Subject:	**FINANCING NEW HOUSING MANAGEMENT SYSTEM FOR EAST KENT HOUSING**
Meeting and Date:	**Cabinet - 12 May 2014** **Council - 14 May 2014**
Report of:	**Director of Finance, Housing and Community**
Portfolio Holder:	**Councillor Sue Chandler, Portfolio Holder for Housing, Children's Services and Safeguarding, Youth and Community Safety**
Decision Type:	**Key**
Classification:	**Unrestricted**
Purpose of the report:	To seek approval to make loan finance available to East Kent Housing for the procurement of a new housing management IT system
Recommendation:	That Cabinet recommends to Council to approve: (i) The provision of loan finance to East Kent Housing for the procurement of a new housing management IT system, the amount and terms to be approved by the Director of Finance, Housing & Community in consultation with the Portfolio Holder for Housing, Children's Services and Safeguarding, Youth and Community Safety. (ii) Subject to loan terms being agreed and procurement and implementation being undertaken to the council's satisfaction, to transfer current system support budgets to East Kent Housing

1. Summary

East Kent Housing (EKH) is the Arms Length Management Organisation (ALMO) established jointly by Dover District Council, Canterbury City Council, Shepway District Council and Thanet District Council in 2010 to undertake the management of the council's housing stock.

EKH is requesting that the four, joint owning councils, provide loan finance to enable it to purchase and implement a new, single, IT system across the four districts so as to facilitate the delivery of operational efficiencies. The request is supported by a business case prepared by EKH which is attached at Appendix 1.

2. Introduction and Background

2.1 EKH is currently using the four, individual housing management IT systems that were in existence in the four councils at the time the organisation was established. The IT systems are different in each of the four councils.

2.2 The current system in Dover was supplied by Anite Public Sector Holdings and implemented in 2008. The system is embedded and operates satisfactorily and the Oracle databases upon which it operates was recently updated. The cost of the system was approximately £475k when purchased in 2005. Anite were subsequently acquired by Northgate Information Solutions Limited in 2008. Northgate has continued to maintain and upgrade the Anite system and has not given any clear indication, at this time, that it will be terminating its support for the system. This may happen at some point in the future, should the number of Anite users reduce to a level where it is no longer financially viable for Northgate to continue supporting the system.

2.3 The operating costs related to the Anite system are relatively low (approximately £30,000 per annum) and the system is generally reliable. Although it probably has limited functionality compared to more modern systems, it is currently meeting DDC requirements for managing tenant and leasehold properties.

2.4 EKH has approached the joint owning council's to seek support for a proposal to replace the four existing systems with a new, single system. With support from external consultants SOCITM, they have developed a business case to support their request which is attached at Appendix 1.

3. **Business Case Summary**

3.1 The attached EKH business case is a summary of an initial business case prepared by their consultant Socitm. It updates some of the financial assumptions included in the original business case and explains how EKH believe the operation of four separate systems prevents the effective deployment of staff across the four council areas and therefore limits their productivity, their ability to improve efficiency and provide a consistent level of service. It also seeks to show how the cost of acquiring a new, single system can be funded from related financial savings over a six year period. The business case does not show that acquisition of a new, single system will directly generate any significant financial savings in the short term and the DDC officer view is that it is unlikely to deliver any substantial reduction in the management fee. However, the basis of the business case is that savings will at least 'pay back' the cost of the new system over a six year period based on the 'worst cost'/'worst savings' outcomes provided by EKH.

3.2 The most recent iteration of the business case shows the costs and savings based on a worst case scenario as follows:

	Total project cost £	**Existing EKH budgets £**	**Total new costs £**
Highest cost outcome	1,195,025	167,000	1,028,025
Lowest benefit outcome			1,042,566 (£173,761pa)
Net benefit over 6 years to be shared across the partners			**£14,541**

3.3 However, EKH believes that implementation of a single system will enable them to achieve additional savings over and above the savings or 'benefits' as set out in Appendix 1 of their business case report. These additional savings are shown in section 2 of the report and EKH advise that these are only likely to be delivered in the event that a single system is implemented. EKH has identified these savings as opportunities to reduce the management fee. Our evaluation of the impact of these savings will have on the DDC management fee is shown in 9.1.

3.4 The additional financial benefits identified by EKH include potential income from the provision of housing management services on behalf of other landlords. However, the legal advice received is that the provision of such services (if to landlords other than providers of social or affordable housing) would require an amendment to the memorandum and articles of EKH and therefore specific consents would have to be given by each of the councils as required by the owners agreement. Undertaking such activities while the loan was outstanding could also run the risk that a 0% interest loan would be construed as 'State Aid' because this could be construed as an 'economic activity' taking the loan outside the 'services of general economic interest' provisions for assistance to social and affordable housing in the state aid rules. The issue is considered further at 4.3 below. DDC officer advice is that potential future income (shown in the business case as totalling £35k for the period to 2018/19) from providing services to other landlords should be disregarded until the legal position is clarified.

3.5 EKH also advise that having to use four IT systems does act as a constraint on their ability to provide efficient services, by restricting the effective deployment of staff and the ability to develop digital service delivery. These service delivery issues are set out in section 1 of the EKH business case report.

3.6 In addition to the business case it should be recognised that the existing Anite system is likely to need replacing at some time in the future although, at this time, we don't know when this might be required or what the cost would be.

3.7 EKH is not seeking a direct financial payment from the joint owning council's to cover the cost of acquiring the new system but rather a loan from each council.

4. **Details of the Loan Arrangement**

4.1 In Section 5 of their business plan, EKH estimate they will require £892,000 to procure the new system and they are seeking a loan of £223,000 from each of the four councils based on an equal (25%) share of the cost.

4.2 The business case shows that the loan will start to be repaid from 31 March 2017, the point at which EKH expects the new system to start delivering savings. The EKH business case indicates that the maximum period within which the loan will be repaid will be six years i.e. by 2023.

4.3 The loan could be provided interest free, or at a modest interest rate, with a compensating increase in the management fee to neutralise the impact on EKH. As mentioned in 3.4 above while EKH is currently exempt from State Aid Rules further clarification is needed to determine whether an interest free loan could fall to be regarded as state aid given EKH's aspiration to provide management services to other landlords. Even without the loan the provision of services to other landlords could trigger state aid issues and the provision of such services would probably also require other consents. This report is therefore recommending that agreement of the final terms of the loan should be delegated to the Director of Finance, Housing & Community in consultation with the Portfolio Holder for Housing, Children's Services and Safeguarding, Youth and Community Safety, and the additional income attributed, in the business case, to be generated from the provision of services to other landlords should not be included in Members considerations..

5. **Key Risks**

5.1 The key risks and mitigations are set out below.

Risk	Mitigation	Residual Likelihood	Residual Impact
Loss of exit route.	The sharing of a system could make any exit from EKH difficult and expensive. Therefore it is an absolute requirement that a separate or clearly partitioned database (with its own code structures, interfaces etc) will be created so each partner can exit simply and cleanly, should they chose to do so, without major cost, or impact on the other partners.	Low	Low
Implementation overspend	All major ICT implementations carry an inherent risk of overspend. EKH have committed to underwrite any overspend relating to costs within their control. This would be met from their own resources and should help minimise any impact on the partners. However, these resources are, ultimately, owned by the partners via their 25% shares, as EKH does not generate any separate resources or income.	Medium	Medium
Failure to deliver on-going savings	EKH have committed to delivering the proposed savings. Further discussion is required on this, but one option would be to incorporate the savings into a longer term agreement on the management fee between the council's and EKH. The financial impact of a failure to deliver savings is mitigated by the current sustainability of the HRA	Medium	Low
Timetable slippage	All major ICT implementations carry an inherent risk of overrun.	Medium	Low

Risk	Mitigation	Residual Likelihood	Residual Impact
	As the implementation for each partner will be "modular" and on a separate database, the direct impact on DDC of slippage will be limited, although slippage would probably lead to cost overrun and delay in delivery of subsequent savings.		
Insufficient EKH staff resources	EKH have procured support from SOCITM. However, the in-house ICT resources of EKH are limited, and vulnerable to loss of key staff, and this can create a client side weakness.	Medium	Medium
Insufficient DDC staff resources	DDC have limited resources to support the implementation, from specification through to testing and sign-off. EKH have included within the business case, provision to provide support to all partners for the backfilling of posts. This is welcome, but the practicality of procuring and dropping into place temporary staff who can back-fill existing staff is open to debate.	Medium	Medium
Functionality compromises	All 4 partners currently use different systems. These are embedded and procedures and processes will have adapted to work with the strengths and weaknesses of the particular systems. In addition, all 4 partners will have some differences in their business needs. In the majority of cases it will be necessary for partners to accept some change in current practices and requirements in order to find the best overall compromise. However, in some instances, such as the conditions of leases or tenancies, it may not be possible to compromise on functionality.	Low	High

Risk	Mitigation	Residual Likelihood	Residual Impact
	Nonetheless, modern systems should be able to cope with the majority of requirements. The main area of weakness in property management systems has tended to centre on the functionality for managing commercial and residential leases and service charges.		
Implementation compromises	The implementation will be undertaken in a modular fashion, with DDC the last authority to implement. The maintenance of 4 separate databases will enable each authority to generally clone from a standard model, but introduce variations that meet their own needs. The challenge will be to ensure that key decisions made in the first implementation do not compromise the position for the other partners and subsequent implementations. It will therefore probably be necessary for all partners to maintain a watching brief, to some degree, on all implementations.	Low	High
Loss of Anite	The alternative, of staying with Anite, also carries risks. The most significant risk is that Northgate withdraw support for Anite, forcing DDC to find an alternative system. There is no indication that this is likely to happen in the short term, but the likelihood in the medium to long term is difficult to assess. Should this happen, DDC would probably have to undertake an implementation on its own. On the one hand, this would avoid some of the complexities and compromises of a 4 partner	N/A	High

Risk	Mitigation	Residual Likelihood	Residual Impact
	implementation, but it could also lose economies of scale, and, unlike the current proposal, is unlikely to be self-financing over 5 or 6 years.		
State Aid	In order to prevent issues arising with regard to state aid consent to EKH providing services to other landlords will not be given without first obtaining specialist advice.	Low	High

6. **Management & Owners Agreement Implications**

6.1 The procurement process will require EKH to directly enter into contractual relationships with a new system supplier with the result that EKH will own the new system. There are clauses within the Owners Agreement and Management Agreement which relate to this procurement arrangement and which will require unanimous, Joint Decisions of the Officer Panel to enable it to proceed. The specific consents that will be required from all four councils are:

- Consent to contract directly with a supplier other than the councils (Clause 9, schedule 3 of the Owners Agreement).
- Consent to borrow money (Clause 10, schedule 3 of the Owners Agreement).
- Consent to use new software that interfaces with the council's systems (Management Agreement)

6.2 While these consents are referred to in the recommendations section of the EKH business case report they do not require formal cabinet approval as the necessary decision making authority is delegated to the council's Client Officer.

6.3 The procurement arrangements will not require any variations to be made to the terms of the Management Agreement or the Owners Agreement.

7. **Identification of Options**

7.1 The options are:

7.2 Option 1: Agree to the EKH request to provide the required loan finance, transfer existing system support budgets and make the required Joint Officer decisions.

7.3 Option 2: Reject the request

8. **Evaluation of Options**

8.1 Option 1 is the recommended option as EKH advise it will enable EKH to deliver services more efficiently. While DDC officers do not believe the procurement of a new system will generate any significant level of management fee saving in the short term, the financial appraisal in the EKH business case does appear to show that savings will cover the cost. The economies of scale to be derived from the joint procurement should also mean that DDC will benefit from a new system at a lower cost than if it were to have to replace Anite at some future date on an individual basis.

9. **Resource Implications**

9.1 The main aspects to consider within the resource implications are:

- Financing of the single system
- Impact on the EKH Baseline Budget
- The future attribution of costs of the single system
- Future savings on the management fee

Financing of the Single System

EKH will purchase the new system and EHK have requested a loan of £223,000 per Council, to be repaid from 2017 - 2022. The potential loss of interest to the Council is, at current rates not high, and will be between 0.5% and 0.75% per annum, or a cash loss of between £1,115 and £1,673.

However the provision of a loan, does generate some potential problems. First, if EKH were to start providing services to third parties other than the 4 partner councils or providers of social or affordable housing, then there could be a challenge on the basis that they have received state aid. Although this challenge may be defensible, even if no interest has been charged, nonetheless, charging interest at market rates (probably 2.5%) would strengthen the argument that no state aid is involved..

Second, the provision of an interest free or “soft” loan may generate some complex and unproductive accounting complexities.

It would therefore be simpler to charge EKH interest on the loan and adjust the management fee they can charge, by the interest amount. The effect is therefore neutral on EKH, but unnecessary accounting complexities are avoided. This issue will be discussed with partners, and if consensus can be reached, then interest will be charged. Failing that, a soft loan will be provided and measures put in place to mitigate the risks and complexities..

Impact on the EKH Baseline Budget

At present DDC pays EKH a management fee and meets the cost of its own housing system. The annualised costs are:

EKH Management Fee (2013/14)	£2,048,810
Costs of Anite, met directly by DDC	£27,785
Total	£2,076,595

EKH have proposed that at the time the new system becomes operational in each of the councils, the budgets currently held by them in respect of system support provided by existing IT suppliers (Northgate in the case of DDC). The budget would be transferred after implementation of the new system and would continue on this basis for the 6 year business plan period. The relevant DDC held budget for this is approximately £30,000 per annum.

Therefore, after transfer of the budget, for Anite, to EKH, the total above will represent the new EKH baseline fee for DDC, against which future savings will be measured.

Future attribution of costs of the single system

East Kent Housing is seeking the transfer of budgets relating to the cost of system support currently provided by the council's system providers. All partners are currently spending significantly different amounts on their in-house housing systems at present. Each will therefore transfer a different amount to EKH, to form their new baseline. However, the four partners have agreed in principle that their respective contributions towards system support should remain at current budget levels for the 6 year loan payback period but that at the end of this period the system support costs should be apportioned equally.

Future Savings on the Management Fee

The business case for the single system is broadly neutral, after allowing for the repayment of the financing loan, in the period from 2017 – 2022.

However, as referred to at 3.3 EKH expect the system to facilitate cashable savings identified in their Vision and Funding Plan, as follows:

Year	2014/15	2015/16	2016/17	2017/18	2018/19
Total cumulative cashable savings	£4k	£44k	£174k	£269k	£289k
DDC share (assumed to be 25%)	£1k	£11k	£44k	£67k	£72k
% of current management fee	0.05%	0.54%	2.15%	3.27%	3.51%

10. **Corporate Implications**

10.1 Comment from the Section 151 Officer: The original business case for EKH, approved by Council on 17th February 2010, stated that in the first instance:

> *"Savings in the region of £660,000 per annum (at 10% of current operating costs) could reasonably be anticipated."*

It also noted that the initial savings were not dependant on a new system:

> *"An obvious example in East Kent will be that a single housing IT system for the new organisation will be required, as well as reductions in annual support costs. However, as these savings may not be realised at least until*

after year two or even beyond five years of the service they have not been factored into the financial modelling"

We are now looking at "phase 2" and the ICT system savings.

The proposal to purchase a single system for EKH is, in direct financial terms, likely to be cost neutral. Any savings are expected to come from subsequent operational changes that the new system facilitates.

The current system in use at DDC, Anite, is functionally sound, well embedded, and costs £27k per annum. The system is mature and is likely to require replacement at some time – but we have no imminent concerns that this is about to happen.

As there is, presently, no formal agreement on the future management fee and agreed deliverable savings, compared to the current fee baseline, there is a risk of on-going debates as to whether the proposed savings have been delivered, following implementation of the new system, and the basis upon which they have been apportioned between the partners.

10.2 Comment from the Solicitor to the Council: The Solicitor to the Council has been consulted in the preparation of the report and has no comment further comment to make other than that EKH's aspirations to provide management services to other landlords potentially raise issues which go beyond the scope of this report. Consent to provide such services should not be given without further detailed consideration by the councils.

10.3 Comment from the Equalities Officer: This report does not specifically highlight any equalities implications however, in discharging their responsibilities members are required to comply with the public sector equality duty as set out in section 149 of the Equality Act 2010 http://www.legislation.gov.uk/ukpga/2010/15

10.3 Other Officers (as appropriate): None received

11. **Appendices**

Appendix 1 – East Kent Housing Business Case Report

12. **Background Papers**

None

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