

Guidance note on stock options appraisal



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Guidance note on stock options appraisal

1. Introduction

1.1 This note has been developed for local authorities to inform their appraisal of the options for the management and maintenance, and/or ownership of their housing stock.

It is also intended for local authority officers to use with elected members and executive teams who may be less familiar with the stock options process, government expectations and/or the housing sector.

This note does not provide detailed guidance on the financial element of options appraisal.

1.2 The content is based on an ideal approach to options appraisal; local authorities will want to consider which elements are relevant to their context. Information has been provided for local authorities who are:

- Just beginning to consider the options for their stock (Part One)
- Undertaking a more detailed appraisal of a short-list of options (Part Two)

Guidance on who should be involved in the stock options appraisal process and identifying the strategic 'fit' of the local authority stock is provided in Part One; these sections may be useful to local authorities at all stages of the process.

1.3 For local authorities who have decided to retain their ALMO and are considering whether the ALMO should take on additional roles and responsibilities, a similar approach to that described in this note is required:

- The intended outcomes and objectives should be clear
- The ALMO option should be appraised against other available options, using defined and agreed criteria
- Stakeholder involvement is important from an early stage. As stakeholders in the core role of the ALMO, tenants and leaseholders should still be involved, alongside other customers who will benefit from the desired outcome

1.4 Information in this note is presented under the headings which reflect the most commonly asked questions about stock options appraisal, with more practical steps provided in text boxes.

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Reference points for this note

1.5 There is no current, specific, guidance from the government on housing stock options appraisal. Given that the housing stock is a significant asset for local authorities, requiring very considerable investment, and providing a home for over one million households, this template has been developed by referring to the following, relevant, guidance and research:

- National Audit Office (January 2011) *Assessing business cases for changes to arm's length bodies: memorandum for the Public Administration Select Committee*ⁱ
- HM Treasury (2007) *Public Sector Business Cases using the Five Case Model: a Toolkit*ⁱⁱ
- European Strategy Services Unit (2007) *Options Appraisal Criteria and Matrix*ⁱⁱⁱ
- HM Treasury (2003) *The Green Book: Appraisal and Evaluation in Central Government*^v [this remains the key Treasury guide on options appraisal]
- DCLG (2006) *Review of Arms Length Housing Management Organisations* [this is the only published guidance related to ALMOs and options]^v

Part One: For local authorities who are just beginning to consider stock options

2. What is an options appraisal?

2.1 There are a number of definitions for options appraisal:

“To help develop a value for money solution that meets the objectives of [the organisation]. Creating and reviewing options helps decision-makers understand the potential range of action that they may take.”

The HM Treasury Green Book

“A thorough options appraisal is an essential pre-requisite for good decision making on reorganisations. It provides an assurance that the most appropriate institutional form has been chosen – one that best fits the objectives the change is trying to achieve, and which ensures that the change is the most cost-effective one.”

The National Audit Office

2.2 In simple terms options appraisal seeks to assess whether there are:

- Better ways to achieve objectives, and
- Better uses for the resources involved.

3. When and why should an options appraisal be undertaken?

3.1 There should always be a clear rationale for an options appraisal and it should be reasonable to assume that the benefits leading from the appraisal will be cost effective ie, they will exceed the costs of conducting the appraisal process. Options appraisals, if undertaken properly and in relation to a large or high value service (such as council housing stock, its management and maintenance), will have a cost associated with them.

3.2 The main drivers for stock options appraisals in the current climate are:

- The completion of decent homes programmes

Establishing an ALMO was one of a limited number of options open to local authorities to attract additional resources for investment in their homes.

- The end of existing management agreements

Typically agreed for the period of time required to attract funding and deliver improvements, changes may have been made to accommodate delays in

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reaching the 'two star' service standard required to attract funding and/or changes in the availability of funding by the previous and current government.

- The introduction of self-financing and distribution of debt

Self-financing will begin in April 2012. In summary it should enable local authorities to manage their business plans more effectively in the longer term and be a fairer system for tenants – their rent will be used for the service they receive.

3.3 The following issues are also likely to influence the need for a stock options appraisal:

- Reduced spending in the public sector

Options appraisals should not be considered as a means solely to manage local funding reductions but there are likely to be opportunities to reduce spending through sharing costs, for example. However, it should be remembered that rental income should 'benefit those who pay'¹, and that there are priorities for where rental income should be spent, beginning with the debt repayment and maintaining homes to a standard that continues to attract income.

- Accountability

Improving accountability to customers and the public is one of the government's top priorities; it is expected to enable people to scrutinise spending and identify areas for improvement. Improving accountability is one of primary reasons for the government's approach to changing its own arm's length bodies².

It is suggested that the process of stock options appraisal should ask:

- How each option improves accountability to different people, for example to tenants and leaseholders, the wider public, elected members etc
- If there are logical reasons for why an option should be independent from elected member control or vice versa
- Whether there are any wider public administration impacts, for example on the local authority 'parent' department

¹ Grant Shapps in a response to the National Federation of ALMOs on the Localism Bill

² The government's own criteria for a body being independent of ministerial control are:

- where bodies have a precise technical function
- where they make politically impartial decisions to distribute taxpayers' money, or
- where facts need to be transparently determined

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4. How many options should be appraised?

4.1 Good practice for options appraisal is to:

- Create a wide range of options
- Review these options (and in the process, consider what the parameters should be for an appropriate solution)
- Create a shortlist for detailed appraisal

To establish the initial options the following actions are suggested:

- Research and consult widely (including with tenants and leaseholders) to gather intelligence relevant to the objectives and scope of the problem.
 - Research should consider the particular challenges to meeting housing needs and aspirations in the local area, with reference to housing market intelligence.
 - Further detail on communication and involvement is provided later.
- Identify significant dependencies, priorities, incentives and other drivers.
 - A PESTLE³ analysis would be an appropriate approach to use here; it would identify drivers such as welfare, health and social care reform.
- Identify existing practice solutions
 - There are a number of options that could be explored, and combinations of options. The National Federation of ALMOs report, *A future for ALMOs – within local communities*¹ describes a number of these
 - In summary options include returning the stock to council management; retaining the ALMO; transfer to a housing association; tenant management organisation; housing co-operatives; Community Gateway model; Community Land Trust; Development Trust; the mutual model
- Consider the full range of issues likely to affect the objective
- Identify the full range of policy instruments or projects that may be used to meet the objectives
- Develop and consider radical options (they can be helpful to test the parameters of feasible solutions)

4.2 The process of short-listing is discussed in more detail later under 'strategic fit', but all options taken forward to a more detailed appraisal stage should be:

- Realistic, likely to have political support and be sustainable
- Together, cover a wide range of potential action (to ensure that these are not lost at too early a stage)
- Compatible with the corporate priorities of the local authority

³ PESTLE – political, economic, social, technological, legal, environmental

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- Compatible with the project's objectives

4.3 The shortlist must include the 'do minimum' option to act as a check against more interventionist action. A 'do nothing' option is not considered good practice on the basis that there are few situations where standing still is desirable. However, there is a risk that the process of short-listing will eliminate the optimal solution before it is given full consideration.

Appraisal and optimism bias

4.4 This means that there is a tendency for appraisers to either:

- Use limited information and narrow evaluation criteria so that a particular option will appear the most favourable, and/or be
- Overly optimistic about project parameters such as capital costs, works duration, operating costs; and under delivery of benefits

4.5 To avoid this a rigorous approach to appraisal is needed. This will also enable the local authority to consider the longer-term needs and outcomes, rather than short-term interests. This is particularly relevant to stock options appraisal given that self-financing will afford local authorities a longer-term approach to business planning.

Risk management strategies for the options appraisal process and for implementation of the agreed option are also recommended. More information on this can be found in the documents referred to at the beginning of this guidance.

5. What should an options appraisal process involve?

5.1 In thinking about what an options appraisal process should involve, it is helpful to think about the decisions that will need to be taken along the way eg, agreement on a shortlist of options, and at the end of the process. What information will be needed to enable these? Who will be taking the decisions?

To make a decision people (elected members, tenants and leaseholders, officers and stakeholders) will need to understand, and be confident, that the option/s presented:

- Make sense given the current, wider, national and local context. For example, a decision to bring an ALMO back in house when the local authority priority is to improve value for money through outsourcing services would not make sense
- Optimise value for money (remembering that value for money means the optimum balance between economy, efficiencies, and effectiveness ie, it's not just about the cost)

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- Are commercially viable and financially affordable
- Are achievable (this is also referred to as the 'management case')

It is worth referring to Part Two to understand what sort of information will be needed in decision making, and therefore what action should be taken in the process of options appraisal.

5.2 To get to this point requires a lot of work; the options appraisal process should be properly planned, managed and resourced.

The process should include:

- Robust management. The usual arrangement is for a dedicated officer/team, with support from corporate colleagues in finance, legal etc, directed by an executive and/or elected member led group
- A methodology based on best practice and corporate policies
- A robust evidence base, with forecasts, assumptions, and consultation feedback recorded and available to those with an interest in the process
- A clear process for engaging and consulting with relevant people and organisations (see next section)
- A budget that is sufficient to undertake a rigorous approach
- A strategy for reporting and communications
- An agreed approach to evaluating the appraisal process eg, by a Scrutiny Panel/Committee

6. Who should be involved in options appraisal, and when?

6.1 There are benefits from consultation with stakeholders⁴, tenants and leaseholders in options appraisal at an early stage, preferably before options are shortlisted.

Early involvement can:

- Inform the short-listing process
- Identify unforeseen problems, risks and unintended consequences of the options
- Open up thinking to external challenge and new ideas

⁴ In addition to local authority officers and elected members (bearing in mind that the ALMO is likely to provide services to other, non-housing, departments), stakeholders should include the ALMO itself – Board and staff, other registered providers in the area, voluntary and community sector organisations that have a relationship with the ALMO, private sector organisations with a role in the ALMO eg, as major contractor.

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- Help to increase the robustness of costs and benefits
- Deepen an understanding of equality issues and how adverse impacts may be eliminated or mitigated
- Help to consider environmental impacts which are often difficult to evaluate

In the current climate effective consultation could also identify alternative ways for delivering services, building on the capacity of customers and the community – this would fit with the government’s Big Society and Localism agendas.

6.2 In terms of stock options appraisals existing DCLG guidance⁵ states that:

- Any consultation on a significant change to the local authority’s management arrangements with the ALMO should be as comprehensive as that undertaken before the setting up of the ALMO
- Any decisions on an ALMO’s future should take account of all stakeholders and importantly, those whose homes are managed by the ALMO
- Tenants should always be consulted on winding up an ALMO during an existing contract, not renewing its contract and making substantial changes to the services provided by the ALMO.

It is also deemed good practice to consult with tenants when extending an ALMO’s contract or when extending or making changes to an ALMO’s remit. It is advisable to seek a legal perspective on the approach to be taken to consultation, particularly where a change to the ALMO agreement is likely.

Communication and involvement plan

6.3 Alongside a project plan for stock options appraisal it is good practice to have a specific communication and involvement plan. The ideal position would be for this plan to be developed in partnership with tenants and leaseholders, using communications and involvement expertise from within the local authority and/or the ALMO.

⁵ 2006 DCLG guidance reflects s105 of the Housing Act 1985

The communication and involvement plan should include:

- 1. Objectives – what is the purpose of communication and involvement?**
- 2. Who are the stakeholders, how do they like to be communicated with and involved? What is their preferred means of response?**
- 3. What forms of communication and involvement will be used, and how will they be used?**
 - These could include existing channels for example, forums, networks and local panels, and consultations being undertaken by other organisations. An example of 'how' would be to deliver a common presentation at all meetings.
 - Specific forms of involvement would be good practice eg, establish a steering group, bring together groups of people who share a common interest etc,
 - Details on the production of a regular communication bulletin/newsletter for circulation to all stakeholders considering for example, frequency and format
 - A description of how feedback from stakeholders will be used, and how this will be shared back with people who contribute
 - This list will not necessarily be the same as for the previous section – this section should explain why
- 4. What resources will be used?**
- 5. What are the timescales for communication and involvement?**
- 6. How will we measure success?**

Measures should reflect the different target audiences, their level of engagement and satisfaction with opportunities to be involved, and their level of understanding based on the information provided
- 7. What risks are associated with delivering this plan?**

How will these be managed?

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7. How do you define strategic fit, outcomes and objectives?

7.1 To inform the options appraisal it should be clear what the role of council's housing stock is in the local area.

In more detail local authorities working with stakeholders, tenants and leaseholders, should agree:

1. What contribution from the housing stock, its management and maintenance, is expected to the overall ambitions for the area?

- These ambitions are usually described in Sustainable Communities Strategy
- They are usually described in fairly high-level terms eg, improved health
- They should be described as outcomes

2. What contribution is expected to the ambitions for housing and housing services?

- These ambitions are usually described in the housing strategy, and possibly in the ALMO business plan
- Using the outcome as 'improved health' the contribution could be 'healthy homes', and specific objectives could include homes are safe and warm, homes are well-managed.
- These are likely to be a combination of outcomes and objectives

3. What contribution is expected to the local authority's ambitions?

- These should be described in the corporate plan
- These are likely to be a combination of outcomes, objectives and outputs

4. What contribution do tenants and leaseholders expect from the housing stock, its management and maintenance, to their ambitions?

- This perspective should have been collated in the process of business planning, as part of developing the local offer and from other engagement activities.
- These are likely to be a combination of objectives and outputs.

7.2 Using these ambitions as the starting point enables us to think about the role of the housing stock in the longer term ie, strategically. This is something we've not necessarily done before now; the housing revenue account subsidy system only allowed for a short-term perspective.

Tenants and leaseholders, as residents of the local area, should also have had some involvement in establishing the ambitions for a local area; it might be reasonable to assume that they will support options that contribute to these ambitions. However, in practice it would be worth testing tenant, leaseholder and elected member opinion.

A simple SWOT⁶ analysis of the 'long list' of options against the various ambitions (outcomes, objectives and outputs) will help to narrow down the options that will be appraised in more detail.

⁶ SWOT – strengths, weaknesses, opportunities and threats

Part Two: For local authorities who have agreed a shortlist of options to appraise in more detail

It is assumed that the local authority has agreed a shortlist of options which will be subjected to a more detailed appraisal process, based on early involvement from tenants and leaseholders (amongst others) and consideration to the strategic 'fit' of the council's housing stock, its management and maintenance. Guidance on the latter two points can be found in Part One.

8. What is the appraisal process after short-listing?

8.1 The appraisal process stages after short-listing are described here.

Stage	Content
1. Agree key issues to be addressed in achieving objectives	<p>The first two stages should have identified most of these but it will probably be necessary to identify which issues are essential to address and which are desirable.</p> <p>The issues need to be clear to all involved in the options appraisal process; it would be wise to prioritise in consultation with relevant stakeholders.</p>
2. Agree the criteria against which to assess options	<p>The next section of this guidance considers criteria in more detail.</p> <p>Again, the first two stages should have identified relevant criteria. At this stage it will be important to:</p> <ul style="list-style-type: none"> • Select criteria that reflect all the important dimensions of strategic choice. • The criteria should be agreed by stakeholders. • They need to be carefully defined so people are clear about their meaning – ideally they should be measurable to enable comparisons
3. Shape options	<p>Part One of this guidance dealt with generating a long list of options and the approach to short-listing.</p> <p>Once a shortlist has been reached it will be important to consider in more detail the opportunities that might exist within each option to achieve the objectives. A review of the options being considered elsewhere (see Part One) is also likely to have identified opportunities that you would like to consider further. Examples you might want to give consideration to are:</p> <ul style="list-style-type: none"> • Co-locating services and sharing facilities • Sharing expertise

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Stage	Content
	<ul style="list-style-type: none"> • The commercialisation of some services • Varying the balance between outsourcing and providing services in-house • The quality targets you want to achieve <p>In shaping the shortlisted options you should particularly bear in mind:</p> <ul style="list-style-type: none"> • The danger of overlooking important options for the future management and maintenance of the housing stock • The need to be inclusive: the widest range of options – and short-listing – will be best informed if there is wide engagement eg, with tenants and leaseholders • Options need to be described in enough detail to be capable of appraisal
<p>4. Undertake a cost/benefit analysis of options to understand their relative value</p>	<p>There is considerable guidance available on cost/benefit analysis but in summary you should consider:</p> <ul style="list-style-type: none"> • The relevant costs and benefits to local government, tenants and leaseholders, other customers and the wider public. Decision makers can then compare the results between options to help select the best. • Attaching a value to identified benefits. This is not the same as the cost. It is a measure of the outputs and results that could be expected by different stakeholders, for example one option may deliver a greater number of repairs than another, resulting in a higher level of satisfaction with services compared to another option. By attaching a value it enables a comparison. • Benefits to the wider local area and community eg, the economy (see the next section on criteria for examples) • The opportunities that exist from each option, and what would be 'lost' by pursuing one option over another – the 'opportunity cost' • Necessary adjustments to costs and benefits to take account of distributional impacts and opportunity costs
<p>5. Assess risks and uncertainties</p>	<p>A risk management strategy for options appraisal is recommended, followed by a risk management strategy for implementation. This approach is suggested in order to overcome the likely bias within options appraisal (see the appraisal bias section in Part One).</p> <p>The process of risk assessments should include an expected value of all risks for each option, and consider</p>

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Stage	Content
	how exposed each option is to future uncertainty (the previously mentioned PESTLE exercise should inform this).
6. Appraise options against criteria	Examples of criteria are presented in the next section but these should be agreed at an early stage of appraisal.
7. Select the option	The approach to selecting an option should be agreed at an early stage in the appraisal process and clearly communicated to those involved in the process

9. What are the criteria we should appraise options against?

9.1 An appraisal of options against agreed criteria is a critical part of the process, enabling other factors to be considered alongside cost and measurable benefits.

It is expected that options will be appraised against a combination of criteria, of which some will have greater importance than others. Examples are provided next. This is not an exhaustive list, local authorities will wish to establish their own criteria and assign importance to these in partnership with stakeholders.

Criteria	Questions to answer
1. Design and scope	How well does each option: <ul style="list-style-type: none"> • Contribute to strategic objectives, vision and aspirations? • Meet current and future housing needs and aspirations? • Meet with tenant and leaseholder views? • Affect ambitions to offer choice eg, by extending the provider market? • Provide scope for synergies with other plans?
2. Accountability, governance and participation	How can each option: <ul style="list-style-type: none"> • Enhance democratic accountability, transparency and scrutiny? • Improve tenant and leaseholder accountability and engagement? • Enable greater/more effective staff involvement?
3. Financial assessment	For each option: <ul style="list-style-type: none"> • What are the whole life and transaction costs? • What are the investment needs? • What funding is required and where can this be

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Criteria	Questions to answer
	<p>acquired from?</p> <ul style="list-style-type: none"> • Can we afford it? • What are the financial risks associated with the option?
4. Quality of service	<p>For each option:</p> <ul style="list-style-type: none"> • What will it achieve in terms of performance – outputs and outcomes in the short and longer term? • Will continuous improvement and innovation be assured? • Will services reflect tenants, leaseholders and other customer’s needs and aspirations? Are they accessible, responsive, and flexible – are they able to be personalised? • Is there opportunity to integrate services with others (including other organisations) to enable holistic provision to the individual eg, older tenants in need of care and support?
5. Quality of employment	<p>What employment model will be necessary for each option?</p> <ul style="list-style-type: none"> • This should consider: • Ability to retain terms and conditions, pensions and labour standards • Working practices and workplace training • Access/provision of childcare • Health and safety in workplace and community
6. Capability, management and intellectual knowledge	<p>How will each option:</p> <ul style="list-style-type: none"> • Affect the retention of key skills and intellectual knowledge? • Enable change to be managed effectively? • Affect compliance with regulatory frameworks (bearing in mind role of tenants and leaseholders in co-regulation)?
7. Organisational arrangements	<p>What arrangements will each option have and how will these affect:</p> <ul style="list-style-type: none"> • Flexibility and responsiveness in a variety of situations (day-to-day and planned)? • Scope for collaboration and consortia? • Enable accountability (see earlier criteria)?
8. Local economy	[If economic growth, health and wellbeing are strategic

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Criteria	Questions to answer
	<p>objectives this criteria may be covered]</p> <p>What will each option:</p> <ul style="list-style-type: none"> • Provide for in terms of employment and training opportunities for the local population? • Offer to tenants and leaseholders who are in receipt of welfare benefits but are willing and able to work? • Contribute to the local economy in terms of purchasing power and the supply chain? • Contribute to reducing other economic and related inequalities and disadvantage eg, financial exclusion?
<p>9. Ability to address social justice and inequalities</p>	<p>What will each option:</p> <ul style="list-style-type: none"> • Contribute to the reduction/elimination of health and other inequalities and discrimination for different equality groups? • Contribute to building community capacity, power and participation? <p>Depending on the local area it may be relevant to consider the contribution in terms of different areas.</p>
<p>10. Sustainable development</p>	<p>What will each option contribute to:</p> <ul style="list-style-type: none"> • Local and regional producers and suppliers? • Reducing carbon emissions? • Improving the neighbourhood environment? • Local targets to minimise environmental impact?
<p>11. Added value</p>	<ul style="list-style-type: none"> • What do the options offer over and above the core requirements? • Are there additional community benefits? <p>[The application of the Social Return On Investment Model^{vi} may be a useful exercise to undertake in relation to this criteria]</p>
<p>12. Corporate impact on the authority</p>	<p>What is the impact of the option on:</p> <ul style="list-style-type: none"> • Viability of in-house provision (efficiency and effectiveness)? • Service integration and delivery eg, a ‘one-stop shop’ approach?

Developed from the ESSU research report

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9.2 Relatively recent (2009) government guidance on undertaking multi-criteria analysis is available^{vii}, which builds on HM Treasury's Green Book approach to options appraisal.

References and further reading

ⁱ National Audit Office (2011) Assessing business cases for changes to arm's length bodies: memorandum for the Public Administration Select Committee
www.nao.org.uk/publications/1011/pasc_memo_arms_length_bodies.aspx

ⁱⁱ HM Treasury (2007) Public Sector Business Cases using the Five Case Model: a Toolkit
www.hm-treasury.gov.uk/d/greenbook_toolkitguide170707.pdf

ⁱⁱⁱ ESSU (2007) Options appraisal criteria and matrix
www.european-services-strategy.org.uk/news/2007/pfi-ppp-appraisal-matrix/essu-options-appraisal.pdf

^{iv} HM Treasury (2003) The Green Book
www.hm-treasury.gov.uk/data_greenbook_index.htm

^v DCLG (2006) Review of Arms Length Housing Management Organisations
www.communities.gov.uk/publications/housing/reviewarms

^{vi} Social return on investment <http://www.thesroinetwork.org/>

^{vii} DCLG (2009) Multi-criteria analysis: a manual
http://eprints.lse.ac.uk/12761/1/Multi-criteria_Analysis.pdf

^{viii} National Federation of ALMOs Limited (NFA) (2009) A future for ALMOs – within local communities

Also

- CIH (2011) Implementing self-financing for council housing- Briefing for Members
- HouseMark (November 2010) Whose stock is it anyway? Local authority perspectives on the future of ALMOs

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