested in proceeding with stock transfer and PFI projects, in order to demonstrate that these are viable options for modernising the council housing stock.

***Recommendation 7:** The Assembly Cabinet should promote the full range of options available to local authorities for overcoming the repair and modernisation backlog for council housing.*

***Recommendation 8:** The Assembly Cabinet should consider how best to advise local authorities which are interested in proceeding with stock transfer and PFI projects.*

**5.5** When local authorities are considering how best to modernise their stock, the Committee feels that it is important for them to enter the options appraisal process with an open mind. It is unlikely that a single approach will be appropriate for the entire stock, so authorities may need to adopt a range of solutions to tackling their problems. It is important that local authorities are seen to be impartial in their consideration of alternatives at the options appraisal stage.

***Recommendation 9:** Local authorities should be required to assess the full range of management and ownership options as part of the options appraisal process.*

**5.6** The Committee is conscious of the importance of ensuring a reliable estimate of the value of any stock transferred to a registered social landlord. It is aware of at least one transfer where the condition of the stock turned out to be significantly worse than identified in a pre-transfer stock condition survey carried out on a sample basis. Such a situation will inevitably create difficulties for the stock transfer organisation at an early stage in its development, with implications for tenants. It should of course no longer be a problem when local authorities have reliable estimates of the value of their stock as part of the proposed local authority housing stock business plans.

**5.7** In present circumstances, there are a number of different stock condition approaches which can be adopted. At the options appraisal stage local authorities need reliable, up-to-date information to gauge the level of backlog and future works costs over a 30-year period. Care needs to be taken over the methodology of this survey, although generally reliable results can be achieved by a 10 per cent sample survey. This type of survey, with suitable warranties, is used as the basis for financial modelling to assess the Tenanted Market Valuation. In addition, complete and accurate information is needed on the specific repair requirements of each property. Prior to a potential management or ownership transfer, there should be a full assessment of the works required per property. The cost of this assessment would be reflected in the net receipts for the transfer.

**5.8** This two-stage approach should provide local authorities with suitable information for the initial options appraisal decision-making process and ensure that complete and accurate information is available on the value and condition of the housing stock before any management or ownership changes are made. It would provide an important safeguard for tenants, the local authority and any new landlord.

***Recommendation 10:** Until such time as local authorities have reliable information on the value of their housing stock, they should be required to undertake a statistically representative sample stock condition survey as part of the options appraisal process, with a fuller assessment of works prior to any stock transfer.*

**5.9** Local authorities will hold information on adaptations for disabled people, although this information may not be complete. Any full assessment of the works required per property (that is a 100 per cent survey) would provide an ideal opportunity to update this information. There should be little cost involved in doing this, as it should be a straightforward matter to collect information on disabled adaptations at the same time as the assessment.

**Recommendation 11:** *Local authorities should be required to undertake an accessibility audit as part of any full assessment of works.*

**5.10** The Committee is particularly concerned that there should be genuine consultation with tenants during consideration of the various options. The draft stock transfer guidelines encourage authorities to involve tenants from an early stage. However, the Committee is conscious of the strong views on this issue which were expressed by the Welsh Tenants Federation.

**5.11** In the light of these concerns, the Committee feels that there should be a firm requirement on local authorities to consult as part of the options appraisal process, and not just when a decision has been made to carry out a stock transfer. This could mean a two-stage consultation process, depending on the option chosen. The cost of this would fall on the local authority.

**Recommendation 12:** *There should be a requirement for tenants to be consulted as part of the options appraisal process, before the council has decided its position on the most appropriate way forward.*

**5.12** The Committee considers that it is important for tenants to have access to independent advice at the options appraisal stage. The draft stock transfer guidelines make it clear that authorities must appoint independent consultants to act as a Tenants' Adviser prior to the development of detailed stock transfer proposals. The Committee feels that if tenants are to be consulted as part of the options appraisal, they will need access to independent advice at that stage.

**Recommendation 13:** *Local authorities should be required to ensure that independent advice is available to tenants when they are consulted during the options appraisal process.*

**5.13** The Committee also feels that the options appraisal report should consider the impact of the various options on tenants and the local community. The recommendation would make it a firm requirement for local authorities to prepare a tenant and community impact report as part of the options appraisal.

**Recommendation 14:** *Local authorities should be required to undertake a tenant and community impact report at the options appraisal stage.*

**5.14** Finally, the Committee feels that it is important for local authorities to involve the staff working on housing management and maintenance, including staff in direct labour organisations, in the options appraisal process. Keeping staff informed and involved is good management practice, particularly as they are likely to have a key part to play in making a success of whatever option is chosen. As a matter of law, staff transferring to a new landlord under stock transfer would be protected by the Transfer of Undertakings (Protection of Employment) Regulations 1981.

**Recommendation 15:** *Local authorities should be encouraged to involve the staff working on housing management and maintenance in the options appraisal process.*

## Chapter 6 - The stock transfer process

**6.1** The Committee has some reservations about large-scale transfers. It has considered whether there is an optimum size for a transfer, and in particular whether there should be an upper limit on the size of the transfer. In England an upper limit was initially set at 4,000 homes, although this was subsequently increased to 12,000 homes.

**6.2** The Committee takes the view that the transfers which are most likely to succeed are those which are related closely to a particular community or communities. Local authorities would need to take into account a range of considerations, such as the local geography, cohesiveness, governance arrangements and tenant involvement. It would be difficult to specify any particular rules on the size of transfers, and the recommendation is a recognition that local authorities are best placed to respond to the needs of their communities.

***Recommendation 16:** No restrictions should be placed on the size of stock transfers, leaving this entirely as a matter for the local authority to decide.*

**6.3** The Committee is keen to encourage competition in the stock transfer process, both from existing and new registered social landlords. This will ensure that transferring tenants have a genuine choice of successor landlord, and also that the transfer secures the best possible deal for the local authority. The presumption should be that local authorities will hold a competition to choose the successor landlord(s). Authorities should be required to explain to the National Assembly why a competition is not appropriate if they consider that to be the case.

***Recommendation 17:** Local authorities should be required to hold a competition to choose a successor landlord, or alternatively explain to the National Assembly why a competition is not appropriate.*

**6.4** The Committee is also concerned that over time stock transfer organisations might develop, particularly through mergers, into large and unresponsive organisations which are remote from their tenants. It did however note that the National Assembly regulates the registered social landlord sector, and that there are zoning rules which govern the geographic operation of registered social landlords. In addition, the draft stock transfer guidelines make it clear that the National Assembly will expect new landlord bodies to serve a defined local area, normally not exceeding the area of one local authority.

***Recommendation 18:** The Assembly Cabinet should keep the regulatory framework for registered social landlords under review as the stock transfer process develops, to ensure that the interests of tenants continue to be protected. Particular attention should be paid to ensuring that stock transfer organisations do not become remote from their tenants.*

**6.5** The Committee is particularly concerned to ensure that any proposals for stock transfer are taken forward as part of the wider community regeneration agenda. It has already made a general recommendation to the effect that local authorities should be encouraged to ensure that any investment decisions on council housing are consistent with their community strategies. As part of this, the Committee considers it important that any stock transfers in deprived communities are linked to the community regeneration programmes, including Communities First, for those areas.

**Recommendation 19:** *Local authorities should be encouraged to link any stock transfer proposals to community regeneration programmes, including Communities First.*

**6.6** The Committee feels that any prospective stock transfer organisations should address community development issues in their transfer proposals (or alternatively explain why it is not relevant to do so).

**Recommendation 20:** *Prospective stock transfer organisations should be required to include in their transfer proposals an element of community development (or to explain why it is not relevant if that is the case).*

**6.7** The Committee feels that local authorities should be able to pursue, where supported by tenants, stock transfer models other than the traditional 'Community Ownership' model (these are non-profit organisations controlled by Boards with one third tenants, one third local authority representatives and one third independent members). The local authority would however need to ensure that the stock transfer organisation was classified as outside the public sector.

**6.8** The Committee does not consider it appropriate to be prescriptive about alternative models, given its view that local authorities should be free to develop whatever approach is best suited to the needs of local communities. For example, it is aware of the work being taken forward in England to develop the 'Community Mutual' model, which might be relevant in Wales. This is an incorporated body which is wholly owned by tenants.

**Recommendation 21:** *The Assembly Cabinet should be prepared to consider stock transfer models other than the traditional 'Community Ownership' model, where these have the support of tenants.*

**6.9** For some Welsh local authorities, stock transfer may generate a positive capital receipt after clearing the outstanding housing debt. The Committee's general view is that local authorities should be free to determine how to spend the resources available to them. However, it does feel that authorities should use the bulk of these resources for community regeneration in connection with the stock being transferred. This might include demolition and new build in certain locations.

**Recommendation 22:** *Local authorities should be free to determine how best to use any surplus capital receipts arising from stock transfer. The Committee does however expect the bulk of these resources to be allocated to community regeneration in connection with the stock being transferred.*

**6.10** For stock transfers of 500 or more properties, the UK Government currently imposes a levy of 20 per cent on the excess of capital receipts over the housing debt. The levy is paid into the Consolidated Fund. The Assembly Cabinet is currently consulting on a proposal to suspend the levy for three years from February 2002. This would benefit any authorities making stock transfers which generate positive net capital receipts, in that it would increase the resources available to them. The Committee supports this suspension and feels that the Cabinet should be ready to press for a further suspension beyond 2005.

***Recommendation 23:** The Committee supports the suspension of the stock transfer levy for three years, and considers that the Assembly Cabinet should be prepared to press for a further suspension beyond 2005.*

**6.11** For a significant number of local authorities in Wales, the capital receipts from the sale of the housing stock would be insufficient to clear their outstanding housing debt. In the circumstances, it seems unlikely that the authorities would be able to pursue stock transfer without assistance from the UK Government. Better Homes for People in Wales makes it clear that the National Assembly will aim to assist local authorities with overhanging debt, either by a one-off grant to clear the debt, or by continuing to pay Housing Revenue Account subsidy.

**6.12** The Committee feels that the Assembly Cabinet should press H M Treasury to make funding available for this purpose.

***Recommendation 24:** The Assembly Cabinet should press H M Treasury to make financial provision available for one-off payments (or alternatively continuing subsidy) to help local authorities redeem any overhanging debt.*

**6.13** The Committee supports strongly the requirement for local authorities to appoint a Tenants' Adviser to provide independent advice to tenants during the transfer process. It has already made recommendations to the effect that authorities should be required to ensure that independent advice is available to tenants during the initial options appraisal process. In making these arrangements, the Committee feels that authorities should pay particular attention to meeting the needs of tenants in vulnerable categories.

***Recommendation 25:** Local authorities should be encouraged to pay special attention to ensuring that the arrangements which are put in place to provide tenants with independent advice adequately meet the needs of tenants in vulnerable categories.*

**6.14** The Committee also supports strongly the commitment in Better Homes for People in Wales to develop a Tenants' Stock Transfer Charter, which will set out the rights of tenants involved in the stock transfer process. The Charter, which is to be incorporated into the stock transfer guidelines, should help to ensure a greater level of understanding about what stock transfer means for tenants.

***Recommendation 26:** The Assembly Cabinet should press ahead with the development of a Tenants' Stock Transfer Charter.*

## Chapter 7 - Post stock transfer issues

**7.1** The Assembly Cabinet's policy on rents for stock transfer organisations is that the rent of transferring tenants must not increase at faster rate than if they had remained tenants of the local authority, and must not exceed the benchmark level set for registered social landlords.

**7.2** The Committee endorses this policy. However, during the consultation exercise, concerns were expressed about the socially divisive nature of stock transfer organisations charging new and transferring tenants different rents for similar properties. Although the Committee recognises that there are a number of competing interests on rents, it feels that there is an important point of principle here.

**Recommendation 27:** *For stock transfer organisations, new tenants should be charged the same rents as transferring tenants for broadly comparable properties.*

**7.3** In the light of these concerns, the Minister for Finance, Local Government and Communities has informed the Committee that she intends to amend the policy relating to transfer bodies to ensure that for comparable properties, and allowing for transitional arrangements, rents of new tenants are the same as transferring tenants.

**7.4** The Committee is also concerned about the fact that post stock transfer transferring tenants might find it more difficult to distinguish between the responsibilities of their landlord and their local authority. To some extent, this difficulty will be reduced if the local authority and registered social landlord are working in partnership to deliver the local housing and community strategies.

**7.5** The Committee is aware that the Welsh Federation of Housing Associations and the Welsh Local Government Association have developed the concept of Community Housing Agreements. These set out the primary aims and objectives of the local authority and the registered social landlord, as well as a performance plan and monitoring and liaison arrangements. The coverage of Community Housing Agreements is patchy at present, and the Committee feels that the Assembly Cabinet should more actively promote the benefits of these Agreements. This would particularly help tenants following a stock transfer.

**Recommendation 28:** *The Assembly Cabinet should promote more actively the benefits of Community Housing Agreements between local authorities and registered social landlords.*

**7.6** The Committee is aware that some English local authorities have contracted out their strategic housing functions, that is the management of their waiting list or their homelessness functions, to stock transfer organisations. With the increasing emphasis on local authorities' strategic housing role, the Committee did consider whether it was appropriate for local authorities to retain these core functions in-house.

**7.7** The Committee came to the view that local authorities are responsible for carrying out their strategic housing functions, and that it is a matter for authorities to determine, in the light of local circumstances, the best arrangements for carrying out that responsibility.

**Recommendation 29:** *Post stock transfer no restrictions should be placed on local authorities in relation to contracting out the management of strategic housing functions. This would enable an authority to enter a contract with a stock transfer organisation to manage the waiting list, for example.*

**7.8** Finally, the Committee is anxious to ensure that there is a thorough evaluation of the policy on stock transfer. The National Assembly is responsible for regulating the registered social landlord sector, which means that it will have available a range of information on the performance of individual organisations. However, the Committee feels that in due course there should be an in-depth independent evaluation of stock transfer.

**7.9** Exactly how this evaluation is undertaken would need to be determined in the light of the take-up of the stock transfer option by local authorities. The evaluation would probably need to focus on a representative sample of stock transfer organisations. It would seem appropriate for the evaluation to take place five years after the first transfers, as this would make it possible to take a view on whether the transfer had been a success, including whether the commitments given at the time of the transfer had been delivered.

**Recommendation 30:** *The Assembly Cabinet should ensure that an independent evaluation of the stock transfer policy is undertaken five years after the date of the first transfers.*

## Chapter 8 - Summary of recommendations

**Recommendation 1:** The Assembly Cabinet should continue to bring pressure to bear on H M Treasury to change the rules governing local government borrowing so that authorities are free to borrow on the same terms as registered social landlords.

**Recommendation 2:** Stock transfer, with appropriate safeguards for tenants, should continue to be an option available to local authorities for modernising their housing stock.

**Recommendation 3:** The Assembly Cabinet should ensure that the proposed local authority housing stock business plans can be used to produce a definitive assessment of the size of the backlog of repairs and modernisation work, as well as the value of the council housing stock.

**Recommendation 4:** Local authorities should be encouraged to ensure that any investment decisions on council housing are consistent with their community strategies.

**Recommendation 5:** The Assembly Cabinet should ensure that any proposals for stock transfer or Private Finance Initiative schemes should be consistent with the policy framework set out in [betterwales.com](http://betterwales.com).

**Recommendation 6:** The Assembly Cabinet should prepare strategic guidance to set out the options available to local authorities for modernising their council housing stock, including the financial implications.

**Recommendation 7:** The Assembly Cabinet should promote the full range of options available to local authorities for overcoming the repair and modernisation backlog for council housing.

**Recommendation 8:** The Assembly Cabinet should consider how best to advise local authorities which are interested in proceeding with stock transfer and PFI projects.

**Recommendation 9:** Local authorities should be required to assess the full range of management and ownership options as part of the options appraisal process.

**Recommendation 10:** Until such time as local authorities have reliable information on the value of their housing stock, they should be required to undertake a statistically representative sample stock condition survey as part of the options appraisal process, with a fuller assessment of works prior to any stock transfer.

**Recommendation 11:** Local authorities should be required to undertake an accessibility audit as part of any full assessment of works.

**Recommendation 12:** There should be a requirement for tenants to be consulted as part of the options appraisal process, before the council has decided its position on the most appropriate way forward.

**Recommendation 13:** Local authorities should be required to ensure that independent advice is available to tenants when they are consulted during the options appraisal process.

**Recommendation 14:** Local authorities should be required to undertake a tenant and community impact report at the options appraisal stage.

**Recommendation 15:** Local authorities should be encouraged to involve the staff working on housing management and maintenance in the options appraisal process.

**Recommendation 16:** No restrictions should be placed on the size of stock transfers, leaving this entirely as a matter for the local authority to decide.

**Recommendation 17:** Local authorities should be required to hold a competition to choose a successor landlord, or alternatively explain to the National Assembly why a competition is not appropriate.

**Recommendation 18:** The Assembly Cabinet should keep the regulatory framework for registered social landlords under review as the stock transfer process develops, to ensure that the interests of tenants continue to be protected. Particular attention should be paid to ensuring that stock transfer organisations do not become remote from their tenants.

**Recommendation 19:** Local authorities should be encouraged to link any stock transfer proposals to community regeneration programmes, including Communities First.

**Recommendation 20:** Prospective stock transfer organisations should be required to include in their transfer proposals an element of community development (or to explain why it is not relevant if that is the case).

**Recommendation 21:** The Assembly Cabinet should be prepared to consider stock transfer models other than the traditional 'Community Ownership' model, where these have the support of tenants.

**Recommendation 22:** Local authorities should be free to determine how best to use any surplus capital receipts arising from stock transfer. The Committee does however expect the bulk of these resources to be allocated to community regeneration in connection with the stock being transferred.

**Recommendation 23:** The Committee supports the suspension of the stock transfer levy for three years, and considers that the Assembly Cabinet should be prepared to press for a further suspension beyond 2005.

**Recommendation 24:** The Assembly Cabinet should press H M Treasury to make financial provision available for one-off payments (or alternatively continuing subsidy) to help local authorities redeem any overhanging debt.

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**Recommendation 27:** For stock transfer organisations, new tenants should be charged the same rents as transferring tenants for broadly comparable properties.

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**Recommendation 29:** Post stock transfer no restrictions should be placed on local authorities in relation to contracting out the management of strategic housing functions. This would enable an authority to enter a contract with a stock transfer organisation to manage the waiting list, for example.

**Recommendation 30:** The Assembly Cabinet should ensure that an independent evaluation of the stock transfer policy is undertaken five years after the date of the first transfers.

# Annex 1



Cynulliad Cenedlaethol Cymru  
The National Assembly for Wales

Bae Caerdydd / Cardiff Bay  
Caerdydd / Cardiff CF99 1NA

25 July 2000

Dear Colleague

## **LOCAL GOVERNMENT AND HOUSING COMMITTEE: POLICY REVIEW OF HOUSING STOCK TRANSFER**

### **Background**

The Local Government and Housing Committee of the National Assembly is undertaking a policy review on the transfer of local authority housing stock into Community Ownership.

The review will consider whether the emerging model for Community Ownership is sufficiently flexible to meet the needs of local communities and whether there are alternative approaches which could generate the finance necessary to overcome the backlog of repairs and essential modernisation work.

### **Invitations for submissions**

The Committee wishes to invite you to contribute to its consideration by providing a written submission setting out your organisation's views on housing stock transfer, including any detailed factual information to support your views. There is no prescribed format for submissions, but you may find it helpful to bear in mind the terms of reference for the review (see below). I have also set out below an indication of the sort of issues which the Committee will be considering as part of the review.

The Committee may in due course wish to invite you to give an oral submission in support of your written submission.

## **Terms of reference**

The terms of reference for the review are:

*To consider the policy on the transfer of local authority housing stock into Community Ownership, and in particular:*

- *the emerging model for Community Ownership and the extent to which the model can be tailored to meet the needs of local communities (including disabled people and others with particular requirements);*
- *whether there are alternative approaches which could generate the finance necessary to overcome the backlog of repairs and essential modernisation for council housing.*

## **Issues to be considered in the review**

In taking forward the review, the Committee will be considering the following questions (this is not an exhaustive list, but simply intended to give a flavour of the areas to be covered by the Committee):

- What are the advantages/ disadvantages of the emerging model of Community Ownership?
- Is the Community Ownership model sufficiently flexible to be adapted to meet the needs of local communities?
- Are there other stock transfer models which should be considered?
- What role might stock transfer play in community regeneration and sustainability?
- Should there be a maximum or a minimum size of stock transfer?
- What lessons can be learnt from the estate transfers which have taken place in Wales?
- What lessons can be learnt from the stock transfers which have taken place in England and Scotland?
- What would be the implications of a transfer to a Community Ownership organisation for local councils and tenants?
- What processes are needed to engage the community and ensure that their views are heard, particularly those with special needs?
- Within the current public sector borrowing rules, are there any options other than stock transfer which would deliver investment on a scale necessary to overcome the backlog of repairs and essential modernisation for council housing in Wales (estimated at around £1 billion)?

- What are the advantages/ disadvantages of stock transfer compared with housing PFI projects?
- What lessons can be learnt from housing PFI projects in England?
- What are the advantages/ disadvantages of the proposal in the Housing Green Paper for arms-length management companies for local authority-owned housing?
- What would be the implications for council housing of a continuation of the status quo?

### **Publication of consultation responses**

The Committee plans to make all the responses to the consultation available to the public on request. I will assume that you do not object to this unless you specify otherwise in your response.

### **Timetable**

I would be grateful if you could send me any submission you wish to make by Friday 29 September 2000.

For your information, the Committee has invited submissions from the organisations on the attached list. In addition, a copy of this letter has been posted to the National Assembly's web-site so that other organisations and individuals can submit their views.

Yours sincerely



MARTIN STEVENSON  
Committee Clerk

## **Policy review of housing stock transfer**

### **Organisations to be consulted as part of review**

Age Concern Cymru

Care and Repair Cymru

Centre for Housing Management and Development, Cardiff University

Chartered Institute of Housing

The Commission for Racial Equality

Council of Mortgage Lenders

Disability Wales

The Federation of Black Housing Organisations

Help the Aged

House Builders Federation

National Association for Local Councils

North East Wales Institute of Higher Education (NEWI)

Shelter Cymru

Society of Directors of Public Protection in Wales

Tenant Participation Advisory Service Wales

University of Glamorgan

University of Wales Institute of Cardiff (UWIC)

Wales Association of Community and Town Councils

Wales Council for Voluntary Action

Wales TUC Cymru

Welsh Consumer Council

Welsh Federation of Housing Associations

Welsh Local Government Association

Welsh Tenants Federation

Welsh Women's Aid

# Organisations consulted in the policy review

## Written consultation exercise

1. The Committee sought views on housing stock transfer through a written consultation exercise. A letter inviting written submissions was sent to relevant organisations (a copy of the letter, including a list of recipients, is at **Annex 1**) and also posted to the Committee's Internet site so that other organisations and individuals could submit their views. Written submissions were received from the following organisations:

- Cardiff University
- Chartered Institute of Housing
- Council of Mortgage Lenders
- Nationwide Building Society
- UCATT Wales
- UNISON
- Wales Council for Voluntary Action
- Welsh Local Government Association
- Welsh Tenants Federation
- Wrexham County Borough Council

## Oral consultation sessions

2. The Committee subsequently held oral consultation sessions with the following organisations:

- Chartered Institute of Housing
- Disability Wales
- Shelter Cymru

- Trowers and Hamlins
- Wales TUC Cymru
- Welsh Local Government Association
- Welsh Tenants Federation

### **Informal briefing sessions**

**3.** The Committee held informal briefing sessions with:

- Council of Mortgage Lenders
- Glyntaff Tenants and Residents Association
- Newydd Housing Association
- The Public Private Partnerships Programme (also known as the '4Ps')
- Welsh Federation of Housing Associations

### **Visits to stock transfer organisations**

**4.** Finally, the Committee visited three stock transfer organisations in England. These were:

- Severn Vale Housing Society, Tewkesbury
- South Somerset Homes, Yeovil
- Westlea Housing Association, Chippenham

**5.** The Committee wishes to express its gratitude to all those who submitted their views or otherwise contributed to the review.

# Policy statement by the Minister for Finance, Local Government and Communities on housing stock transfer, 1 November 2000

I would like to make a statement to the Committee about our policy on the possible transfer of local authority housing stock to the registered social landlord sector.

First, I would like to make it clear that, despite perceptions to the contrary, it has never been the Government of Wales's intention to push local authorities to transfer their housing stock to the registered social landlord sector. Our major concern is the poor state of social housing in Wales and I know that all members of the LGH Committee share this concern.

Inadequate investment over many years has led to many Welsh families occupying homes which fall below what should be expected in the 21st Century – homes which are often located in areas which suffer from high levels of deprivation and where the surrounding environment is in decay due to years of neglect.

We are committed and giving high priority to tackling social disadvantage. Improving living conditions is fundamental to this. Everyone should have a right to a home that meets basic modern day standards. It gives people pride and a base from which they can build their confidence. The problem we are facing is the massive funds needed to tackle the backlog of repairs and improvements. A conservative estimate of this is in excess of £750 million.

I am pleased to have been able to increase the Housing Capital in my draft budget proposals and to have reversed the trend of the last 5 years. However, we still have to be realistic about authorities being able to fund such investment and the Assembly being in a position to support them in this task when there are so many calls on resources. The problem is not going to disappear and could get worse if the levels of investment are insufficient to match the rate of deterioration.

We are committed to tackling the problems of our most deprived communities, many of which are council estates. We may have to look at the priorities for resource allocation. We need to examine all of the available options.

Stock transfer is simply one of these options. There are other options. Councils can, of course, retain their social housing and continue with modest investment in repairs and maintenance. We are doing what we can to support them in this through Housing Revenue Account Subsidy. I will also be consulting on the possible introduction of a major repairs allowance into the Housing Revenue

Account as part of the consultation on the National Housing Strategy. In certain areas, PFI may be appropriate to deal with some problems.

Some local authorities may be able to modernise their stock with the resources available to them. However, in other authorities the reality is they would be struggling to provide basic, decent council housing without having to cut back drastically on other services.

I want to make it clear today that our policy is to encourage local authorities to improve the council housing stock by whatever means they consider appropriate. It is not, and I stress not, to encourage them to transfer all their stock to a registered social landlord.

I understand the reasons why the Committee felt it necessary to commission a policy review of housing stock transfer. But the legislation to enable authorities to pursue the process is in place and so, we, as the Government of Wales, are under an obligation to provide guidance on the process. This guidance is under preparation and we hope to issue it early in the New Year.

I and my officials are happy to contribute to the Committee's review of housing stock transfer policy and I will be prepared to consider its findings when conclusions have been reached.

### Estate transfers in Wales

- 1.** The first estate transfer took place in 1991 when 209 homes on the Oldford Estate in Newtown, Montgomeryshire (now Powys) transferred to the Clwyd Alyn Housing Association. Clwyd Alyn Housing Association provided replacement homes for tenants on an estate of non-traditionally built properties.
- 2.** The second transfer was in 1993, when 432 homes on the Glyntaff Estate in Taff Ely (now Rhondda Cynon Taff) transferred to Newydd Housing Association. This was a Tenants' Choice transfer under the Housing Act 1988. Following the transfer, Newydd Housing Association regenerated the estate.
- 3.** The third transfer concerned stock formerly owned by the Development Board for Rural Wales (DBRW). When the DBRW was wound up in April 1996, it transferred over 1,000 properties to Powys and Gwynedd County Councils and to the newly established Newtown Housing Association, which was part of the Gwalia Housing Group.
- 4.** The most recent transfer took place in Newport in March 2001, when some 480 tenanted pre-fabricated homes transferred to the newly-registered Newport Housing Trust. The Trust will be demolishing existing pre-fabs and building new bungalows.

# Technical note on capital financing and securitisation

## Large Scale Voluntary Transfer and the capital markets

**1.** The capital markets, that is investments made by investors such as pension funds and insurance companies in debenture stocks or bonds, are the natural providers of long term fixed rate finance. To date however very few Large Scale Voluntary Transfer (LSVT) fundings have incorporated capital markets finance. The primary reasons for this are:

- Size – a stand alone capital market issue would require a minimum of £50 million to be drawn at issue.
- Certainty – a capital markets issue is priced on the day of issue and then fixed long term. LSVTs must pay for the stock on the day of transfer, when market conditions may not be advantageous.
- Structure – most LSVTs require a capital sum to purchase the stock followed by regular drawdowns to finance repair and improvement programmes etc. Capital markets issues are generally drawn in full on the day of issue.
- Investor understanding – investors are generally unwilling to devote a significant amount of time in understanding the credit issues relating to complex transactions such as LSVTs.
- Pricing – over the past year or so as LSVT activity has escalated, long term fixed rate funding has been available from banks at lower rates than from the capital markets. Three LSVTs have however been funded through capital markets issues. These have been Pavilion Housing Association (previously Rushmoor), L and Q Bexley Housing Association/Quadrant Housing Finance (part of the London & Quadrant Housing Group) and South Somerset Homes. The latter two were financed by the capital markets at the day of transfer whilst Pavilion was funded initially with bank debt and then refinanced.

**2.** The difficulties outlined above have been overcome by:

- Size – all three required funding in excess of £50 million.

- Certainty – both Quadrant and South Somerset Homes had backstop bank facilities in place to fund the transfer in the event that capital market rates were not attractive. These were only used to fund the period between launch (completion, usually at the point of transfer) and closing (the period of around 10 days investors are given to deliver the funds).
- Structure – all three financings have also included an element of bank finance to fund repair and improvement programmes.
- Investor understanding – all three financings have been guaranteed by an American monoline insurer who (in exchange for a premium) guarantees to investors the timely payment of principal and interest. These insurers are AAA rated. The issue therefore attracts finer pricing and investors look through the credit of the issuer (the LSVT) to that of the insurer.
- Pricing – the markets are quite volatile, particularly with regard to the margins payable on bank fixed rate debt (swaps) and in the capital markets. The pricing relationship will therefore change.

**3.** More recently some banks have developed structures which enable borrowers (including LSVTs) to switch relatively small amounts (£10 million or so) of their bank debt to the capital markets. This is possible because the banks themselves have issued much larger bonds which can be ‘tapped’ for smaller amounts and the proceeds on lent. This is an important development providing LSVTs maximum flexibility in their funding arrangements. The option should preferably be incorporated at the outset so that the necessary arrangements with regard to security and inter-creditor relationships can be made. This can be arranged subsequently but typically at greater cost.

## **Securitisation and local authorities**

**4.** Securitisation is a method of raising finance, usually through the issue of bonds on the capital markets, backed by an income producing asset; in this case the rental income of the council's housing stock. Under current Treasury accounting rules this is not a viable option, as the costs of borrowing would count as public expenditure under the Public Sector Borrowing Requirement (PSBR) rules. It has been confirmed by the Department of the Environment, Transport and the Regions that Ministers will not consider this option until at least 2004.

**5.** There are few live examples of securitisation in social housing and it is a funding mechanism used largely in the private sector. The Welsh Local Government Association and the Local Government Association are interested in developing this approach. An outline of the proposed model is described below.

## The principles of securitisation

- 6.** The securitisation model involves a stock transfer but, unlike a conventional transfer, it could be to a body wholly owned by a council. As in any transfer out of the public sector, tenants would have to be consulted and would become assured tenants if they voted in favour of transfer. The new landlord would need to be a registered social landlord. There may also be a subsequent lease of the stock to a special purpose vehicle.
- 7.** Securitisation requires the new landlord to issue bonds to investors, either directly or through a separate vehicle (known as a "special purpose vehicle" - SPV). A bond is a financial document promising to pay the bondholder a certain sum over, and/or at the end of, a given period. The bond needs to raise sufficient funds to invest in the stock and to pay off a council's outstanding loan debt (unless other finance were to be available, such as overhanging debt funding). The new landlord is then committed to repaying the bondholders and to paying interest out of the income stream from the housing.
- 8.** The new landlord would offer the bondholders (or the SPV) security over the stock and the bondholders/SPV would appoint a Trustee to the Board of the landlord. The Trustee would have powers to act in the interests of the bondholders in specified circumstances if the Board failed to ensure a given level of performance. In order to minimise risk, the landlord would not be a direct provider of services. This separation of ownership and management means that on the one hand, if the landlord (and more particularly the Trustee) is not happy about the quality of service being offered, the service contract can be terminated; and on the other hand, if the management company gets into financial difficulties, it would have no recourse to the housing assets. A council could be the provider of the management service, though this would need to be scrutinised carefully to ensure that sufficient risk was passed from the public sector to the private sector.
- 9.** The performance of the stock would be monitored to ensure that the income stream is sufficient to pay interest to the landholders. Monitoring would include either a three yearly or five yearly stock condition survey. If performance standards were not met, the Trustee would have the power to take remedial action, including appointing new managers and selling the stock. Remedial action may include holding all the income from the stock in a charged account until the position is rectified.
- 10.** If the net cashflow exceeds the level required to pay interest on the bond over a 35 year period, it could be retained by the landlord. If the net cashflow is insufficient to repay interest, the landlord does not "owe" the difference to the landholders but it is likely that the Trustee would take swift remedial action as described above.

**11.** At the end of the 35 year period, the interest of the bondholders would expire and the stock could potentially return to a council if the landlord is wholly owned. However, at that point a council may well be exploring other methods for investing in the stock and reversion to council ownership may be not be practical, so is unlikely to be a guaranteed part of the scheme.

## The perceived advantages

**12.** The cost of wholesale funding through the capital markets may be cheaper than the cost of retail funding from banks and building societies. This cost saving is a product of the use of a bond (which is an instrument already being used by several large traditional registered social landlords for their borrowing) rather than of securitisation itself. A bond issue is a feasible approach in a conventional stock transfer and a small number of transfers have been bond financed, as described above.

**13.** The cost of capital to the landlord through a bond is, however, lower compared to the traditional debt-funded LSVT. The greater value generated from the stock can be realised in one, or a combination, of:

- a higher purchase price payable to a council;
- lower rents;
- greater investment.

**14.** The separation of ownership and management arguably minimises financial risks to bondholders and for tenants.

**15.** Regular monitoring on behalf of bondholders should help ensure that standards are maintained for tenants.

**16.** A council might be attracted by the idea of having a close link with the stock in the form of a local authority company, and by the prospect of taking over full ownership again in 35 years.

## The perceived disadvantages

**17.** As well as all of the perceived disadvantages of stock transfer, this funding mechanism has some additional disadvantages:

**(i)** Under current rules (which the UK Government has not indicated willingness to change) the borrowing would count as public spending, and thus count against a council's credit approvals.

- (ii)** The mechanism has not been widely adopted within the social housing sector. Thus there are likely to be complex legal and administrative issues to be dealt with by the pathfinder.
- (iii)** The costs associated with achieving a suitable credit rating and managing the bond issue are high at an estimated 1.5 per cent of the bond value. Moreover, continuing monitoring costs will be high.
- (iv)** This mechanism depends upon a positive and regular cashflow. Also, it is only feasible for issues worth at least £50 million.
- (v)** The powers of the Trustee may be of concern to tenants and a council.
- (vi)** Members of staff may find the idea of providing the housing management service on a contractual basis to the asset-owning company unattractive because of the risk of the contract being terminated.

Mike Jones HACAS Exchequer Services  
Judith Wayne HACAS Chapman Hendy  
March 2001