Melton Borough Council

ASSET MANAGEMENT MODELLING

FINANCIAL ANALYSIS
POSITION STATEMENT

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1.0 EXECUTIVE SUMMARY

1.1 This report sets out the initial findings from the asset modelling that has been carried out on the tenanted housing stock of Melton Borough Council (MBC).

1.2 The modelling is intended to inform an investment strategy based on an active asset management approach where MBC seeks to make investment decisions based on the financial performance of the stock, in a way that strengthens the Business Plan and contributes to meeting the Council's social objectives.

1.3 The analysis focuses on 1,891 tenanted units. For the purposes of analysis the stock is broken down into 16 asset groups, containing properties with similar characteristics. The results of the modelling can also be analysed at estate level with stock broken down into 48 different geographical areas.

1.4 The asset management model produces the following key results:

- The 30-year NPV of MBC's tenanted housing stock of 1,891 units stands at £25.7m or £13,597 per unit. This reflects a range of NPV levels across the stock.
- Approximately 55% of the stock analysed is shown to have a poor or below average net present value when compared with the valuation carried out by CLG for the purposes of self financing (e.g. below an asset group average of £17,834 per unit).
- The remainder of the stock performs well, with investment need met by rental income over time

1.5 The results from this asset modelling can be used to develop an asset management strategy including

- Development of a 5 year investment strategy for the stock, based on a transparent investment standard which prioritises investment decisions based on the performance of the assets and business plan affordability
- The production of a 30 year investment profile that manages critical points in the business plan cashflow

- Identification of candidate estates or asset groups for more detailed options appraisal
- The establishment of links between the performance of the assets to development potential in order to identify potential opportunities that could be explored in the context of HRA reform

2.0 PROJECT OVERVIEW

2.1 This report sets out our initial findings in respect of the financial performance of Melton Borough Council (MBC)'s housing stock. The work can provide the evidence basis on which investment and other strategic decisions can be taken in respect of the stock.

2.2 The objective of the financial exercise is to produce income and expenditure projections for each asset group over a defined investment period. The model has also been constructed to enable this analysis at estate level. From this it is possible to identify the stronger and weaker performing assets within the stock and to provide the Council with more detailed information to assist in future investment decisions. The results of this work can also advise on where best to target other initiatives, such as disposals or re-development.

Properties Included

2.3 The properties covered in this report include all stock classified as "Tenanted" by the Borough. We have excluded in the current version of this report all other elements of stock including leasehold, garages, and commercial property.

2.4 The overall tenanted stock number comprises 1,891 units. Separate more detailed analysis which is development – driven can be undertaken with MBC to include related assets such as garages and open spaces if required.

2.5 The following paragraphs set out the key stages of works associated with the financial modelling process.

STAGE 1: Financial Model: Categorisation of Properties

2.6 For the purposes of financial analysis, we have broken down the tenanted housing stock (comprising 1,891 units) into 16 'asset groups'. The asset groupings have been agreed with MBC and have been designed to comprise groups of properties which benefit from similar characteristics with respect to:

- Use: General Needs or Sheltered
- Dwelling Type: Low-rise Flats, medium-rise flats, houses, bungalows and bed-sits
- Construction Type: Traditional or Non-Traditional
- Location: Urban/Rural

2.7 The asset groups chosen are at a high level. However the breakdown by housetype helps to ensure that the assets comprising the groups perform similarly from a financial perspective and can be identified easily to aid further detailed analysis. The stock breakdown by asset group is shown in the table below:

Asset Group	Units	Proportion
GNFLATTRADRURAL	58	3.1%
GNFLATTRADURBAN	47	2.5%
GNHOUSENON-TRADRURAL	33	1.7%
GNHOUSENON-TRADURBAN	75	4.0%
GNHOUSETRADRURAL	274	14.5%
GNHOUSETRADURBAN	509	26.9%
GNMRFLATTRADURBAN	156	8.2%
SHBEDSITTRADURBAN	28	1.5%
SHBUNGNON-TRADRURAL	29	1.5%
SHBUNGNON-TRADURBAN	46	2.4%
SHBUNGTRADRURAL	166	8.8%
SHBUNGTRADURBAN	45	2.4%
SHFLATTRADRURAL	88	4.7%
SHFLATTRADURBAN	160	8.5%
SHHOUSETRADRURAL	1	0.1%
SHMRFLATTRADURBAN	176	9.3%
Grand Total	1891	100.0%

Table 2.1 Breakdown of stock by asset group

2.8 An additional layer of analysis has been carried out at geographical level to help the Borough to understand the impact of geography in order to inform local investment strategies. This breakdown is based on 48 groups of estate/village and is shown in the table overleaf.

Estate/Village	Units	Proportion
Ab Kettleby	18	1.0%
Asfordby	175	9.3%
Barkestone	5	0.3%
Barsby	1	0.1%
Beckmill Court	54	2.9%
Bottesford	80	4.2%
Burrough	9	0.5%
Craven - Town Centre	289	15.3%
Croxton Kerrial	18	1.0%
Eastwell	4	0.2%
Eaton	10	0.5%
Egerton	306	16.2%
Egerton View	68	3.6%
Fairmead	146	7.7%
Frisby	9	0.5%
Gaddesby	10	0.5%
Garthorpe	3	0.2%
Great Dalby	24	1.3%
Grimston	8	0.4%
Harby	37	2.0%
Holwell	1	0.1%
Hose	30	1.6%
Kirby Bellars	1	0.1%
Knipton	9	0.5%
Knossington	2	0.1%
Lake Terrace	22	1.2%
Langdale	33	1.7%
Long Clawson	53	2.8%
Muston	3	0.2%
Nether Broughton	6	0.3%
Newport	9	0.5%
Old Dalby	37	2.0%
Pickwell	1	0.1%
Plungar	5	0.3%
Queensway	203	10.7%
Redmile	6	0.3%
Saltby	3	0.2%
Scalford	15	0.8%
Sewstern	1	0.1%
Somerby	15	0.8%

Estate/Village	Units	Proportion
Sproxton	2	0.1%
Stathern	20	1.1%
Stonesby	1	0.1%
Sysonby - Nottingham Rd	99	5.2%
Twyford	5	0.3%
Victoria Street	13	0.7%
Waltham	12	0.6%
Wymondham	10	0.5%
Grand Total	1891	100.0%

Table 2.2 Breakdown of stock by estate/village

STAGE 2: Financial Model: Information Collected

2.9 The financial model has drawn upon data supplied by MBC. The information we have collected can be broken down as follows:

- Stock data (including addresses, dwelling types, age, construction types, occupational status);
- Current (2011/12) rent and service charge levels;
- Historic void periods (setting out rent loss days in the previous year) for the tenanted stock;
- Day to day repair and management costs including planned/cyclical, response and void maintenance derived from the HRA business plan
- Data from the Council's stock condition database, which provide a 30-year cost profile for programmed repair costs. This data was produced from a survey carried out by CPC in October 2010 with adjustments made by the Council following a review of the treatment of communal block costs.

2.10 The data provided as well as the underlying modelling assumptions have been designed to fit with those used in the HRA business plan. It should be noted that this produces unit costs for management and maintenance which are lower than the allowances used in the CLG debt calculation as set out overleaf. This is unusual and the Council may wish to consider whether the figures reflect the true costs of the day to day operation of the housing business.

Cost	£ per unit MBC business plan	£ per unit CLG debt settlement
Management	£574[1]	£600
Maintenance	£898	£1,023

Table 2.3 Unit cost comparison

STAGE 3: Financial Model: Cashflow Modelling

2.11 All the data above, both current and historic, is allocated to individual property UPRNs and therefore to their corresponding asset groups or estate. This allows an interpretation of the historic performance of each group. This creates a detailed review of data and data analysis specific to each asset group.

2.12 Aggregated data for the asset groups provides 'input data' for the cashflow modelling. The cashflow model is run to produce Net Present Value figures together with supporting information cashflow surplus/deficit for each group.

2.13 The outputs are then collected and analysed to identify strengths, weaknesses and trends within the stock. The aggregation of asset groups allows the analysis of provider's asset management financial performance.

Key Financial Modelling Issues

2.14 Our financial model focuses exclusively on property. Our model does not account for MBC's capital structure. In other words, our analysis does not take on board any additional costs such as debt. It does not take additional subsidies into consideration either, such as Supporting People grant. In the event that service costs are not covered fully by service charges, the net cost is included in the management cost figure.

2.15 For the purposes of the model, cost assumptions reflect real cost requirements across the stock as measured by the stock condition survey (as opposed to levels of actual expenditure that may be planned for the stock in current budgetary submissions).

[1] Includes "contingency" allowance of £160K + net service costs

Outputs: Working asset model

2.16 A working asset model is provided with this report, in two parts. Part one shows the key inputs and calculates a net present value at individual property level. Summary analysis at a whole stock level is available on the front sheet.

2.17 The worksheets within part two of the model provide a detailed summary of the financial analysis, including inputs and outputs from the cashflow model (part one) such as Net Present Value and surplus and deficit projections. Part two of the model enables the Council to analyse results by asset group and by estate/village. Inputs in part one can be varied to enable a range of different sensitivities to be run in the linked part two model.

2.18 The two models can be used for assessing the profile of stock performance and identifying any correlations between financial inputs and outputs. Strong performers can be confirmed and weaker stock identified for further review and option appraisals. Results can be presented in graphic form to help in understanding the range of performance across the stock.

2.19 The key to understanding the financial strengths and weaknesses across the stock is in the manipulation of the two models.

3.0 DATA INPUTS AND LIMITATIONS

3.1 There are a number of limitations associated with the inputs used within the modelling exercise.

Asset Groups and Statistical Significance

3.2 The final iterations of the asset groups have resulted in 1 asset group which has a single dwelling. It is noted that the range of tenanted stock asset group units sizes is from 1 unit to 509 units. At estate/village levels, the final iteration of the estate groups has resulted in 25 estates with 10 or fewer dwellings. The estate group units' sizes vary from 1 to 306 units.

3.3 All asset groups have the same input data applied. For good statistical comparison of the performance of the groups, the data inputs must be correct. As we set out below, this is not the case across all data, especially where financial assumptions are being made. For larger groups, data is 'smoothed' across the assets, which may reduce to some extent the margin of error. This will not happen in smaller groups.

Stock Condition Costs

3.4 The above argument is particularly relevant in the context of stock condition (or major repair) costs, which have been derived on the basis of a sample survey across the stock and input into a database which has then been manipulated locally. Given the level of cloning taking place in the original survey, smaller asset groups may be allocated costs which may not reflect the reality of existing stock condition. This would need to be considered where more detailed analysis is indicated for specific asset groups.

3.5 In summary, the data associated with the smaller asset groups must therefore be treated with caution and a 'sense-check' should be made of the results.

Management Costs

2.20 The degree to which supervision and management costs can be broken down to asset groups will depend on the degree to which accounts are kept at a lower geographical level than the overall entity being assessed. In this case, these costs are accounted for at a whole stock level. In reality the costs of management and maintenance of different property types will vary, as is reflected in the calculation of allowances used in housing subsidy, and in the debt settlement. This may serve to accentuate the differences in financial performance between different asset groups.

3.6 As such, the most straightforward apportionment of costs for both management and supervision and repairs administration is on an average per unit basis across the stock. The limitation of this is that the figures will not reflect the 'management-intensive' nature of certain groups of properties, both from a supervision and repair point of view.

Repairs Data

3.7 Data in respect of planned/cyclical, void and response costs as well as gas servicing has been provided from the HRA business plan and therefore is included on an average per unit basis across the stock.

Void data

3.8 Void data is taken from one year only. This produces results which indicate some asset groups (e.g. General needs houses of non-traditional construction in rural locations) with no voids. Whilst this is reflective of the low turnover typical of this property type, it is unrealistic to assume that there will never be any voids in properties of this type. Data taken over a longer time period may produce a more realistic picture, however this may not be material to the consideration of the relative performance of the portfolio. An analysis by asset group of the voids information provided is set out below to illustrate this issue.

Asset group	Units	Average void rate per unit per annum	Turnover pu pa
GNFLATTRADRURAL	58	1.7%	4
GNFLATTRADURBAN	47	2.0%	6
GNHOUSENON-TRADRURAL	33	0.0%	0
GNHOUSENON-TRADURBAN	75	0.4%	3
GNHOUSETRADRURAL	274	0.6%	12
GNHOUSETRADURBAN	509	0.6%	26
GNMRFLATTRADURBAN	156	2.1%	23
SHBEDSITTRADURBAN	28	2.6%	4
SHBUNGNON-TRADRURAL	29	0.5%	1
SHBUNGNON-TRADURBAN	46	1.0%	1
SHBUNGTRADRURAL	166	1.0%	9
SHBUNGTRADURBAN	45	2.4%	4
SHFLATTRADRURAL	88	1.0%	4
SHFLATTRADURBAN	160	2.7%	33
SHHOUSETRADRURAL	1	0.0%	0
SHMRFLATTRADURBAN	176	1.9%	16
	1891	1.2%	146

Table 2.4 Void and turnover rates by asset group

4.0 FINANCIAL AND SUSTAINABILITY MODELLING RESULTS

4.1 This section sets out the results of the modelling process.

4.2 From a financial point of view, the 30-year NPV of MBC's tenanted housing stock of 1981 units stands at £25.7m or £13,578 pu. This reflects a range of NPV levels across the stock. These are demonstrated in the graph below, with asset groups (represented as blue columns) ordered according to their value. The lower NPVs are shown to the left increasing gradually to the highest NPVs on the right.

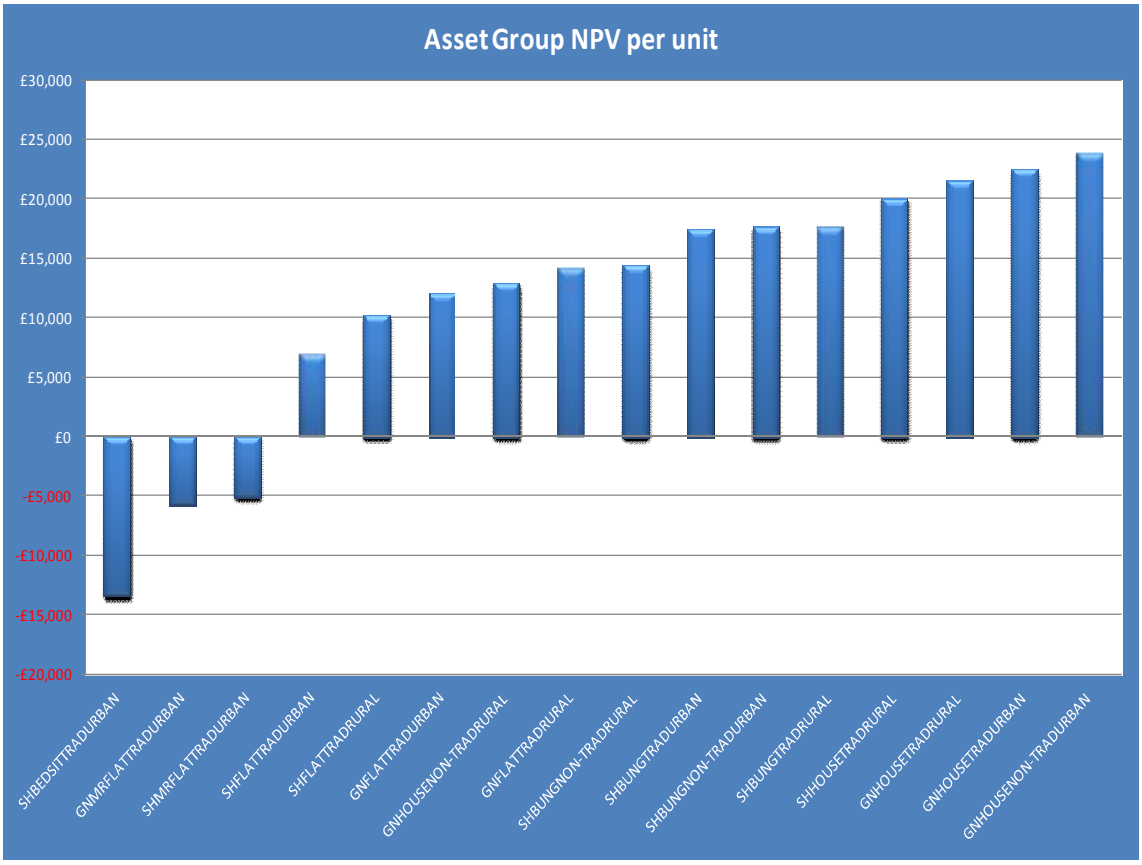

Figure 4.1: 30 Year NPV per Unit Profile by Asset Group

When analysed at estate level, the following distribution is produced.

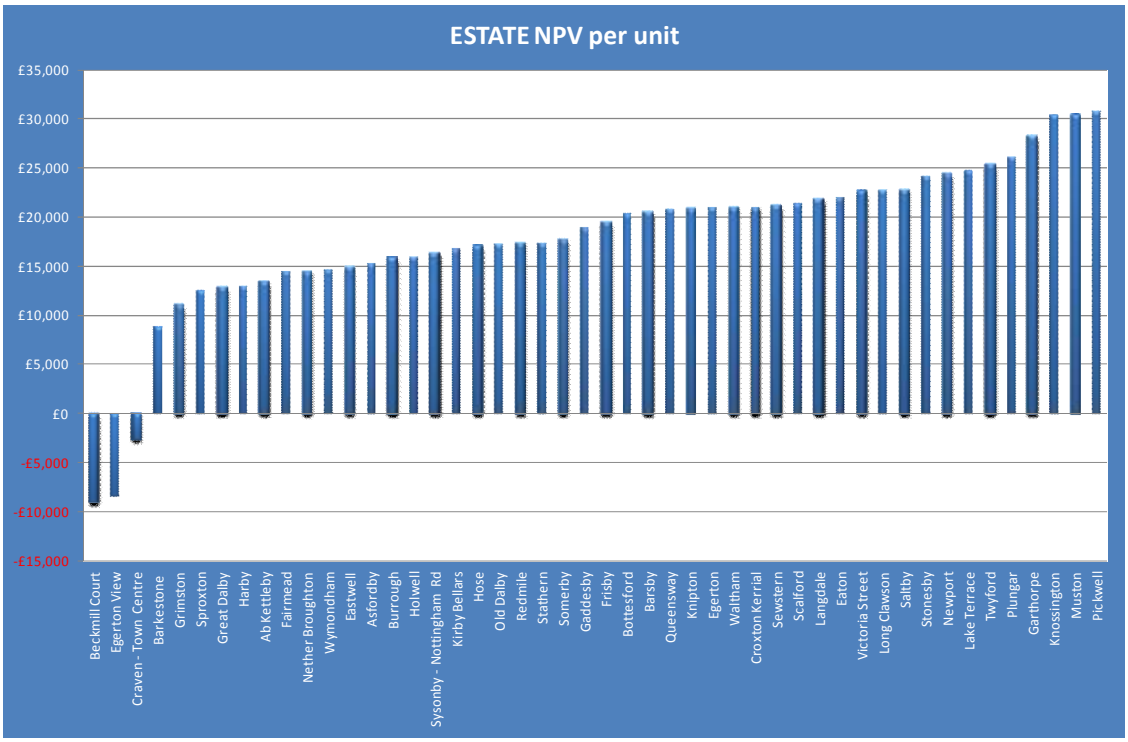

Figure 4.2: 30 Year NPV per Unit Profile by Estate/Village

4.3 We would suggest in the context of our overall experience that the stock has a reasonable average 30-year NPV per unit when compared with other similar authorities. The asset groups with a negative NPV include sheltered bedsits and medium rise flats which is a pattern that is common in other authorities. The estates where these negative NPVs materialise are in Beckmill Court, Edgerton View and Craven in the town centre of Melton Mowbray.

4.4 When compared with the NPV calculation used in the CLG's draft debt settlement issued November 2011, this illustrates that when analysed at asset group level, 55% of the stock is performing below the level assumed in this calculation. This is being driven by high capital costs per unit, compared with allowances used in the subsidy calculation. Those units with lower NPVs have an impact of reducing the overall value of the stock, and the capacity of the self financing business plan.

4.5 On the basis of the above NPV profile, we have determined the following financial; performance bands, based on a comparison of the CLG debt valuation:

30 year net present value per unit	Performance description	No. of units	% units	Total 30 year NPV	NPV per unit
Below £0	Very poor	360	19.0%	-£2,180,208	-£6,056
Between +£0 and £9,999	Poor	160	8.5%	£1,107,664	£6,923
Between £10,000 and £17,834[2]	Below average	512	27.1%	£7,652,141	£14,946
Above £17,835	Good	859	45.4%	£19,133,195	£22,274
Total		**1891**	**100.00%**	**£25,712,793**	**£13,597**

Table 4.1: Performance bands for asset groups

4.6 The graph shows that while more than 45% of the stock is performing above the level assumed in the CLG debt calculation when reviewed at asset group level, there are significant variations within the portfolio. Improvement could be delivered through alternative investment strategies or through management initiatives – for example, increases in income or service charges, or reductions in underlying maintenance or repair expenditure or reduction of voids. Land use and development potential may also impact on investment strategies.

Net Income

4.7 In order to understand NPV, it is important to understand the future cashflow profiles for each asset group and estate in terms of surpluses and deficits. Deficits in the early years may be capable of being sustained by surpluses made elsewhere in the stock if there are longer term surpluses to be generated further down the line. Figure 4.3 below shows the net position of investment costs v rental income over the business plan period. Figure 4.4 shows the overall Council cashflow position over 30 years. This is an operating cashflow of the existing stock before any corporate liabilities such as bank interest are taken into consideration.

[2] Average debt per unit in CLG debt settlement draft determination November 2011

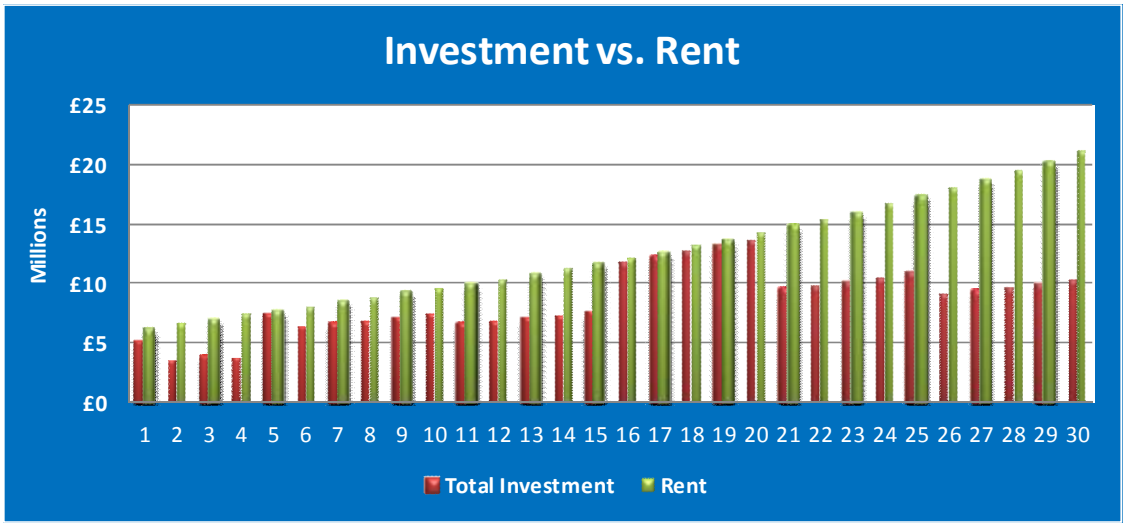

Fig 4.3: Investment v rent

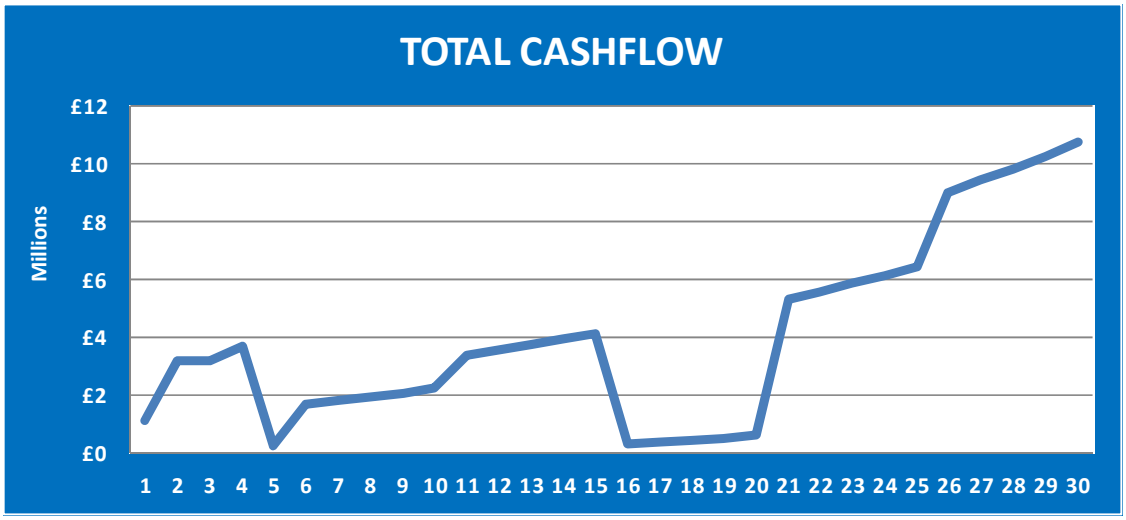

Fig 4.4: Portfolio cashflow

4.8 Although the graphs show a net cashflow surplus over the entire investment period, there are significant periods in the medium term where cash flows become marginal and the business will need careful management. It is largely the capital expenditure which is driving this picture. Critical to a viable business plan during this period will be the deliverability of assumptions on low costs for day to day management and expenditure.

Actions to consider alternative investment strategies that reduce these peaks of expenditure would also assist in relieving some of the pinch points in the plan.

4.9 The cashflow position can be analysed at asset group level in order to highlight peaks and troughs of expenditure that would need to be smoothed over time through a long term investment strategy.

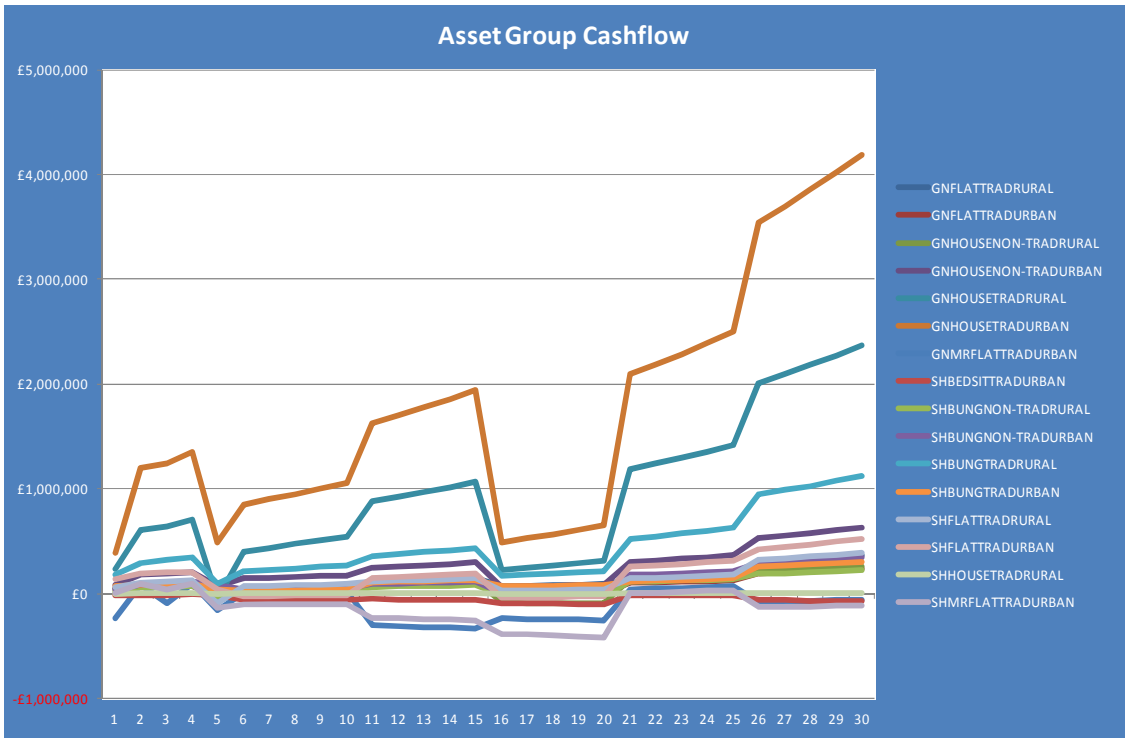

Fig 4.5: Total annual net cashflow, all tenanted stock by asset group

4.10 The cashflow position can be analysed at estate group level in order to highlight those estates whose cashflow is significantly negative over the 30 years. Combined with an analysis of NPV, these can be used to generate candidate lists for further analysis and options appraisal.

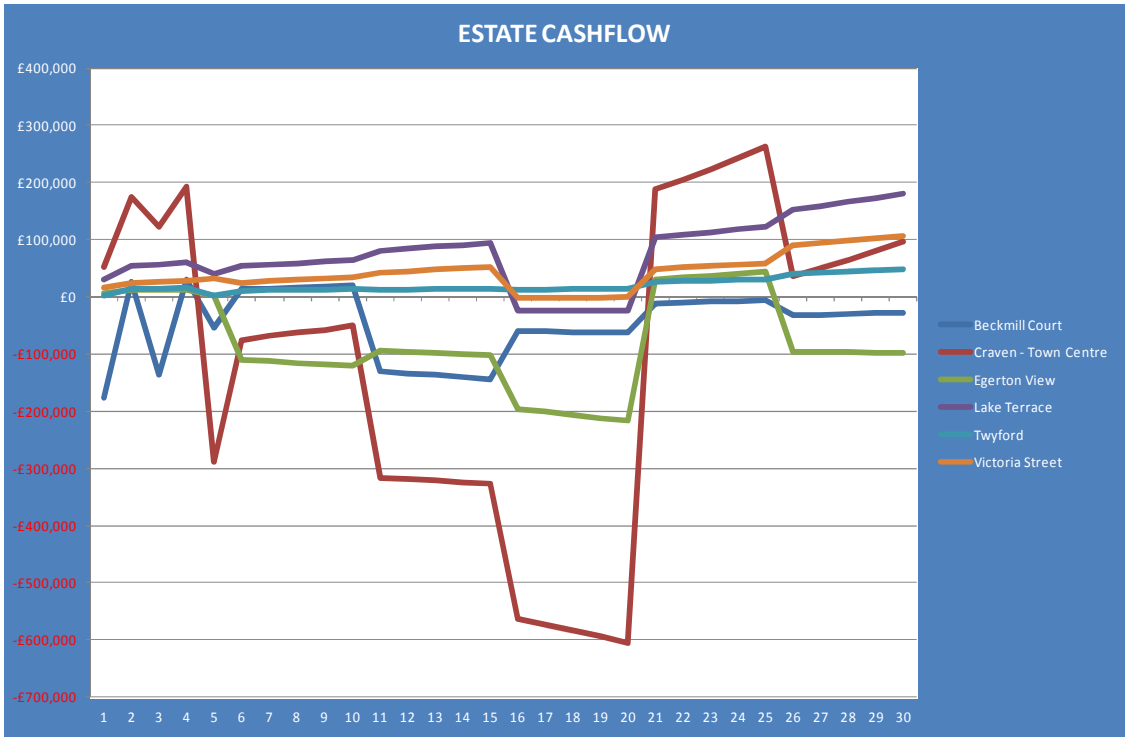

Fig 4.6: Total annual net cashflow, by individual estate

5.0 APPLICATION OF POSITION STATEMENT RESULTS

5.1 This report focuses on a current-day financial analysis of the stock at a high level. The work has been carried out in conjunction with Council's preparations for HRA self financing. The asset analysis work can be used to increase business plan capacity under a self financing business plan in order to:

- Bring long term funding to support the improvement and repair of high quality, affordable homes
- Improve communication between the Council and tenants and leaseholders about investment strategies
- Consider alternative options for assets with poor financial viability, taking into account the sustainability issues of neighbourhoods
- Maximise the value for money of available investment resources
- Address regeneration needs to improve the sustainability of neighbourhoods.

5.2 Issues to consider in understanding the outputs from the results include

- The variations in performance within the portfolio.
- The difference between the asset group cashflows and the assumptions underlying the CLG HRA self financing valuation which produces a total value which is some £8m higher. Typically this difference will be due to backlogs of expenditure need not reflected in the CLG model, or local factors including lifecycles and schedules of rates. However further analysis can point to a requirement to consider other elements of the business plan including the low management and day to day repair costs in the business plan, compared with CLG allowances, as these will be masking a larger difference in capital expenditure assumptions. Further analysis would also help in understanding the allocation of debt between different archetypes to inform local investment appraisals.
- Land use and development potential within asset groups or estates which may present opportunities for additional affordable housing.

5.3 Focus in the short term on those asset groups identified performing at below average for the stock, either on the basis of NPV or cashflow or both will highlight areas where further appraisal may be of benefit in order to consider options for investment in these areas. This will ensure that calculated resources are allocated to units that represent value for money investment.

5.4 Our recommended next steps following approval of this report include the following:

- Consider non financial indications of sustainability including deprivation, crime and anti social behaviour, education, health, access to key amenities, and quality of environment and cross reference these with the financial results to produce a combined financial and sustainability analysis in order to identify long term sustainability of individual neighbourhoods.
- Consider options for timing of investment to smooth cashflows within a coherent investment strategy
- Consider a validation of the combined results of the CPC survey, with the Council's manipulation of costs, to test the robustness of the base line of capital expenditure requirements.
- Compare asset cashflows from this exercise with those in CLG's HRA self financing valuation to inform discussions with DCLG around the final settlement
- Consider development potential, land use and vacant possession values as part of a strategy to increase affordable housing levels across the Borough.

5.5 The key result of this further work would be

- Investment funding targeted to improve the business plan
- 5 – 10 year local investment plans in place across all areas
- Efficient and effective procurement and delivery
- Additional affordable housing