

Briefing Paper

Arms length Management Organisations

Adrian Waite – July 2004

What are Arms Length Management Organisations?

In its statement on Housing policy of December 2000 the government offered local authorities that perform well the option of establishing an Arms Length Management Organisation for the management of their housing stock as an alternative to a Large Scale Voluntary Transfer. Arm's-length management is a practical manifestation of splitting the strategic and day-to-day management aspects of housing provision.

An Arms Length Management Organisation is an organisation set up by a local authority to manage and improve all or part of its housing stock. Some of the main implications of this are:

- The Arms Length Management Organisation is a company that is wholly owned by the local authority
- The Arms Length Management Organisation is included within the public sector for purposes of calculating public expenditure and the public sector borrowing requirement
- The Arms Length Management Organisation has a board that includes tenant representatives and where council nominees are in a minority
- The Arms Length Management Organisation manages council housing, including investment, on behalf of the local authority. It may manage all or part of the stock.
- Arms Length Management Organisations were originally limited to the management of no more than 12,000 dwellings, although this rule has now been relaxed.
- The housing stock remains in the ownership of the local authority and the local authority remains the tenants' landlord.
- Tenants remain secure tenants of the authority. There is no change in their rights, such as the right to buy, right to repair and right to manage.
- The Arms Length Management Organisation has a significant degree of independence from its parent local authority.

Arms Length Management Organisations are normally companies which are 100% controlled by the local authority, and they are usually constituted as companies limited by guarantee. A Tenant Management Organisation may be able to form the basis for an Arms Length Management Organisation provided it carries out an appropriate range of functions.

The relationship between a local authority and an Arms Length Management Organisation is covered in an agreement that sets out the obligations of each party.

Many types of council are attracted towards the option of an Arms Length Management Organisation because it appears to be the only way of achieving the decent homes standard while avoiding a Large Scale Voluntary Transfer and thus retaining a significant role in Housing Management. The Arms Length Management Organisation sets rents, manages estates and determines investment, but the Council retains ownership of the stock and is able to influence the company.

Arms Length Management Organisations have their own budgets and business plans, retain all surpluses earned, and receive all monies paid to the Council for their support.

To establish an Arms Length Management Organisation, an authority must meet the following conditions:

- Clear separation of the housing strategic and landlord roles with housing management and investment the responsibility of the Arms Length Management Organisation.
- The Best Value Inspectorate must have given the authority an 'excellent' rating for housing management or a good rating with a likelihood of improvement to the excellent level. However, where an excellent rating is not achieved the level of resources offered will be set at 50% of the full level.
- There must be a high quality housing strategy and Housing Revenue Account Business Plan.
- Government plans for rent restructuring and lettings must be in the process of being implemented.

By July 2003, 21 councils had passed the management of more than 350,000 homes to arms length management organisations. A further fourteen councils applied to fund 200,000 homes in the third round of bidding and fourteen more applied in round four in December 2003.

Financial Arrangements

The financial incentive to set up an Arms Length Management Organisation is additional annual funding.

Arms Length Management Organisations produce their statement of accounts in Companies Act format. Their main revenue source is all-in management fees paid to the Arms Length Management Organisation by its parent council.

The parent council remains the fundraiser – mainly by borrowing – for capital projects. The parent council is also governed by all the accounting requirements for its housing stock that would apply if there were no Arms Length Management Organisation. It is eligible for housing subsidy on Arms Length Management Organisation-managed properties.

Financially, therefore, the main differences for the parent council are:

- Additional capital spending power potentially available
- Greatly simplified accounting and financial management for its housing management function.

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The arrangements for securing additional funding are as follows:

- There is an annual Arms Length Management Organisation bidding round. (Round 1 –2002-2003, Round 2, 2003-2004 and so on.)
- As a broad guide, Arms Length Management Organisations successful in bidding rounds 1 and 2 ended up with about £5,000 extra capital per dwelling. This limit no longer applies.
- In rounds three and four Local authorities are able to bid for whatever additional resources they need to achieve decent homes. But they must use a new Building Costs Model to demonstrate that the proposed costs are reasonable.
- Arms Length Management Organisation resources are in addition to all other sources of finance, such as the Major Repairs Allowance, available to local authorities for Housing Revenue Account housing. From April 2004 capital resources are allocated in the light of recommendations from Regional Housing Boards.
- Authorities are expected to continue to spend all such funds (or, in the case of partial Arms Length Management Organisations, the appropriate share of such funds) through the Arms Length Management Organisation, so that the Arms Length Management Organisation delivers major improvements as quickly as possible.
- At least £700 million is available for new Arms Length Management Organisations in 2004/05 (£380m) and 2005/06 (£320m). The Office of the Deputy Prime Minister will keep these figures under review in the light of progress by all Arms Length Management Organisations in using their allocations. £160million was made available in 2002/2003 and £300million in 2003/2004.

Financial management and subsidy issues for Arms Length Management Organisations and influenced by the accounting treatment of the Arms Length Management Organisation by the government. Because the Arms Length Management Organisation is owned by the local authority it is treated as being part of the local authority for purposes including housing subsidy and capital expenditure controls; while because it is at arms-length it is treated as being independent for matters such as the additional funding programme.

Local authorities continue their Housing Revenue Account and receive subsidy in the normal way. Subsidy is calculated on the authority's overall stock, assumed borrowing and rent rebates in respect of the total stock, irrespective of whether or not some of that stock is managed by an arm's-length company.

Expenditure on repairs, management and maintenance of the stock are items within the company's accounts. As far as the council's Housing Revenue Account is concerned, there may only need to be an entry representing the payment to the arms length company.

Revenue payments are determined by the agreement between the authority and each arm's-length company. They are funded largely by subsidy, or by rental income collected on behalf of the authority. Some part of the revenue payments may be designed to help meet capital expenditure.

The Major Repairs Reserve should also be available to the arm's-length company. Under the current system, credit approvals (if any) continue to be issued to the authority, and capital receipts will accrue to it.

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The company would ask the authority to undertake any borrowing, primarily because of the benefits to be gained by corporate exchequer management and authorities' access to the Public Works Loan Board.

Assets managed by the arm's-length company remain those of the authority. The authority's accounts will show the effects of the capital expenditure incurred by the company on the authority's behalf. Authorities determine the overall rent requirement for a year – within the constraints of the rent restructuring regime, including any which is managed by an arm's-length company.

The Accounts of an Arms Length Management Organisation – An Example

When a local authority establishes an Arms Length Management Organisation it retains its Housing Revenue Account, but within that it usually divides its budgets into three. First, the management budgets are generally delegated to the Arms Length Management Organisation and appear in detail in the company's accounts, while a single management fee is paid by the Housing Revenue Account to the company. Second, there are managed budgets that are controlled by the Arms Length Management Organisation but charged directly into the Housing Revenue Account, that often include repairs and maintenance and rent income. Third, there are the budgets that for which the local authority retains full responsibility that continue to be charged directly to the Housing Revenue Account as usual.

An example of a Housing Revenue Account for an authority with an Arms Length Management Organisation follows:

Income	£,000	Expenditure	£,000
Managed budgets	24,502	ALMO Management Fee	10,604
Council Managed Budgets		Council Managed Budgets	
Housing Subsidy	28,892	Capital Charges	19,098
Interest	350	Rent rebates	18,914
		Insurance	721
Sub-Total	29,242	Sub-Total	39,956
Total Income	53,764	Total Expenditure	50,560
		Surplus	3,184

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The Managed Budgets can be further analysed as follows:

Income	£,000	Expenditure	£,000
Rent & Hostel Income	28,266	Responsive Maintenance	4,892
Service Charges	8,518	Planned Maintenance	4,802
Commercial income	1,551	Contract Cleaning	1,497
Other income	1,633	Electric, heat & water	1,249
		Provision for bad debts	1,106
		Other responsive repairs	525
		Other expenditure	1,395
Total income	39,968	Total Expenditure	15,466
		Net Income	24,502

The Accounts of the Arms Length Management Organisation are company accounts where the management fee paid from the Housing Revenue Account represent the income:

Trading Account	£,000	Administration Account	£,000
Turnover	10,604 Cr	Employee Costs	7,351
Total Administrative costs	10,778	Premises Costs	399
Administrative costs net	174	General Administration	493
Other operating income	159 Cr	Tenant Participation	67
Operating Deficit	15	Supplies & Services	75
		Services from council	1,749
Net interest received	69 Cr	Play scheme	7
		IT services	250
Profit before tax	54 Cr	Legal & Professional costs	387
Taxation	7	Total Administrative costs	10,778
Profit after tax	47 Cr		

Communities Plan

On 5th February 2003 the Office of the Deputy Prime Minister issued the 'Communities Plan'. With regard to Arms Length Management Organisations it stated that:

"Following the recent consultation on local authority housing finance, we will set out details of possible further freedoms and flexibilities for high performing (three star) Arms Length Management Organisations to borrow prudentially within public expenditure control totals."

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It is understood that the government has yet to decide on the best way to enable the highest performing arms length management organisations to become self-financing, but consultation is expected soon. One option is for council housing debt to be restructured so that authorities would not need housing subsidy and could operate in a more 'businesslike' way. This may mean that some authorities would have to make a substantial payment as the price of 'opting out' of the subsidy system and realising greater flexibilities. Other authorities may receive a payment to help them to repay debt.

Arms length management organisations are especially seeking powers to:

- Build homes and apply for social housing grant
- Borrow against rental streams
- Issue anti-social behaviour orders
- Spend more on the sustainability of estates and not just decent homes
- Be freed from certain Office of the Deputy Prime Minister statutory requirements

Some arms length management organisations have argued that they should be eligible for the Housing Corporation's research and innovation grants.

The government is expected to issue a consultation paper in Spring 2004 that will propose that the government cancel some of the debt of top performing Arms Length Management Organisations to allow them headroom to borrow more money under prudential borrowing. The idea is to allow Arms Length Management Organisations to move beyond achieving the decent homes standard and to do community and environmental work.

The Communities Plan included a requirement for Arms Length Management Organisations in rounds three and four to spend 5% of their bids on environmental improvements. This contrasts with the requirement in rounds one and two that additional Arms Length Management Organisation funding was only available to meet the decent homes standard.

Effect of revised management and maintenance allowances

Round one and two Arms Length Management Organisations were established with additional Arms Length Management Organisation funding that was sufficient to meet their requirement for funding to achieve the decent homes standard. The calculation of the funding that was required was on the basis of the housing subsidy and housing investment programme regimes that were in place at the time.

However, the revisions to the housing subsidy system as a result of the recalculation of management and maintenance allowances and the revisions to the housing investment programme as a result of the comprehensive spending review and the involvement of the regional housing boards has reduced the funding that is available to these arms length management organisations. As a result these arms length management companies will no longer be able to achieve the decent homes standard.

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A Fifth round of Arms Length Management Organisations

The government determined that it would fund a fifth round of Arms Length Management Organisations following the July 2004 comprehensive spending review.

Conclusions

The government sees the arms length management organisation as their preferred structure for local authority owned housing, and it prepared to provide additional public funding to arms length management organisations. Many authorities are attracted to the option because they retain ownership of the stock, but the government continues to believe that the option should be confined to those authorities that achieve a high level of performance.

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