JOINT HOUSING COMMITTEE AND POLICY & RESOURCES COMMITTEE	Agenda Item 4 Brighton & Hove City Council

Subject:		**Homes for Brighton & Hove – Development Company opportunity**	
Date of Meeting:		**21 October 2020**	
Report of:		**Executive Director Housing, Neighbourhoods & Communities and Executive Director Economy, Environment & Culture**	
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Ward(s) affected:		**All**	

FOR GENERAL RELEASE

1. PURPOSE OF REPORT AND POLICY CONTEXT

1.1 Since the Homes for the City of Brighton & Hove (known as Homes for Brighton & Hove or HBH) joint venture partnership with The Hyde Group was set up in 2017, a national matter relating to mortgage lending and issues with project viability have necessitated a review of how to proceed. In addition, there have been two significant national policy changes which present a more favourable landscape for the council than had existed in 2017. These factors combine to provide a perfect opportunity for the partnership to reassess its delivery model and put in place a more favourable structure for delivery.

1.2 This report details the process by which the joint venture can:-
- Institute a more straight-forward partnership approach
- Bring in significant additional funding for the development of 346 homes on its first two sites
- Achieve lower rent levels than previously agreed in the joint venture business plan for the first two sites
- Bring the rented homes into direct council ownership

1.3 The proposal for achieving the benefits outlined above, and for taking advantage of the new national funding environment, is to re-configure the joint venture's delivery model to that of a Development Company.

1.4 The HBH Board agreed (with one abstention) to seek Reserved Matters approval for this change through their respective governance structures at their September meeting.

1.5 Hyde's Board agreed at their September meeting to the principle of moving to a Development Company model, and to the potential for providing grant funding to the council as a Delivery Partner under their Strategic Partnership with Homes England.

2. RECOMMENDATIONS:

That Housing Committee recommends to Policy & Resources Committee that it:

2.1 Approves the principle of changing HBH to a Development Company model as detailed in this report and grants delegated authority to the Executive Director Housing, Neighbourhoods & Communities and the Executive Lead Strategy Governance & Law after consultation with the Housing Supply Member Board to take all necessary steps to implement the proposal as outlined in paragraphs 1.2 and 1.3 (including adjusting the Business Plan as outlined in this report and entering into Development Agreement/s);

2.2 That the council accessing funding as a Delivery Partner under Hyde Strategic Partnership with Homes England be approved;

2.3 That it be noted that the development sites will be transferred to HBH and contracts awarded by the HBH Development Team;

2.4 That the purchase of completed homes for rent at Portslade and Coldean by the Housing Revenue Account (HRA) with an estimated value of up to £41m be agreed; and

2.5 That it be noted that this will be reported via the annual HRA budget setting process.

That Policy & Resources Committee:

2.6 Approves the principle of changing HBH to a Development Company model as detailed in this report and grants delegated authority to the Executive Director Housing, Neighbourhoods & Communities and the Executive Lead Strategy Governance & Law after consultation with the Housing Supply Member Board to take all necessary steps to implement the proposal as outlined in paragraphs 1.2 and 1.3 (including adjusting the Business Plan as outlined in this report and entering into Development Agreement/s).

2.7 That the council accessing funding as a Delivery Partner under Hyde Strategic Partnership with Homes England be approved;

2.8 That it be noted that the development sites will be transferred to HBH and contracts awarded by the HBH Development Team;

2.9 That the purchase of completed homes for rent at Portslade and Coldean by the Housing Revenue Account (HRA) with an estimated value of up to £41m be agreed; and

2.10 That it be noted that this will be reported via the annual HRA budget setting process.

3. CONTEXT/ BACKGROUND INFORMATION

3.1 Homes for Brighton & Hove (HBH) was established as a Limited Liability Partnership (LLP) in 2017 with the aim of developing and managing 1,000 homes. There were to be an equal mix of shared ownership and rented homes, with rents set at 37.5% of the national Living Wage.

3.2 The main reason for setting up Homes for Brighton & Hove (HBH) was to overcome significant local and national issues limiting the delivery of affordable rented homes. These included a borrowing cap on the Housing Revenue Account (HRA), a national funding regime focused on Starter Homes/shared ownership, and a lack of truly affordable rented homes being developed in the city. Since then, however, the HRA borrowing cap has been lifted, and social rents have been included in Homes England's Affordable Housing Programme. These national policy changes have significantly enhanced opportunities for delivering affordable social housing using different models.

3.3 In 2019 the joint venture received planning permission for its first two sites totalling 346 homes, but there is currently a viability gap in delivering these projects. Outputs for the initial HBH sites, Coldean and Portslade, have moved away from the Business Plan (BP) targets agreed in December 2017. This is due to adverse movement in scheme assumptions in two key areas – build costs and shared ownership sales values.

3.4 **Build cost** - There has been build cost inflation of around 4.3% since the assumptions in the BP financial model were agreed. In addition, site specific challenges and regulatory changes (including the requirement to fit sprinkler systems) have meant that it has not been possible to achieve the BP target for building efficiency – i.e. for internal communal space in apartment blocks not to exceed 20% of the total habitable/saleable space.

3.5 **Shared ownership values** – The HBH financial model used sales values and build costs at "current day (late 2017) levels" and did not to estimate inflation in costs and values over the development period. The assumption is that any build cost inflation over the development period (from December 2017) would be at least offset by growth in sales values. In practice house prices in Brighton and Hove have not kept pace with build cost inflation over the development period for the initial HBH sites. The sale price of flats in the Brighton & Hove market between the period of November 2017 and October 2019 has remained broadly static.

3.6 In addition to the viability gap outlined in paragraphs 3.3 to 3.5, it became evident in 2019 that mortgage providers were unwilling to provide mortgages for shared ownership homes not managed by a registered provider of social housing (RP). Both the council and Hyde are registered providers, but HBH is not. Advice has been received that HBH would be unable to sell shared ownership homes in its current form (a Limited Liability Partnership). However, registering as an RP is a complex and lengthy process with significant financial implications.

3.7 These matters led to the HBH Board reviewing of the current delivery model and options to address the issues at its 16 June meeting. The preference of the HBH Board was to convert HBH to a Development Company (DevCo), with completed units sold to Hyde and BHCC rather than be retained by HBH. The key benefits of this model are that it:

- Takes advantage of the new funding environment
- Significantly reduces the council's funding liability
- Overcomes viability issues
- Rented homes are owned directly by the council
- Shared ownership mortgage issue is resolved
- Lower rents than originally agreed
- Less complex
- Enables consideration of a broader range of sites for future projects

3.8 The new rent levels proposed range from 29% to 21% lower than those in the original business plan, this is detailed in table 1 below. The calculation of the social rent is based on the formula rent set by Central Government as required to access the Homes England grant funding. This is subject to change and will require confirmation of the January 1999 value of each unit type when the properties are complete and ready to let.

Table 1 - Year 1 Rent Comparison	**Studio**	**1 Bed**	**2 Bed**	**3 Bed**
Coldean				
37.5% Living Wage rent	-	£148.49	£179.83	£188.04
Social Rent	-	107.70	£127.19	£142.37
Social rent as a percentage of Living Wage	-	73%	71%	76%
Portslade				
Living Wage	£117.16	£148.49	£179.83	£188.04
Social Rent	£92.37	£108.51	£130.84	£143.63
Social rent as a percentage of Living Wage	79%	73%	73%	76%

3.9 The key changes to the current Business Plan are outlined on the table below:

Proposed change	**Effect on Business Plan**	**Notes**
Rented homes rents set at government social rent level.	Inclusion of additional rent level. Lower rents than originally envisaged (see above).	Positive impact as rents lower than originally set.
Annual rent increases in line with government rent standard for social housing.	Rents rise at rent standard rate (currently Consumer Price Index (CPI)+1%) increasing from CPI in original Business Plan.	Rent increases in line with other council homes and higher rise off-set by lower rent. This is an expectation of Homes England in order to qualify for grant.
Inclusion of Homes England Grant.	Significantly reduce the capital contribution from each party.	Shared ownership homes will now fall under national programme, but can be marketed locally, including to essential workers.

Homes will be sold to the council and Hyde.	Originally planned that homes would be owned by Homes for Brighton & Hove.	Council would have direct ownership of the homes it purchases. The process for selling the homes to each party will need to be agreed by the LLP Board and reflected in the legal agreements.

3.10 The HBH Board agreed (with one abstention) to seek Reserved Matters approval for this change through their respective governance structures at their September meeting.

3.11 Hyde’s Board agreed at their September meeting to the principle of moving to a Development Company model, and to the potential for providing grant funding to the council as a Delivery Partner under their Strategic Partnership with Homes England.

3.12 The team and HBH Board are keen to award the contracts and progress with the project as soon as possible in order to ensure that the current contract price is held and the Coldean project can start within the current ecology window (before March 2021).

The Development Company Proposal

3.13 Hyde has provided a detailed overview of how the development company model could work and this is presented below.

3.14 There would be two parties involved –HBH/DevCo as developer, and the Council/Hyde as owner of the completed units. HBH/DevCo would pay for and acquire the sites and would undertake the development of the sites. HBH/Dev Co would make a development profit (current estimates are 8-10% of its development costs), this would be shared 50/50 between the council and Hyde as equity partners. A contractor from the Hyde Framework would be appointed by HBH/Dev Co to build the schemes.

3.15 The Council and/or Hyde could enter into a Development Agreement with HBH with the first payment usually being made at ‘golden brick’ stage (i.e. when work starts above foundation level) at which point the Council/Hyde would acquire a legal interest in the land. Funding for the development from ’golden brick’ to completion would usually be through stage payments from the Council/Hyde to the LLP for completed work.

Table 2 - Lead and funding for Dev Co model			
Key stage	**Undertaken by**	**Funded by**	**Estimated date**
1. Acquisition of site	HBH LLP as DevCo	HBH LLP as DevCo	December 2020
2. Development up to golden brick	HBH LLP as DevCo through its Design & Build Company (D&B Co)	HBH LLP as DevCo	November 2021

3. Land transfer at golden brick	Transfer from HBH LLP to Hyde HA/BHCC	Hyde HA/BHCC	November 2021
4. Development from golden brick to completion	HBH LLP as DevCo through its D&B Co	Hyde HA/BHCC	October 2022 – October 2023 (units will be completed during this period)
5. Transfer of completed homes at completion	Transfer from HBH LLP to Hyde HA/BHCC	Hyde HA/BHCC	October 2022 – October 2023 (units will be completed during this period)
6. Ownership/letting/sale/management of completed homes	Hyde HA/BHCC	Hyde HA/BHCC	Marketing launch for new homes – May 2022

3.16 If it is to proceed as originally planned the council would need to fund 50% of the site acquisition costs (as an equity partner), the receipt from sales of Council land to the LLP would go to the General Fund in line with the original business plan approved by Policy & Resources in 2017.

3.17 It is the council's intention for the ownership of any completed homes and funding for the development of these homes to be made through the Housing Revenue Account (HRA). It is usual for a developer to look to recover 40% of its total scheme costs at the golden brick stage so this is the initial proposal from Hyde. If the council is able to access Homes England grant it is possible that it could draw down grant funding to cover the golden brick acquisition costs. The HRA would then need to fund stage payments for the build of units to be acquired to completion although depending on what grant funding agreement is reached this could be offset by grant drawdown in terms of cash required.

Homes England funding

3.18 A significant benefit of the DevCo approach is the ability to bring in Homes England funding, helping to reduce the financial liability for each party and overcome the viability issues detailed above. This was not an option when the JV was established as funding for lower rents was not available through the Affordable Homes Programme at that time. Indeed, one of the key reasons for establishing HBH was to overcome the lack of national funding.

3.19 Homes England announced the Affordable Housing programme 2021-2026 on the 8th September 2020. The programme will include a social rents stream, however details of how organisations can bid will not be published until the end of 2020. This is too late to inform decision making at the speed required to unlock these projects and there is also a risk that funding at the level required per home will not be achieved in any bid.

3.20 The 2021-26 programme will also include a process for RPs that wish to bid to become Strategic Partners of Homes England. This enables successful organisations to directly draw down funding for their schemes at a pre-agreed subsidy level per home depending on tenure. It is an aim of the council to become a Strategic Partner in the longer term, but bidding on this will not open until 2021 so does not fit with the current timetable.

3.21 Hyde Housing are already a Strategic Partner of Homes England and have offered to provide funding to the council under this arrangement as a Delivery Partner. This has been approved by their Board and would have the benefit of guaranteeing funding to the council for the homes at the rate required (subject to a due diligence process and contract). This brings more certainty to the decision-making process as the council has more assurance that it will be able to purchase the homes at the required price without having to provide further subsidy from the HRA.

3.22 One of the conditions by accepting the social rent grant via Homes England directly or through Hyde as a delivery partner is that rents will need to be set in line with the Government policy. This includes setting rents based on a calculation of the formula rent using the January 1999 valuation and increasing rents by CPI+1% in perpetuity.

3.23 If the council does not take up this offer the project could move forward at risk (of not receiving Homes England funding) with an option for the council to purchase the rented homes (i.e. if Homes England funding agreed). If it were not able to exercise this option due to a lower rate or zero funding Hyde could purchase all the homes. If the council decided it could not progress and Hyde were able to purchase all of the homes the outcome would therefore be a mix of homes at social rent and shared ownership managed and owned by Hyde. The council would have covered its costs and generated a small profit, capital receipts and nomination rights to the rented homes. Potential scenarios are in the table under section 4 below.

3.24 Modelling of the DevCo options to establish potential financial outputs for HBH if converted to a DevCo was presented to the HBH Board at their meeting on 13 September 2020. The Board agreed (with one abstention) to seek Reserved Matters approval through their respective governance structures. The Board requested that this is pursued as quickly as possible in order to award the contracts and get the projects on site.

Legal advice

3.25 Homes for Brighton & Hove has received advice from Trowers and Hamlyn. The advice is that Reserved Matters approval will be required for the LLP to operate as a development company delivering affordable homes to a registered provider or local authority.

3.26 There are several legal implications for the council itself that will need to be considered, and the council has re-engaged Bevan Brittan who originally advised the council on the establishment of the partnership. They have provided high-level advice on the following:

3.27 **What are the legal implications for BHCC of the JV (Homes for Brighton & Hove) delivering development on behalf of others or developing sites and**

selling complete units to others instead of developing, owning and managing homes itself?

3.28 The overall legal structure would still be suitable; the LLP as currently structured can own, be financed and develop in the way envisaged. Provided consent was obtained from the members, the LLP could then dispose of the developed units rather than retain.

3.29 Such a change would be a Reserved Matter under the LLP Members' Agreement either for the specific sites or more generally. It will therefore require the consent of both members in accordance with the terms of the Members' Agreement.

3.30 The joint venture documentation does not currently provide for selling units and therefore there are no agreed positions about what the process / rules would be. The agreed position should be incorporated into the joint venture documentation, most obviously through amendment to the business plan, as part of the members giving consent so there is legal certainty on such matters.

3.31 The parties would not have to commit to pursuing a development or retention model in all cases. There is flexibility in the structure for different approaches to be taken for different developments.

3.32 Are there any legal implications/risks arising if BHCC were to use its General Fund (GF) to finance construction and then its Housing Revenue Account (HRA) to purchase the homes to hold within the general housing stock? What is the most appropriate structure for the LLP to put in place from the Council's perspective to avoid the HRA 'subsidising' the GF?

3.33 The proposed transactions are capable of being done in a legally compliant and consistent with the rules of the general fund and HRA.

3.34 The council has power to finance the LLP and dispose property from its general fund as covered in the original advice and reports associated with the establishment of the LLP. Receipts for sale of sites will affect the general fund capital financing requirement as they are not sites appropriated to the HRA.

3.35 The council has the power to acquire housing, acquire land for housing and erect houses under s.9 and s.17 Housing Act 1985. These are the principal acquisition and development powers for housing to be held as housing under Part 2 Housing Act 1985 (i.e. within the HRA).

3.36 The fact that the Council would be purchasing the housing from an LLP of which it is a 50 per cent owner does not affect the legitimacy of relying on these powers.

3.37 This is subject to the general public law point that local authorities must make decisions for a proper purpose. The reasoning for the purchase should be to meet the Council's assessment of housing need in accordance with Part 2 Housing Act 1985. This seems to be reasonably clear based on the facts known.

3.38 The financing of the acquisition and associated implications for the HRA Capital Financing Requirement would need to be considered in the normal way.

4. ANALYSIS & CONSIDERATION OF ANY ALTERNATIVE OPTIONS

4.1 The table below details alternative options. Option 1 is preferred and would happen if the council took up the offer of receiving funding as a Delivery Partner of Hyde or received grant at the required level through an independent application.

Table 3 – Options

Option	Notes	Financial implications – Coldean	Financial implications – Portslade
1. Full Homes England funding achieved e.g. through Hyde's Strategic Partnership	The council would be able to progress with purchase of the rented homes and let at government social rents (lower than 37.5% Living Wage)	HRA could afford to invest up to £28.9m inclusive of any on costs for the rented units. GF retains capital receipts generated from the land sale.	HRA could afford to invest up to £12.1m inclusive of any on costs for the rented units. GF retains capital receipts generated from the land sale.
2. No Homes England grant, but council pursues purchase	Council would need to subsidise purchase through HRA or other means e.g. Right to Buy receipts (although not enough to cover so would impact on the current delivery programme). Rents would be considered at 37.5%LW levels.	RTB receipts earmarked against NHFN programme. HRA could afford to invest up to £20.6m inclusive of any on costs for the rented units. GF retains capital receipts generated from the land sale.	RTB receipts earmarked against NHFN programme. HRA could afford to invest up to £8.4m inclusive of any on costs for the rented units. GF retains capital receipts generated from the land sale.
3. Council withdraws from JV and JV ends	Would need to progress through agreed closure procedure. Could look at purchasing designs but would lead to significant delay to projects.	Initial investment of £3.1m at risk Risk of construction cost increase	

5. COMMUNITY ENGAGEMENT & CONSULTATION

5.1 Extensive community consultation was undertaken as part of the development and planning process for the two proposed development sites.

6. CONCLUSION

6.1 Homes for Brighton & Hove was established to increase the supply of affordable homes in the city, partly in response to the HRA borrowing cap and limited opportunities for national funding for affordable rented homes. The two issues that have arisen around viability and shared ownership mortgages have provided an opportunity to review the delivery model for the joint venture in relation to changed national and local environment.

6.2 Moving to a Development Company model will tackle these two key issues and also significantly reduces the complexity of the initiative (for example there will be no need for separate contracts for management and maintenance of the new homes or an separate allocations policy). It will also bring significant benefits to the council; primarily reducing the funding requirement and bring at least 50% of the homes directly into the council's housing stock.

7. FINANCIAL & OTHER IMPLICATIONS:

Financial Implications:

7.1 If the council opts to become a Delivery Partner under Hyde Housing's Strategic Partnership with Homes England it would allow the council to gain access to grant funding totalling up to £14.5m across both sites. For this project in its current position opting to enter into this agreement with Hyde would represent more certainty for the council. A condition set by Homes England for the social rent grant programme is to increase rental income by CPI+1% in perpetuity.

7.2 Standard financial modelling for a housing delivery project utilising the grant funding has been undertaken for this proposal. This includes a 60-year cashflow analysis, using the discount rate advised by the Treasury Green book and social rents based on the Governments requirement to set rents based on the January 1999 valuation of the properties. On this basis the HRA could afford to invest up to £28.9m for the Coldean units and £12.1m for the Portslade units, whilst maintaining a breakeven position as a minimum. This meets the minimum requirements set out in the latest financial appraisal carried out for the LLP.

7.3 Without access to the grant funding from Hyde or Homes England the HRA could afford to invest up to £20.6m for the Coldean units and £8.4m for the Portslade units, whilst maintaining a breakeven position as a minimum. This does not meet the requirements set out in the latest financial appraisal carried out for the LLP and would require further subsidy from the HRA to meet them. This option would require rents to be set at the approved 37.5% Living Wage rates as per the original business case.

7.4 All other sources of funding, such as RTB receipts and commuted sums are currently earmarked for the existing new housing supply programme, including the New Homes for Neighbourhood Programme and Home Purchase Policy. Switching funding from those programmes would impact on the delivery of new homes.

7.5 The net capital receipts generated from both sites totals £4.510m. This will be retained fully within the GF and will contribute to the future GF capital investment programme.

7.6 The budget variations required for the HRA to invest will be reported in line with the HRA budget setting report for 2021/22 and included within the HRA capital investment programme.

7.7 Further financial due diligence will be carried out on any future changes to the business plan and reported back to Housing Supply Member Board in line with recommendation 2.2.

Finance Officer Consulted: Craig Garoghan Date: 05/10/2020

Legal Implications:

7.8 The legal implications of the proposal are set out in the body of the report.

Lawyer Consulted: Alice Rowland Date:22/9/20

Equalities Implications:

7.9 Homes will be allocated through the council's existing Housing register reducing the potential for negative equalities impacts.

Sustainability Implications:

7.10 The homes will be built to high sustainability standards.

Brexit Implications:

7.11 If the current contracts are not awarded there is a risk of significant construction cost increases following the completion of the Brexit process.

Any Other Significant Implications:

7.12 The provision of 346 affordable homes will help to tackle the city's Housing Crisis.

Crime & Disorder Implications:

7.13 This provides an opportunity to provide new, well-designed homes which link to the council's wider housing and regeneration aspirations for the city, including the council's economic development and sustainability objectives. Well-designed housing has been shown to positively influence the rate of crime and disorder as well as the quality of life for future occupants.

7.14 Vacant sites can sometimes attract anti-social behaviour. With careful planning, the future development of these sites is likely to improve the safety of existing neighbourhoods by reducing crime and the fear of crime

Risk and Opportunity Management Implications:

7.15 The following risks and mitigations have been identified:

Risk description	***Potential consequences***	***Mitigating controls and actions***
Grant funding not available to the council for either site or only at	Council would need to subsidise from HRA or	Use Hyde Strategic Partnership. Discussions with Homes England.

reduced rate.	agree to Hyde taking all units	
Council not able to have own Strategic Partnership due to use of Hyde's	Unable to bid for Strategic Partnership status.	Homes England have advised that this should not affect future ability to become a Strategic Partner. Alternative would be to bid for grant on scheme by scheme basis.
Construction costs increase	Viability of project affected, and costs of homes increases. More subsidy required.	Early decision to hold current price. Monitor construction market and model contingencies
DevCo model requires more officer and professional resource from the council to support different approach e.g. similar to S106 purchase	Pressure on existing teams. Not able to perform function effectively.	Consider additional resources to support DevCo model.
New homes do not meet Council specification	Different maintenance and repair requirements than current stock and new build	Property & Investment plan for taking homes and quality checks through development process.
Homes England grant for shared ownership will bring it under the national programme	Homes can be marketed locally, but will also be included on national website	Need to have strong local marketing campaign aimed at essential workers. Viability gap will not be closed without Homes England funding on this element
Condition of the Homes England grant will be CPI+1% annual rent increase	Members previously indicated they would like CPI only if possible	Homes England unlikely to change policy so need to accept.

Public Health Implications:

7.16 There are strong links between improving housing, providing new affordable homes and reducing health inequalities. Energy efficient homes which are easier and cheaper to heat are likely to have a positive influence on the health of occupants of the new homes.

Corporate / Citywide Implications:

7.17 Increasing Housing Supply is a City Plan and Housing Strategy priority. In particular, meeting our housing target of 13,200 new homes in the City by 2030.

7.18 In addition, in our Housing Strategy (2015) priority of increasing housing supply to meet identified needs, we are committed to work collaboratively with Adult Social Care, Children's Services and Health to reduce long term social care cost pressures and address issues arising with recruitment and retention of lower income staff in the City essential to the operation of these services.

7.19 The delivery of these projects supports the following Council Plan 2220-23 objectives**:**

- **A city to call home –** Increasing supply of council homes and affordable housing.
- **A city working for all –** Social benefits associated with good quality housing and wider social and economic benefits of development projects.
- **A healthy and scaring city-** support for key worker housing to meet Health and Social Care employee requirements.

7.20 The first two projects will bring a number of benefits to the city and council including:

- 346 new affordable homes
- Regeneration of key sites and public realm improvements
- Each new home has potential to generate new Council Tax
- Potential £3 of economic output for every £1 of public investment based on national calculations
- Apprenticeships and training