CABINET MEETING	Appendix Agenda Item 75 Brighton & Hove City Council

Subject:		**Local Delivery Vehicle**	
Date of Meeting:		**24 September 2008**	
Report of:		**Director of Adult Social Care and Housing**	
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Key Decision:	**Yes**	**Forward Plan No. CAB 3347**	
Wards Affected:	**All**		

FOR GENERAL RELEASE

1. SUMMARY AND POLICY CONTEXT:

1.1 The purpose of this report is to recommend the creation of a housing Local Delivery Vehicle (LDV) to obtain best value for money from Housing Revenue Account (HRA) assets requiring reinvestment and not occupied by Secure Tenants, without freehold transfer. The purpose of the LDV is:

- To bring in additional investment to improve council homes, to assist in meeting Decent Homes Standard and tenant aspirations for improvement of the council housing stock.
- To meet strategic housing and corporate priorities. In particular, to provide accommodation for people with particular needs to whom the council owes a housing duty.
- To refurbish the leased stock.

1.2 The proposal to set up a Local Delivery Vehicle (LDV) to meet the council's corporate priorities and strategic housing objectives, which emerged from Stage 1 of the review of options in the Government's Housing Green Paper *Homes for the Future: more affordable, more sustainable,* has now been developed and refined. Pricewaterhouse Coopers (PwC) have undertaken further financial modelling and soft market testing and Trowers & Hamlins (Trowers) have advised further on a suitable corporate structure and governance arrangements. The key points are outlined in this report.

1.3 Consultation on the proposal with council tenants and leaseholders and their representatives is taking place as set out in section 4 of this report and the outcome will be reported orally to Cabinet at the meeting.

2. RECOMMENDATIONS:

2.1 That Cabinet approve the setting up of the proposed Local Delivery Vehicle to deliver key strategic housing and corporate priorities and generate funding for investment in the HRA to improve council homes and assist the council in meeting the Decent Homes Standard.

2.2 That Cabinet agree:

(a) that the Local Delivery Vehicle (LDV) is incorporated as a Company Limited by Guarantee and seeks charitable status and

(b) that the LDV is established with a board of management of 12, comprising one third council nominees, one third BHCC tenants (selected by Area Housing Management Panels) and one third independents (appointed by the other board members of the company), and that board composition is reflected at company membership level, making the LDV independent of the council.

2.3 That Cabinet note the potential for two funding sources (namely private sector funding or via council borrowing). That Cabinet instruct officers to undertake all actions necessary to put a private sector funding solution in place concurrently with further assessing the council borrowing option (including, if necessary, seeking any consents from the Secretary of State under sections 24 and 25 of the Local Government Act 1988). That Cabinet instruct officers to report back to a committee of the Cabinet comprising the Cabinet Members for Housing and Finance once all due diligence work is completed for determination of the funding option to be used. It is anticipated that this will be completed by December 2008.

2.4 That Cabinet agree the proposal to enter into a VAT shelter arrangement with the LDV (including a development agreement with it for the refurbishment of leased properties) and authorise the Director of Adult Social Care and Housing to take all steps necessary for its establishment following legal advice.

2.5 That Cabinet authorise the Director of Adult Social Care and Housing, after consultation with Cabinet Member for Housing, to take all steps necessary or incidental to the formation of the LDV including but not limited to the granting of the leases and other steps necessary to implement the proposals in the report and to report back on progress when seeking the determination on funding solutions referred to in 2.3 above.

2.6 That Cabinet approve the use of up to £45 million generated from the leasing of HRA assets to the LDV for affordable housing and in particular for the carrying out of improvements to the council's retained HRA stock under the council's Decent Homes programme during the period from April 2009 to April 2016.

2.7 That Cabinet recommend to Full Council that it authorises the making of an application to the Secretary of State for consent to lease to the LDV (with vacant possession for a period of up to 125 years) the 106 Housing Revenue Account dwellings listed in the schedule in Part 2 of this agenda (exempt under paragraphs 1, 2 and 3 of schedule 12A to the Local Government Act 1972 (as amended)) under the requirements of s32 Housing Act 1985 and any additional application necessary or incidental to the granting of such leases or under any other relevant legislation.

2.8 That Cabinet recommend to Full Council that it authorises the making of an application to the Secretary of State for consent to lease to the LDV (with vacant possession) for a period of up to125 years such other Housing Revenue Account dwellings, in addition to those listed in the schedule above (up to a maximum of 499 in total, including those covered under 2.7 above, within a five year period) that satisfy the criteria referred to in paragraph 3.4.9 of this report. For the avoidance of doubt Cabinet and Council delegate the power to make decisions on the inclusion of individual properties to the Director of Adult Social Care and Housing after consulting with the Cabinet Member for Housing.

3. RELEVANT BACKGROUND INFORMATION/CHRONOLOGY OF KEY EVENTS:

3.1 PURPOSE OF THE VEHICLE

3.1.1 As set out in the council housing (HRA) asset management plan the purpose of the LDV is:

- To bring in additional investment to improve council homes and thus to meet Decent Homes Standard and tenant aspirations for improvement of the stock.
- To meet strategic housing and corporate priorities. In particular, to provide accommodation for people with particular needs to whom the council owes a housing duty
- To refurbish the leased stock.

3.1.2 Given tenants' overwhelming rejection of the stock transfer proposal in 2007, the following parameters have been set:

- No RSL involvement
- No freehold transfer
- No transfer of tenanted properties
- Maximum transfer of 499 properties within a period of 5 years.

3.2 **STRATEGIC CONTEXT**

3.2.1 Around half of all council homes in Brighton and Hove fall below the Decent Homes Standard. The financial situation is such that the authority cannot, under its own resources, achieve the Standard.

3.2.2 Following the outcome of the tenants' stock transfer ballot, officers reviewed strategic housing options to reflect the decision that the stock will be retained by the council and identify a strategy to fund the investment gap to achieve Decent Homes Standard and meet tenant aspirations for improvements to the stock.

3.2.3 Two key approaches have been followed:

- A Procurement Strategy that would see the council enter into a long term partnership agreement for the maintenance and improvement of the council housing stock, reducing overheads and direct costs. The Procurement Strategy for the HRA stock was approved by Policy & Resources Committee on 3 April 2008, having been through Housing Management Consultative Committee and Housing Committee.

- An asset management plan, which could see the creation of a Local Delivery Vehicle that would sit outside the council to utilise HRA assets requiring reinvestment and not occupied by Secure Tenants levering in additional investment to improve the council housing stock.

3.2.4 As part of this review, options set out in the Housing Green Paper, *Homes for the Future: more affordable, more sustainable*, for local authorities to set up a local delivery or similar special purpose vehicle to make the most of existing homes and land to lever in investment, were explored. That paper announced fourteen pilot Local Housing Companies with government support via English Partnerships and another 14 pilot Community Land Trusts.

3.2.5 At Housing Management Sub-Committee (11 March), Housing Committee (27 March) and Policy & Resources Committee (3 April 2008) members noted that external financial and legal advice was being sought in order to support officers to undertake detailed analysis of the practicalities of taking forward any Housing Green Paper options or opportunities. PwC and Trowers & Hamlins successfully tendered in a competitive procurement process and were appointed as financial and legal advisors respectively.

3.2.6 Stage 1 of the review indicated that there was potentially an economically viable, legally robust way of achieving the council's objectives while working within the parameters set and that such an approach could deliver:

- Up to £45 million lease payments that would be used as investment for improvement of council homes
- Funding to refurbish leased stock
- A stable supply of accommodation for homeless households and other groups for whom the council has a duty to provide housing, from Children and Young People's Trust, Learning Disabilities and Adult Social Care.

3.2.7 The Cabinet Member for Housing approved the progression to the development and finalisation phase of Stage 2 of the project, with the support of the Housing Management Consultative Committee meeting on 22 July 2008. During this second phase, the proposals have been further developed and refined and subject to testing of assumptions and assessment of the impact on the LDV, HRA and General Fund. Advice of PwC and Trowers & Hamlins is reflected in this report.

3.2.8 In simple terms, the model is as follows:

- The council leases property to the LDV on a long lease of up to 125 years
- the LDV pays for refurbishment of the properties and lets them to tenants nominated by the council
- the LDV could borrow capital on the basis of secure revenue streams from the rental income; this pays for refurbishment costs and the lease premium to the council
- rents would be within housing benefit levels already used when providing accommodation for the client groups in question.

3.2.9 The LDV proposal and investment it would raise for the HRA would help the council meet numerous priorities, objectives and targets, including those agreed with central government. The **Corporate Plan 2008-2011** for Brighton & Hove identifies 'Providing the homes that people need' as a key element of the priority to 'Protect the environment while growing the economy'. The Plan targets include improving the quality and availability of social housing. The measure of success for this is more council houses are classified as 'decent'.

3.2.10 The **Sustainable Community Strategy** for Brighton & Hove sets out priority areas for 'creating a city of opportunities'. The Local Area Agreement is organised around these key priority areas which include 'Improving Housing and Affordability'.

3.2.11 Our ambitions expressed in the **Local Area Agreement** include support for Affordable Family Housing. Key to this is ensuring that families are housed in decent, affordable homes. This includes a commitment to work together to decrease the percentage of non-decent council homes. National Indicator 158, which relates to reducing the percentage of non-decent homes, is one of the key 35 indicators included in our Local Area Agreement (LAA). Delivering decent council homes is also integral to achievement of a range of other LAA priorities with quality and availability of suitable housing impacting on health, education employment, social networks and communities.

3.2.12 In addition to National Indicator 158 on percentage of decent council homes, improving the quality of council housing will also contribute to the following national indicators for Local Authorities and Local Authority Partnerships:

- NI 5: Overall/general satisfaction with local area
- NI 119: Self reported measure of peoples overall health and wellbeing – (LAA indicator)
- NI 131: Delayed transfers for care from hospitals
- NI160: Local Authority tenants' satisfaction with landlord services
- NI 187: Tackling fuel poverty – (LAA indicator).

3.2.13 Progress on the council's delivery of the government's **Socially Excluded Adults Public Services Agreement** (PSA), which aims to increase the proportion of the most socially excluded adults in settled accommodation as well as in employment, education and training, will be measured by PSA 16 national indicators. These indicators include the proportion of clients in settled accommodation from the following client groups:

- NI 145: adults with learning disabilities
- NI 147: former care leavers aged 19
- NI 149: adults in contact with secondary mental health services.

3.2.14 Improving council homes is also central to our draft **Housing Strategy 2008-2013** with improvement of housing quality a key strategic priority. Poor quality housing is known to have a detrimental effect on households' health, educational and emotional wellbeing. Our Housing Strategy will work to make sure that more residents are able to live in decent high quality homes that are able to meet their changing needs.

3.2.15 Our strategic goals under this objective include development of the Brighton & Hove Standard for high quality and well maintained social housing and improvements to tenants' homes to ensure that they meet the standard.

Strategic actions include:

- Develop a quality standard for the city's council housing in partnership with tenants
- Enter into a long term partnership contract for maintenance and improvement of council housing stock
- Explore use of a Local Delivery Vehicle to raise investment capital.

Success criteria include:

- Brighton & Hove Standard agreed
- Funding to contribute to carrying out decent homes work

3.3 PROPOSED LEGAL STRUCTURE

3.3.1 Charitable status

Seeking charitable status is recommended as appropriate in view of the taxation advantages of acquiring charitable status, in particular, relief from Stamp Duty Land Tax (SDLT) on lease premiums and corporation tax on income from charitable activities and the potential benefits of a VAT shelter for refurbishment costs (see paragraph 3.5.5 below).

3.3.2 Issues arising include registration with the Charity Commission, which can take from three to six months depending upon the complexity of the organisation. The LDV would need to be established with wholly charitable objectives, which would include providing housing and associated activities to people in need, including elderly, mentally and physically disabled persons. Charitable status would limit the LDV's ability to undertake non-charitable activities in the future, for example it could not undertake market renting and any shared ownership schemes would need to be for charitable beneficiaries. However, non-charitable activities could be carried out by a non-charitable subsidiary if necessary. There would be higher expectations of board members as trustees.

3.3.3 A Company Limited by Guarantee (CLG)

As a charity the LDV could be either a Company Limited by Guarantee or an Industrial & Provident Society (IPS). A CLG is quicker and cheaper to register and a more flexible option. A CLG is recommended as an appropriate structure on the basis of this model's frequent use for social housing activities and its familiarity in the market.

3.3.4 **Composition of the LDV**

It is anticipated that three constituencies will be represented in the LDV: the council's interests; the council tenants' interests; and all other interests, or 'independents'. Parity between constituent groups is recommended to avoid issues arising from local authority majority control including 'contracting authority' status for the LDV and potentially charitable status. Regard will need to be paid to issues around conflicts of interest and board member compliance with statutory duties of directors. It is proposed for the company membership to reflect the composition of the Board so that the council, the tenants and independents hold one third each of the voting rights.

3.4 **PROPERTY ISSUES**

3.4.1 **Consents**

The project modelled is based upon a lease of up to 499 properties by the council to the LDV over a 5 year period. A key parameter is that there should be no freehold transfer. Consent is required from the Secretary of State to lease properties to any LDV. Full Council will need to resolve to make an application to the Secretary of State for consent to lease the properties to any LDV. The lease should be for up to 125 years in order that it is of sufficient length to be able to raise private finance. The modelling allows for a break clause at year 30. The council will retain the freehold, will be a party to the lease of the property to the LDV and retain 100% nomination rights for use of properties as accommodation for households with particular needs, homeless households and others to whom the council owes a housing duty.

3.4.2 The maximum number of 499 units for leasing to an LDV over a five year period would represent only 4% of HRA stock and a small proportion of turnover of affordable social rented housing in the city. By way of illustration, 782 council homes were let in the last financial year (excluding Temporary Accommodation). In addition, the city's supply of affordable rented housing is projected to increase by over 500 new properties over the coming four years (subject to planning consent), plus other social housing development in the pipeline for that period. The development programme has delivered an average of 250 new homes per year in recent years. Thus there would be no net loss of social rented housing in the city.

3.4.3 As well as providing funding for the HRA, the model includes provision for the LDV to refurbish the leased properties. The refurbished leased stock would be used to provide a stable supply of good quality accommodation to homeless households and other clients for whom the council has a duty to provide housing, from the Children and Young People's Trust, Learning Disabilities and Adult Social Care.

3.4.4. In addition to its 100% nomination rights to the leased properties, there would be an option for the council to be the landlord for a proportion of these tenancies, under a leaseback scheme. Leaseback may be used under certain circumstances, usually in relation to provision of accommodation for homeless households. Leaseback can be beneficial in terms of rental stream over the leaseback period, up to 10 years, which can in turn be beneficial in discussion with banks. Lease back numbers are limited by our overall targets to reduce the numbers of homeless households in temporary accommodation under National Indicator 156. The government is also due to review how the housing benefit subsidy regime for homeless households operates.

3.4.5 Based on current advice, leaseback is only an option if the private finance route is followed, not if the council borrowing is used (see paragraphs 3.5.1 to 3.5.3 below). Secretary of State consent is required for any leaseback of properties. It is proposed that, if required, this consent is sought at the same time as consent to lease the properties to the LDV.

3.4.7 **Properties to be included**

As part of asset management planning an initial tranche of 106 HRA properties currently used for temporary accommodation have been identified as suitable for leasing to the LDV. The Temporary Accommodation units are scattered street properties owned by the HRA, many having shared facilities and high maintenance and repair requirements. They are currently occupied by non-secure tenants, whose tenancy lasts around six months on average, and have a very high turnover.

3.4.8 If Cabinet approve the setting up of the LDV, it is proposed that Full Council approve an application to the Secretary of State for consent under s32 Housing Act 1985 to lease these 106 properties to the LDV. Suitable alternative accommodation will be secured for the current residents. Other HRA properties which may be identified as suitable for leasing to the LDV would include properties currently empty due to the need for funding for major repairs.

3.4.9 The council has assessed the value and performance of the stock using the Net Present Value (NPV) method to identify poorly performing stock that requires more investment than can be found within the constraints of the HRA. The methodology involves identifying the 30 year estimated cash flows for all items of income (principally rents) and for the items of expenditure, including:

- Management costs
- Investment costs (to maintain the quality and health and safety of the stock)
- Responsive repairs costs
- Cyclical internal and external decoration costs
- Conversion costs
- Contingency costs covering related assets (e.g. drains, car parks)

The Net Present Value of these cash flows is calculated to give a single figure which represents the value of those future cash flows at today's prices.

3.4.10 For the leasing of future empty properties to the LDV, up to the limit of 499 over 5 years, it is proposed that the following criteria are used as parameters for what could be leased:

- That the property is not tenanted
- That the property has a negative Net Present Value to the HRA and requirement for investment
- That the property is not an adapted dwelling.

It is proposed that consent of the Secretary of State be sought on the basis of these criteria at this time rather than going back for approval to lease in the future on a property by property basis.

3.4.11 **Rent levels**

The modelling is based on prudent housing benefit levels. Should any tenants subsequently enter employment, our current allocations policy gives priority to enable them to move to a usual social housing rented tenancy.

3.5 COMMERCIAL AND FINANCIAL ISSUES

3.5.1 A decision on whether the LDV should fund the payment of leases and refurbishment works from private sector funding or prudential borrowing will be sought from Cabinet once all due diligence work is completed and Cabinet is able to weigh up which is the better option in the light of the availability of funding at the appropriate time. The options are outlined below and in section 5.5 of this report.

3.5.2 **Private sector funding**

PwC have conducted a soft market testing exercise which indicated interest in the project from potential private funders.

3.5.3 **Council borrowing**

The modelling undertaken by the consultants also includes council borrowing. However, the council borrowing option will require Secretary of State approval, would prevent any leaseback arrangements and if this funding is the main source of funding to the LDV it could mean that the LDV is likely to be a ‘contracting authority’ for the purposes of European Union (EU) procurement rules.

3.5.4 **Procurement issues**

The preferred arrangement is for the LDV to procure housing management and maintenance contracts from the council rather than carry out these functions itself and to use the council’s contractors for refurbishment works. If the LDV is a ‘contracting authority’ for the purposes of EU procurement rules it would need to procure the housing management in accordance with the EU procurement rules and could not, for example, simply award any such contract to the council (or a council contractor unless the contract had been EU procured by the council on behalf of the

LDV and the council). However, the council is procuring the long term comprehensive partnering agreements for repairs and improvements to the HRA stock in a way which would enable the LDV to also make use of them, which would shorten the LDV's timescales in procuring contracts, limit its tendering costs and ensure continuity as well as potentially reducing its refurbishment and maintenance costs. The leasing of properties to the LDV is not subject to advertisement under EU procurement rules as it would not be primarily a works or services contract. The council will need to carefully consider the extent to which obligations are imposed on the LDV in any land transfer so as to ensure that the disposals on long leases to the LDV fall within the EU land exemption.

3.5.5 **Tax issues**

Consultants have made recommendations in relation to taxation benefits of charitable status in terms of corporation tax and Stamp Duty Land Tax, as highlighted in paragraph 3.3.1 above. The reasons for consultants' recommendation to set up a VAT shelter are set out in paragraph 5.8 below.

3.6 BUSINESS MODEL

3.6.1 Cabinet is recommended to approve the setting up of the proposed LDV on the basis of the business model produced by PwC and endorsed by Trowers & Hamlins which shows a viable 30 year business plan for the LDV and payments to the HRA to invest in improvements to secure tenants' homes. The business model identifies out-turn lease payments, which vary depending upon the borrowing route taken and the cost and income assumptions used in the model. Recommendations include a resolution for lease payments of up to £45m over five years generated from the leasing of HRA assets to be used for affordable housing and in particular improvements to the council's retained HRA stock. This clarity is necessary to ensure that the payment received is fully usable by the council.

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3.6.2 If any decision by a government department or other body is made which makes the business model no longer financially viable prior to leasing of properties, Cabinet would be informed so the proposal could be reconsidered and, if necessary, aborted.

4. CONSULTATION

4.1 As the properties to be leased to the LDV will be vacant, we are advised that the council is not under a statutory duty to consult with secure council tenants about the proposed lease arrangements. However, the Leader and Cabinet Member for Housing have stated their commitment to openness and transparency with tenants on proposals for the future of the housing stock, and widespread consultation with tenant representatives and all council tenants and leaseholders has been or will be undertaken before Cabinet decides whether to establish the LDV on 24 September.

4.2 The proposal to review Housing Green Paper options, which led to this proposal to set up an LDV, was agreed by the Housing Management Sub-Committee at its meeting on 11 March 2008 with the support of tenant representatives. A report on the outcome of Stage 1 of the review was then presented to the Housing Management Consultative Committee on 22 July, at which meeting the Committee recommended that the Housing Cabinet Member approved to proceed to the proposed development and finalisation phases of Stage 2 of this review. Tenant representatives' indicative vote at that meeting was unanimously in favour of the recommendations.

4.3 All tenants and leaseholders have been advised of the LDV proposals in a centre spread in the tenants' newsletter *Homing In*, published on 8 September 2008. *Homing In* invited tenants and leaseholders to a special consultation meeting for tenants and Area Housing Management Panels on 19 September 2008 at the Friends Meeting House, Brighton, to which Area Panel members were also personally invited. In addition, the *Homing In* article gives telephone and email contact details for any tenant or leaseholder to raise any further questions.

4.4 The LDV proposal will be reported to Housing Management Consultative Committee on 23 September for consultation. This meeting is also publicised to all tenants and leaseholders in *Homing In.* Tenant representatives of the Housing Management Consultative Committee and their deputies have been invited to a presentation on 17 September and separate Members' briefing meetings have also been arranged for 16 and 18 September, giving an additional opportunity to raise questions before the proposal is considered by the Committee. The outcome of consultation meetings will be reported to the Cabinet meeting on 24 September.

4.5 If Cabinet approves the setting up of the LDV, then this report seeking approval to apply for the Secretary of State's consent to lease the properties will go to Full Council on 9th October.

5. FINANCIAL IMPLICATIONS

5.1 Summary of financial implications

This project represents a long term financial commitment for the council with a wide range of complex risks but with a potentially significant financial benefit in the form of sizeable lease payments to the HRA to help deliver improvements to the housing stock. The financial model is based upon the council granting 125 year leases to the LDV over a period of 5 years in return for lease payments that will be used as investment phased over the same period. The LDV will need to borrow money both to pay the lease payments to the council and refurbish the leased property units. It will receive rent from the units to meet the borrowing costs and annual maintenance and management costs. The latest model projects that the LDV will be able to repay debt in full within approximately 30 years. There are a number of options about how to use any surpluses created within the LDV. As with any project of this nature further research and due diligence will be carried out over the coming months to enable Cabinet to make the final decisions on the funding route before the LDV is set up.

5.2 The size of the potential lease payments to the HRA for investment

The level of the HRA receipt is dependent on multiple factors and is subject to significant fluctuation depending on the assumptions made. The key factors are shown below and are discussed in more detail in the following paragraphs.

- Rent assumptions and the future arrangements for the payment of housing benefit
- Cost assumptions
- Funding route selected
- The level of interest rates at the time of financial close
- Inflation rate assumptions
- Charitable status and VAT shelter
- Ensuring the receipt is not pooled

On the basis of the assumptions set out in the following paragraphs the receipt would be £43m under a privately funded LDV and £37m using council funding. The impact on the estimated level of the above receipts of changes to each assumption is also shown below.

5.3 Rent assumptions

The amount of rent received by the LDV is dependent upon the housing benefit payable and any additional payment made directly from the Community Care and other General Fund budgets for the management of units. The level of rent is a critical factor in determining the level of the receipt as a 10% variation in the rent varies the receipt by £11m for the privately funded LDV and £9m using council funding. The assumptions used in the model are based upon the existing arrangements for the payment of housing benefit which are under Government review and may change significantly over the life of the project.

5.3.1 The level of housing benefit depends on whether leaseback arrangements can be put in place and it is considered that these can only be put in place if the private funding route is selected. However as the government are reviewing housing benefit arrangements there is a risk that the higher payments may not exist beyond the medium term. The difference in housing benefit is significant for example £208 per week for a 1 bedroom flat with leaseback compared to £150 per week without.

5.3.2 The model assumes that an additional management fee of £50 per week, based on the latest estimates provided by Housing officers to reflect the more intensive management required by these client groups, can be paid to the LDV for the management of General Fund units. This assumes that the LDV will buy back the management from the council. There is a risk that this will not be the case under the council funding route as the LDV could be subject to EU procurement rules. The payments could be maintained without buy back if consequential absorption of costs could be achieved.

5.3.3 The amount of rent receivable will also depend on the mix of property units transferred in terms of type and size, as well as the timing of the transfer and the length of time taken to refurbish the units.

5.3.4 The final assumptions relate to the estimated level of voids and bad debts which impact upon the overall level of rent collected and have been assumed to be 6% and 3% respectively. Each 1% change in the overall provision of 9% results in a £1m variation in the receipt.

5.4 Cost Assumptions

The cost assumption of £27,000 is the estimated amount on average needed by the LDV to refurbish each unit. This is based upon the 2006 Savills report. Over the next few months further survey work will be carried out to more accurately assess the refurbishment costs associated with each property particularly as these can vary significantly from one unit to another. The survey work will also identify whether the assumed average six month refurbishment period is reasonable and achievable. A variation of 10% in this assumption changes the receipt by £2m.

5.4.1 The LDV will also have to meet annual repairs, maintenance and renewals costs currently assumed to be on average £2,383 for each unit. A variation of 10% in this assumption changes the receipt by £2.5m.

5.4.2 The LDV will be responsible for meeting the management costs which are currently assumed to be £1,373 for each unit. A 10% variation in this assumption changes the receipt by £1.5m.

5.4.3 The due diligence process, whether undertaken by the banks or the council, will require much more detailed work to be undertaken into the veracity of all the figures assumed above.

5.5 **Funding options**

5.5.1 Detailed analysis has been carried out to establish whether private funding or council funding through the prudential borrowing regime provides the optimum receipt. The key question is how the impact of the higher costs of borrowing from the banks compares to the higher housing benefit subsidy that could be achieved through the leaseback of properties described earlier. The current financial models show that the higher subsidy more than offsets the higher borrowing costs, which means that the private funding route remains a viable option and therefore it is recommended that this funding route should continue to be pursued. However, this does not rule out the possibility of council borrowing if in the final analysis this provides greater overall benefits to the council.

5.5.2 There are other advantages and disadvantages associated with the alternative funding options that will need further detailed assessment, including:

- EU procurement rules referred to earlier in the report .

- The level of council guarantees required by the banks, likely to be in relation to levels of rent and occupancy for the first 10 years.

- Private funders' view regarding the VAT shelter and charity status.

- The minimum cover ratio required by private funders i.e. the minimum level of income net of costs compared to the cost of servicing the debt in each year. For modelling purposes it has been assumed that net income will exceed debt costs by a minimum of 5% each year after the refurbishment phase is completed.

- The level of debt arrangement fees required by the private funders and an estimate has been included in the financial model.

- Council borrowing option will require Secretary of State approval.

- The debt repayment profile required by the council to meet the requirements of the capital finance regulations.

5.5.3 A key risk is trying to secure private funding in the current market conditions where banks are reluctant to take risks and have less access to funds. However, PwC have carried out some soft market testing and have identified some banks potentially willing to participate although the cost of borrowing will be higher and this has been built into the private funding model. The consultants have advised on the timetable of tasks needed to be carried out to put a private sector funding option in place but a final decision on the most appropriate funding route for the council to take will not be needed until the due diligence process is completed. Cabinet needs to be aware that this timetable is extremely tight and that there could be delays in reaching financial close outside of the council's control, although this will not affect the principle of enabling the company to be set up on 1 April.

Another key consideration in reaching a final decision on the funding option will be the level of risk transfer to the council. Given that the banks are likely to require a number of important guarantees from the council before they will loan money to the LDV then the differences in risk transfer may not be significantly different but this will need to be kept under close scrutiny. The ultimate risk is that the LDV is unable to repay any of the loan back to the council, which may occur as a result of fraud, negligence, change in law or a massive housing market failure in the City. The right controls will need to be put in place through the lease and loan agreements to provide protection against fraud and negligence. Under council funding the maximum level of debt owed to the council is currently estimated to be £58m in year 6 of the project or £116,000 per unit.

5.5.4 Council borrowing could have a direct impact on the HRA by changing the council's entitlement to housing subsidy. This is because housing subsidy is based on the average of all the debt held by the council. If the new debt is borrowed at a lower rate than the current average rate then subsidy will be reduced and vice versa. Based the interest rate assumptions used in the financial model the difference between the rates is small and therefore the impact on housing subsidy is not significant, but this will need to be kept closely under review.

5.5.5 After assumptions have been tested, should there be a case for council borrowing a further report will go to Cabinet.

5.6 **Interest rate assumptions**

As stated above the council is able to borrow at lower interest rates than the banks who will also add on a margin to reflect both market conditions and the risks they are taking. The model is very sensitive to the interest assumptions used and it is impossible to predict with a high level of confidence what the money markets will be like in the early part of next year. The financial models reflect higher borrowing costs than are currently available in the money markets and show that a 0.5% variation in the interest rate assumption produces a £5m variation in the receipt.

5.7 **Inflation rate assumptions**

Most of the costs within the financial model have been inflated by 2.5% per annum over the life of the project. Whilst higher level of inflation will increase costs and reduce the receipt, the impact on the LDV will be offset by income for higher rent increases which are also governed by the rate of inflation. The costs of refurbishment have been inflated by 6% per annum reflecting higher recent increases in building costs although these increases may be offset in the next few years by contractions in the housing construction market.

5.8 Charitable status and the VAT shelter

The achievement of charitable status and the VAT shelter is key to optimising the lease payments that will be used as investment. Charitable status can deliver exemption from Stamp Duty Land Tax (SDLT) and Corporation Tax. SDLT at 4% would be payable on the lease payments so could be up to £1.7m. Once the LDV has repaid debt it has the potential to generate significant surpluses which at the current time would be subject to Corporation Tax.

5.8.1 The VAT shelter could provide two benefits which in total amount to an estimated £8m on the receipt. The first benefit is relief from VAT at 17.5% on the refurbishment works. The second benefit if the council actually carries out the refurbishment, including conversion works which will reduce the number of units, is that the LDV can have up to 499 units post refurbishment instead of 468 units generating additional net income for the LDV. Otherwise, if 499 units are leased to the LDV and they carry out the works and reduce the unit numbers by conversion of shared facility bedsits within the initial tranche of properties, no further units can be leased.

5.8.2The achievement of charitable status and the VAT shelter are by no means certain particularly within the timescales required. Delays in achieving them could significantly reduce the benefits if the LDV is up and running before this time. The model assumes that the VAT shelter will be in place from the start and charity status will be achieved during the first year. The impact of any delay could be mitigated by reflecting this in the level of activity undertaken by the company during this period of time.

5.9 **Ensuring the receipt is fully usable by the council**

The council would normally receive 25% of the HRA receipt and the remaining 75% would be payable to the Government pool. The council can keep 100% of the receipt if a resolution is passed by Cabinet to spend the receipt on affordable housing improvements prior to receiving the money, hence the recommendation shown at 2.6.

5.10 **Viability of the LDV and use of surpluses**

In order to minimise the risks to the council and obtain the most competitive private funding it is essential that all the assumptions underpining the operation of the LDV are vigorously tested and refined. One way to potentially maximise the lease payments that will be used as investment whilst protecting the financial position of the LDV would be to take a proportion of the anticipated receipt, say 80% in the early years, and recalculate the balance once the ongoing financial position of the LDV is known.

5.10.1 The LDV has the potential to generate significant cash-flow surpluses once the initial debt has been repaid but as a charity it would be difficult to use these funds for council purposes directly. The consultants have set out some options on how these surpluses could be used for the benefit of the council, as follows:

- properties could be handed back to the HRA (however, if the LDV is a charity then the properties could not be simply gifted back to the council)

- the LDV could reduce the rents it charges on the properties

- use the money to buy additional properties, with the council being granted nominations rights on these properties

- leave the properties with the LDV as it will be bound by its charitable objects.

5.11 **Accounting issues**

The accounting entries in the financial accounts of the council will depend upon the final structure of the LDV and the funding option chosen, but in any event are likely to be extremely complex. It is therefore essential that sufficient time is allowed to fully resolve the accounting treatment as a material error in the accounts will seriously impact on the use of resources score and the overall corporate assessment of the council. The LDV should therefore not be formally set up before the 1 April 2009 as an earlier set up date would require entries to be made in the 2008/09 accounts. The views of the Audit Commission will be sought by officers.

5.12 **Costs of implementation and funding**

Budget Council in February 2008 agreed funding of £0.5m from Right to Buy receipts to explore LDV options. However, the slowdown in housing sales means that these receipts are now unlikely to be generated in the current year. The consultants have advised that the set up costs can be charged to the LDV and provision of £0.5m has now been made in the financial models to meet these costs. In the unlikely event that the LDV does not proceed then any costs incurred can be met from capital reserves earmarked for the capital programme in future years. The capital reserves can then be replaced by future Right to Buy receipts.

Finance Officer Consulted - Mark Ireland *Date: 12/9/08*

6. Other Implications

6.1 Legal Implications:

The main legal implications are set out in the body of this report. In terms of the council's power to establish and participate in the LDV, the council's power includes those contained in section 2 of the Local Government Act 2000 and the use of the wellbeing power in this context will assist in, amongst other things, meeting the Corporate Plan objectives as set out in paragraph 3.2.9 of this report.

The council's interest will be protected through the terms of the lease which will have detailed provisions, including provisions governing the use of the properties, the payment of rent, restriction on assignment, responsibility for repair and maintenance, provisions for protecting the council in the event of insolvency, a break clause and power to terminate the lease for breach. In addition, the council will be able to use its position as a company member and board member to influence decisions.

Given the complex nature of some of the issues, the proposals in the report were developed with the benefit of advice and guidance of external expert legal advice. Subject to approval, the council's in house lawyers will continue to work with Trowers & Hamlins in progressing the next stages to ensure that all legal requirements are complied with.

Lawyer Consulted: Abraham Ghebre-Ghiorghis *Date: 12/9/08*

6.2 Equalities Implications:

The LDV would provide settled accommodation for households with particular needs including physical and learning disability. Eventual actions in regard to the LDV will be taken with regard to equalities issues. An equality impact assessment will be undertaken.

6.3 Sustainability Implications:

The proposal to set up an LDV, enabling access to funding to refurbish properties and meet strategic housing needs, would contribute to achieving the following council priorities to address sustainability as an integral part of all service delivery and contribute to the UK's Sustainable Development Strategy:

(1) *Sustainable Consumption and Production* - considering the impact of products and materials across a whole life cycle;

(2) *Climate Change and Energy* - greater fuel efficiency and reduction in CO_2 emissions;

(3) *Sustainable Communities* - using engagement and partnership to reduce poverty and environmental degradation.

6.4 Crime & Disorder Implications:

There are no implications for crime and disorder.

6.5 Risk & Opportunity Management Implications:

The council will set up and maintain a risk register highlighting risks and how they might be allayed for all aspects of the project. Key risks and risk mitigation are outlined below. In setting out the risks below it should be noted there are risks in not taking forward this project, which include:

- ability to meet the Decent Homes Standard within an acceptable time frame
- future cost of lack of investment in the council stock
- failure to secure a stable supply of housing for those to whom the council has a housing duty.

Risks during the procurement phase

Funder restriction on properties	The funder may want to restrict the type of properties they receive. This may be for a variety of reasons including location, state of repair or archetype. The council should ensure it is aware of these aspects of the properties and provide as much information to the private sector as possible. The funder may also be required to carry out their own due diligence.
EU procurement law	Risk that council's intentions are not consistent with current legislation.
Stakeholder support	There is a need to involve key stakeholders to ensure the project has buy-in from decision makers and those that can influence the success of the project.
Forecast rents levels	Decisions by DWP prior to issuing commercial documents may result in a reassessment of the value for money of the project. This risk should be covered by running downside sensitivities on rents as well as assessing alternative rents markets.

Refurbishment phase (post financial close)

Interest rate	This risk can be managed through the purchase of fixed interest rate swaps.
Delivery of properties	The council may be contracted to transfer a certain number of properties per annum on an agreed drip-feed basis. The council must ensure it has adequate safeguards in place to ensure it is able to meet its obligations as they may be subject to liquidated damages or even put the success of the project at risk if the conditions are not met.
Cost of refurbishment	This risk should be passed to the operator as the council will not be in a position to control this risk.
Timing of refurbishment	This will be dependent on the specific circumstances of each property. The private sector might be asked to respond on the basis of an average time for refurbishment. It would then be their risk as to whether the refurbishment times are accurate. This is a substantial risk as clearly rental income is lost during the refurbishment process. Alternatively, the council may be carrying out these works (from a VAT efficiency perspective) in which case this risk will sit with the council.

Operations phase

Rents income level	If inflation is a risk for the LDV then inflation swaps can be purchased to help manage the risk.
Housing management costs	The risks associated with this include inflation, intensity of work required and pass-down of deductions for failure to meet the output specification.
Output specification not met	As discussed in housing management costs above, the LDV may look to pass down the risk of non-performance.

Population change	The intended tenant group may change over time. Previous experience of BHCC (on a previous scheme) has shown this not to be the case, however, the nominations rights should allow a wide variety of groups to whom the council owes a housing duty to be accommodated.
Change to required standards	If the council requires a change to the delivery specification, this is likely to be seen as a council change which would require the LDV to be put in a no-better, no-worse position.
Sub contractor default	The LDV or its subcontractors may default for a variety of reasons. However, the housing market is a relatively liquid one which will allow replacement of subcontractors. This may, however, come at some cost to the council.

6.6 **Corporate / Citywide Implications:**

The proposal to set up an LDV giving access to funding to refurbish up to 499 properties in need of investment would support the following council corporate priorities:

(1) protect the environment whilst growing the economy;

(2) make better use of public money;

(3) reduce inequality by improving opportunities.

6.7 The contribution of this proposal to the objectives of the Local Area Agreement is outlined in paragraph 3.2.11 above.

6.8 Securing additional funding to meet Decent Homes Standard and carry out improvements to the council’s stock in consultation with tenants and leaseholders is a key element to achieve a viable 30 year HRA business plan.

7. EVALUATION OF ANY ALTERNATIVE OPTION(S):

7.1 Stage 1 of the review of Housing Green Paper options analysed and evaluated alternative options for achieving the council's corporate priorities and strategic housing objectives within the parameters – set in the light of tenants' 77% vote against large scale voluntary stock transfer in February 2007 - that there should be no freehold transfer, no RSL involvement or transfer of tenanted stock.

7.2 The development and finalisation phase of the proposals has further refined the options available, as set out in this report.

8. REASONS FOR REPORT RECOMMENDATIONS

The reasons for the specific recommendations are set out in detail in the body of the report.

SUPPORTING DOCUMENTATION

Appendices:

1. Schedule of initial HRA properties for leasing to the LDV, subject to approval of Cabinet and Full Council and Secretary of State consent (exempt under paragraphs 1, 2 and 3 of schedule 12A to the Local Government Act 1972 (as amended))

Background Documents

1. Housing Green Paper report to Housing Management Sub-Committee (11 March 2008), Housing Committee (27 March 2008) and Policy & Resources Committee (3 April 2008)

2. Housing Green Paper Options Review report to Housing Management Consultative Committee (22 July 2008) and Housing Green Paper Options Stage 1 Report to Cabinet Member for Housing meeting 22 July 2008.