WEST DUNBARTONSHIRE COUNCIL

Report by the Chief Executive

Council: 31 August 2011

Subject: Housing Maintenance Trading Account - Treatment of Surplus

1. Purpose

1.1 The purpose of this report is to advise the Council of the options for current contract prices provided by Housing Maintenance Trading Operation to undertake repair and maintenance work to be adjusted, the consequences of this action and the financial implications for the HRA and General Services Accounts.

2. Background

2.1 Representatives from the West Dunbartonshire Tenants and Residents Organisation (WDTRO) have in recent times, through a range of forums, consistently raised the issue of the level of surplus being generated by the Housing Maintenance Trading Account (HMTA). Their main concern being that this surplus is returned to the General Services Account as opposed to the Housing Revenue Account.

2.2 At the Council Meeting of 30 March 2011 a report on this matter, by the Executive Director of Housing, Environmental and Economic Development, was considered and the following motion agreed:-

"That this Council thanks the Executive Director of HEED for her comprehensive report. This Council notes that the report at para 4.3 (ii) confirms that it is perfectly possible for this Council to direct the Housing Maintenance DLO to lower its prices and that, whilst too late for the 2010/11 budget process, by doing so, this is likely to generate revenue benefit to the HRA for future years.

This Council is mindful of the need to comply with statutory targets for Trading Accounts by generating revenues not less than the break-even point over a three year rolling period. This Council notes that from the 'profits' currently being generated by the Housing Maintenance Trading Account of £3.204million over the period 2007-2010, it believes that there is scope for lower prices without jeopardising statutory targets.

Therefore, this Council requests the Chief Executive to examine current charges being raised by the Housing Maintenance DLO and with a revised profit target of 1.5% - 2% per annum over the whole account, to bring forward recommendations to this Council by the August Council meeting as to where the current contract prices can be adjusted in order to produce financial benefits for the HRA for future years."

3. Main Issues

3.1 As members are aware the Housing Maintenance Trading Account, as with all other Trading Accounts of the Council, is by definition a general services account.

3.2 The current Housing Measured Term Contract (MTC) was won in 2007 by the Housing Maintenance DLO (HMDLO) in direct competition with a number of external contractors. The contract ends in June 2012 and is the charging method applied to the majority of works allocated from the HRA revenue and HRA capital accounts each year to the Trading Account.

3.3 The Trading Account estimate for 2011/2012 anticipates income from HRA revenue (£6.6M) and HRA Capital (£6.75M) as the main parts of anticipated total funding of £13.933M and targeted surplus of £1.477M (10.6% of turnover). Of this figure £483,000 is an internal recharge and £1.3 million is for works bid for as additional works not subject to the MTC described in 3.2 above. The net income arising from the MTC is therefore £12,150,000.

3.4 The present MTC is based on the National Schedule of Rates and Bills of Quantities.

3.5. The HMDLO tender submission in 2006/2007 offered a competitive percentage discount on National Schedule of Rates and competitive Bill rates. An external validation exercise carried out by SOLACE in February 2010 reported to Housing, Environmental and Economic Development Committee on 3 March 2010 advising that benchmarking of rates used to price repair work showed "that they are lower than average, representing good value for money."

3.6 As a statutory trading operation the DLO is required to achieve a break even position over a rolling 3 year period. Since inception of the current contract the DLO's financial performance has steadily improved. This has been achieved against a background of specific management action to optimise efficiency and reduce costs alongside relative certainty in relation to income levels on overall turnover.

3.7 Future profitability of the HMTA is less certain and will undoubtedly be affected by:

1. the level of workload available to the HMDLO in future years;
2. the decision to extend, or not, the MTC when it ends in June 2012; and
3. whether legacy arrangements to deliver housing maintenance services to receiving Registered Social Landlords (RSLs) following the proposed Partial Stock Transfer in 2013/2014 are entered into.

Given these factors and other risks in terms of the viability of the business as outlined in sections 5 and 6 of this report it is prudent to consider revisions to the targeted level of surplus in this context.

3.8 On the basis that projected workload for 2012/2013 remains at 2011/12 levels, officers having analysed financial and other information relating to the present MTC, are of the view that the most appropriate mechanism to adjust current contract prices to target profit of 1.5% to 2.0% of turnover per annum and to optimise benefit to HRA is to further increase the level of percentage discount offered on National Schedule of Rates referred to in 3.5 above. This will reduce the charge (cost) to the Housing Revenue Account and allow Members to decide on what to do with such a reduced charge, available options include:

1. carry out additional repairs; and/or
2. carry out capital works funded from current revenue; and/or
3. increase the HRA reserve.

3.9 However, this level of targeted surplus leaves only marginal room for variations in performance across the many factors that influence the financial outturn of the DLO and would create a material level of uncertainty about the Councils ability to achieve its statutory duty as set out in paragraph 3.6.

3.10 While it is acknowledged that the current level of surplus being generated appears significant it equates to 10.6% of turnover of the business. Analysis of other providers in both the public and private sector would suggest that margins of 5 - 8% of turnover provide for sustainable business models in the current environment. It may be more prudent therefore to consider a targeted level of surplus within these parameters providing both a challenging target to the DLO and the desired benefit to the Housing Revenue Account.

4. People Implications

4.1 There are no direct people implications; however the proposed reduction in surplus level will place even more importance on optimising employee productivity levels and minimising sickness absence. Given this it will be appropriate to review core staffing levels and trade mix on an ongoing basis.

5. Financial Implications

5.1 The accounting treatment of the Housing Maintenance Trading Account will remain consistent with both the provisions of the Housing (Scotland) Act 1987 and also CIPFA Accounting Code of Practice Requirements.

5.2 There is no statutory provision to allow monies to be transferred from the General Fund Account to the Housing Revenue Account except where the HRA is in deficit. In order to achieve financial benefit to HRA financial adjustment requires to be made before surplus is generated by HMTA and, to optimise benefit to HRA, focus on those works in the current contract carried out under National Schedule of Rates provisions.

5.3 For the purpose of this report it has been assumed that the potential for increasing the percentage discount will apply from financial year 2012/13 onwards. Any earlier application would require Council to identify in-year savings options to offset the effect on the General Fund revenue account in 2011/12.

5.4 Assuming that for 2012/13 the level of turnover for the HMTA as derived from the MTC remains the same as for 2011/12 at £12.35m as described at 4.3 above, then the value of surplus at 1.5% and 2% would be:

Annual Surplus at 1.5% of MTC related turnover would be £182,250; and

Annual Surplus at 2% of MTC related turnover would be £243,000.

5.5 The General Fund revenue budget for 2011/12 includes an assumption of a surplus from the HMTA of £1,476,850 and at present the assumption for 2012/13 onwards retains this level of contribution. As stated at 3.3 above around £1.3 million of the turnover is planned to come from “bid for” projects and aligned to this is an expectation of £65,000 surplus. This means that the expected surplus from activities derived from the MTC is £1,411,850.

5.6 Any decision to reduce the cost charged to the budgets from which the MTC work is generated (HRA revenue and HRA capital) will therefore have a financial effect on the General Fund in future years, creating a “burden” of between:

£1,229,600 (1.5% based on surplus); and

£1,168,850 (2% based on surplus).

5.7 A decision to reduce the level of HTMA surplus will therefore require Council to identify revenue savings of an equivalent value in setting the General Fund revenue budgets in future. As a consequence the identified budget gaps for 2012/13 and 2013/14 in the report on the Council's Financial Strategy reported to this Council meeting will change from £7.156m for 2012/13 and £12.618m for 2013/14 to £8.325m for 2012/13 and £13.787m for 2013/14 (assuming the effect at 2% of the MTC generated turnover).

5.8 As identified at 3.8 above, any reduction to the charge made by the HMTA will reduce the repairs costs within the HRA revenue account which provides options to Council in considering the HRA revenue funding for 2012/13 onwards. The potential benefit to the HRA revenue account would be between:

Benefit with a surplus at 1.5%	£667,900; and
Benefit with a surplus at 2%	£634,900.

This benefit would provide the opportunity to facilitate more responsive repair work within existing budget levels.

5.9 In addition to this benefit to the HRA revenue account, the proposed reduction in HMTA charge will also reduce the charge to the other sources of HMTA turnover derived from the MTC - the HRA Capital account. This would provide options relative to the future level of capital investment of either reducing spend by the amount saved or retaining spend at current levels but thereby obtaining additional spending power. The potential saving to the HRA capital account would be between:

Saving with a surplus at 1.5%	£561,700; and
Saving with a surplus at 2%	£533,900.

In the current climate and with the requirement to improve the condition of properties to achieve the Scottish Housing Quality Standard by 2015 it is considered appropriate that the opportunity of additional spending power is grasped as a mechanism to accelerate/augment current investment activity.

5.10 In financial terms any decision to limit the planned surplus to the proposed value of between 1.5% and 2% increases the risk that the HMTA, and as a result the Council, will not maintain its ability to comply with the statutory requirement to break-even over a rolling 3 year period.

Assuming the surplus expected from the “bid for” works is achieved at £65,000 then the total surplus for the HMTA under the proposed values would be between:

Total HMTA surplus with MTC surplus set at 1.5%	£247,250; and
Total HMTA surplus with MTC surplus set at 2%	£308,000.

Total surplus of the above levels considered dangerously close to break-even and would be more likely to be affected adversely by adverse variances arising from relatively minor variations in performance of the HMTA in the future in relation to variation of employee costs (for example through requirements to cover sickness absence, variations in productivity, variations in Superannuation and National Insurance contributions); materials costs and commodity costs, such as fuel.

Given the current climate it is considered inappropriate to plan for such a low level of surplus given the risks it presents.

5.11 An alternative which reduces the cost to the HRA revenue account and HRA capital account, reduces the effect on the General Fund revenue account and retains a more sustainable level of surplus for the HMTA would be to set the target surplus on MTC works at 5% of turnover.

This would reduce the HMTA surplus by £804,000 to £673,000 (including the £65,000 from the “bid for” works, provide a reduction in charge to the HRA revenue account of £437,000 and a reduction in charge to the HRA capital account of £367,000. The implications for the Councils financial strategy would be proportionately affected also.

5.12 It should be noted that whatever targeted surplus is set for the HMTO, that this may be exceeded as RPI uplifts are applied, efficiency improves further or costs of back office/control support allocations are reduced through efficiencies etc. Equally it is entirely possible that given the uncertainties over future revenue streams, costs of commodities etc. that the target level is not delivered. It should be noted that the general fund carries the full extent of this risk.

6. Risk Analysis

6.1 Should the target for the Trading Account be reduced to between 1.5% and 2%, a significant risk would exist for the Council should the HMTA fail to reach income targets and compromise its ability to meet statutory performance standards for a Trading Account, due to normal business variables as described in 5.10 above. This may be mitigated through consideration of either not imposing a reduction in the surplus or identifying an alternative target rate to the proposed 1.5% to 2% consistent with industry norms of a minimum of 5%.

6.2 Significant risk exists to the generation of future surplus if:

- HMDLO fails to maximise opportunity provided by new income streams outwith the present MTC workstreams;
- HMDLO does not continue to carry out present workstreams beyond June 2012 when present MTC ends; and
- HMDLO and RSLs fail to enter into legacy agreements following partial stock transfer.

6.3 In addition it is considered that limiting planned surplus**,** to between 1.5% and 2.0% and the resultant uncertainty about HMDLO's ability to breakeven, will hinder the capacity of HMDLO to successfully submit tender prices for the "bid for" projects which aim both to generate surplus and manage and maintain workflow and/or drive forward business strategy.

6.4 The above issues require to be balanced against continued dissatisfaction of Tenants' and Residents' representatives if measures are not introduced to produce additional financial benefits for the HRA.

7. Equalities, Health & Human Rights Impact Assessment (EIA)

7.1 No significant issues were identified in a screening of potential equality impact of this report.

8. Strategic Assessment

8.1 The Council's strategic priorities have been considered and the impact of this report could, depending on future decisions around the use of any savings to the HRA revenue and capital accounts, make a positive contribution to strategic strands covering housing quality, housing financial planning and continuous improvement.

9. Conclusions and Recommendations

9.1 Officers have analysed financial and other information relating to the present Measured Term Contract to ascertain the best way to adjust current contract prices to target profit of 1.5% to 2.0% of turnover per annum, as stated in the motion of 30 March 2011.

9.2 A decision to reduce the future HMTA surplus to between 1.5% and 2% of turnover will have significant impact on the General Fund and will increase the financial gap identified in the report also submitted to this Council meeting on the Council's Financial Strategy, as at present the Financial Strategy and the gap generated from it assumes future HMTA surplus maintained at current levels. This assumption is one of a number of assumptions and variables within that document which remain under ongoing review.

9.3 If Council wishes to reduce the cost to the HRA revenue account then the appropriate mechanism of increasing the percentage discount offered on National Schedule of Rates referred to in 3.5 is recommended. To reduce the targeted surplus to 1.5 - 2%, there would be so little margin for absorbing variables across the HM DLO cost base that there could be no certainty of the Council achieving its statutory duty in respect of Trading Operations. This would carry with it associated financial, people reputational and service risks. A more sustainable level of reduction which would release resources to the HRA and effectively mitigate the risks associated with statutory performance requirements/business needs of the HM DLO would be a targeted surplus of 5% of turnover.

9.4 It is recommended that the Council:

(i) note that any adjustments to current arrangements must be made in the context of current financial regulations applying to both HMTO and the HRA respectively;

(ii) agree that an operating surplus target for the HMTO should be established at 5% of turnover with effect from 1 April 2012;

(iii) agree that to facilitate this, the HMTO are required to review the percentage discount on the national schedule in this context;

(iv) agree that the benefit generated to the Housing Revenue Account be utilised over the next 3 years to increase repair activity and support accelerated capital investment;

(v) agree that appropriate adjustments are made to the assumptions contained within the Financial Strategy and 2012/13 budget assumptions to reflect this position;

(vi) agree that the position is reviewed every 3 years aligned to a review of the contract; and

(vii) delegate authority to the Executive Director of Housing, Environmental and Economic Development and Executive Director of Corporate Services to ensure the effective implementation of these respective changes by 1 April 2012.

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Chief Executive
Date: 19 August 2011

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Appendix:	None
Background Papers:	Council Report “Housing Property Maintenance Trading Account - Treatment of Surplus”, 30 March 2011
Wards Affected:	All