

REPORT TITLE: ESTABLISHING LOCAL HOUSING COMPANIES TO SUPPORT
NEW HOMES DEVELOPMENT

CABINET (HOUSING) COMMITTEE - 22 NOVEMBER 2017

CABINET – 6 DECEMBER 2017

REPORT OF PORTFOLIO HOLDER: LEADER WITH PORTFOLIO FOR HOUSING
SERVICES

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WARD(S): ALL

PURPOSE

This report proposes the establishment of a wholly owned local housing company to support the Council's affordable housing development programme.

An investment of £10m in the form of loan funding to the company can support the delivery of 50 units for sub market rent on an assured shorthold basis, but providing a more secure housing offer than the private rented sector currently offer residents in housing need.

The report recommends that, to support the establishment of the company, £10m be included in the Capital Strategy to be considered by Council in February 2018, and that draft governance agreements be prepared for final approval.

RECOMMENDATIONS:

That Cabinet (Housing) Committee support the following recommendations to Cabinet:

1. That the proposal to establish a wholly Council owned non-charitable Company limited by shares to deliver and manage sub market rented housing be approved.
2. That a £10m loan facility to support the company's development activity be included within the Capital Strategy for 2018/19.

3. That a further report be brought to this Committee, setting out the detailed business plan and draft governance agreements for the company.

IMPLICATIONS:

1 COUNCIL STRATEGY OUTCOME

- 1.1 Providing new homes is a strategic priority for the Council and doubling the existing programme by 2020 is a key outcome the Council Strategy is seeking to achieve. Whilst the Council is able to deliver new homes for rent through its Housing Revenue Account, debt cap rules mean that scope for this is limited. The Council also recognises the need for a range of affordable housing products to meet housing need and alternative vehicles will be required to support this.
- 1.2 Establishing a housing company to deliver housing tenures not permitted through Housing Revenue Account rules is also a key priority of the Strategy.

2 FINANCIAL IMPLICATIONS

- 2.1 Any investment through housing companies will rely on prudential borrowing and this report recommends provision of £10m be included within the Capital Strategy for 2018/19 to support development through the Housing Company once it is established.
- 2.2 Alongside the recent recommendation to increase the Strategic Asset Purchase fund by £15m, any additional General Fund investment in housing development will hasten the need for external borrowing (alongside the wider capital programme) for the Council.
- 2.3 Initial modelling based on existing Council developments indicates that a company delivering sub market rented units can be financial viable, although General Fund returns are only projected at 3.4%. Detailed modelling is included at Exempt Appendix A.
- 2.4 All scenarios tested as set out in Exempt Appendix A have negative “net present values” (NPV). However, both the single company and “dual company” scenarios are financially viable and have positive “internal rates of return” (IRR) which are significantly higher than the rates that the Council could achieve from the investment of its cash reserves. The Council will need to determine to what degree it is prepared to borrow to fund development in order for a detailed business case to be prepared.
- 2.5 CAB2911(HSG) approved £100,000 to support the work required to establish a housing company including commissioning the necessary legal and financial advice and additional staff resource. This remains sufficient to support the project.

1 LEGAL AND PROCUREMENT IMPLICATIONS

- 1.1 The proposal to develop housing for “sub-market private rent” and let on assured shorthold tenancies reflects the strategic need for additional housing options for residents threatened with homelessness is one that cannot be

delivered through the Housing Revenue Account and a company structure is therefore required to support such an approach.

- 1.2 The Council's power to set up and use a company or similar structure to support affordable housing delivery depends on whether it is reasonable to use section 1 of the Localism Act 2011 and not section 9 of the Housing Act 1985
- 1.3 The Council has commissioned specific legal advice from Trowers and Hamlins LLP to provide initial legal advice to ensure any vehicle it establishes to support development is in accordance with the Council's legal powers and that any future operation is compliant with those powers. The advice is included with Exempt Appendix A.
- 1.4 Additional support will be required to prepare contractual and other documentation, such as articles, shareholder/Intra-Group agreement and loan facility agreements for on-lending.

2 WORKFORCE IMPLICATIONS

- 2.1 Additional resource to support the delivery of the project has yet to be appointed but will be required if the proposals in this report are approved.
- 2.2 Once established, it is proposed that marginal capacity of existing teams is utilised to support company activity, charged on a cost recovery contractual basis thus generating additional income for the Council. As development activity will be marginal to the Council's overall development programme, no additional resource requirements are projected at this stage.

3 PROPERTY AND ASSET IMPLICATIONS

- 3.1 None at this stage although the proposals set out in this report will support the overall development programme and also allow more flexibility for the management of Council properties with the option of leasing to the company if required.

4 CONSULTATION AND COMMUNICATION

- 4.1 Officers have liaised with other authorities who have established a range of vehicles relating to property development.

5 ENVIRONMENTAL CONSIDERATIONS

- 5.1 None

6 EQUALITY IMPACT ASSESSMENT

- 6.1 None

7 RISK MANAGEMENT

Risk	Mitigation	Opportunities
<i>Property</i> <i>High and increasing development costs in south east</i>	<i>Detailed financial modelling based on current building costs</i>	
<i>Community Support</i>		
<i>Timescales</i>		
<i>Project capacity</i> <i>Capacity to establish company in time to support specific development projects</i>	<i>External support commissioned to assist establishing company</i>	
<i>Financial / VfM</i> <i>Investment doesn't achieve projected return</i>	<i>Detailed financial modelling</i> <i>Careful selection of investment option</i> <i>Sensitivity analysis completed.</i>	
<i>Tax rules/HMRC requirements impacting on viability</i>	<i>Modelling demonstrates that asset values all exceed development costs</i> <i>Additional tax advice to be commissioned</i>	
<i>Future Govt restrictions on prudential borrowing (similar to HRA debt cap) to limit growing public sector debt</i>	<i>All developments to be viable individually and not reliant on profits from future developments</i>	
<i>Legal</i> <i>Council acting outside of relevant powers</i>	<i>External specialist Legal advice on company governance will be commissioned and included within the final report</i>	
<i>Innovation</i>		

<i>Reputation</i>		
<i>Other</i>		

8 SUPPORTING INFORMATION:

Background

- 8.1 CAB2911(HSG) set out an initial proposal to establish a dual structure with a development company for commercial activity, a subsidiary charitable arm to deliver some affordable housing and affordable rented units being purchased by the Council through the HRA. However, financial modelling has demonstrated that developing housing through such a model is significantly more expensive than the current approach of the HRA directly funding development on Council land (as a result of commercial borrowing costs, land transfer costs and tax implications).
- 8.2 The development of affordable housing is a key priority in the Council Strategy. The current New Build programme continues to deliver ahead of targets although plans are limited by the HRA debt cap rules. Also, the Council only has powers to let rented property on a secure tenancy or fixed term basis and has no power to deliver assured shorthold tenancies through its HRA. A company structure would be required to meet the Council Strategy priority to deliver sub market private rented units to support identifying appropriate housing options for families threatened with homelessness.
- 8.3 Whilst the Council Strategy identifies the need for a range of affordable housing tenures, addressing the demand for social/affordable rented housing remains the significant priority. As housing companies cannot deliver this option, it is clear that a housing company will not address the current funding challenges in isolation. Officers have met with Government representatives to discuss the potential for increasing the current debt cap. Also, the Government and the Homes and Communities Agency have indicated that grant levels are likely to increase in the future. In light of this, continuing to rely on the current approach of funding the majority of the Council's development programme through the HRA is recommended.
- 8.4 Accessing the Private Rented Market
- 8.5 With demand on Council housing so high and average waiting times running to several years, private rented housing is usually the only housing option available for many applicants. The City Council can discharge its duty to homeless applicants by identifying appropriate private rented housing. However, private rented housing in many parts of the district is very expensive and frequently nothing can be identified within the "local housing allowance". Deposits and letting fees only add to the high cost of this option.
- 8.6 The Council's "City Lets" initiative seeks to work with landlords by offering a lettings and management service and has achieved some success, with 30

properties either signed up or in the process of being signed up. However, increasing this number will be challenging, with so few landlords prepared to let properties at or near to local housing allowance levels.

- 8.7 In light of the challenges the Council faces in accessing this market, it is proposed that it develops its own units for this purpose. A Housing Company would be required to deliver sub market rented housing on an assured shorthold tenancy. However, as the Council would have full control, it could waive letting fees and deposits, agree longer than the standard 6 month shorthold tenancies and provide a more secure rented offer than the private sector. Whilst not as secure as housing delivered through the HRA, such an approach would support additional development and improve housing options overall.
- 8.8 Housing Company Proposal
- 8.9 To achieve the strategic aim of increasing the supply of sub-market rented accommodation in the district for the needs of local residents, it is proposed to establish a non charitable company limited by shares and wholly owned by the Council. Rather than the previous proposal of a dual structure, a single Company structure is considered to be more appropriate and straight forward reflecting the fact that this tenure will always be a marginal element of the Council's development programme.
- 8.10 An investment of £10m funded from General Fund reserves and/or prudential borrowing would support the development of approximately 50 units. The investment would be in the form of a loan to the Company on commercial terms, providing additional income for the Council.
- 8.11 A proportion of sites or part-sites included in the new build programme can be sold to the company, which would then directly fund development.
- 8.12 Such a company would be a contracting authority and would fall within the scope of EU procurement rules.
- 8.13 It would also be possible to lease existing Council properties to the company for short to medium term use as sub market rented housing. This would allow units where future use has yet to be determined to be used to support strategic aims.
- 8.14 As units are to be let on an assured shorthold basis, they would not be subject to the Right to Buy.
- 8.15 Initial modelling has indicated that developing up to 50 units to be let at 90% of open market rent can generate a positive IRR projected at 3.4%, even when accounting for land being sold to the company at full market value. The Council is able to dispose of HRA land at less than market value.

- 8.16 If Members support the recommendations included in this report, a detailed business case will be prepared and governance arrangements drafted for final approval.

9 OTHER OPTIONS CONSIDERED AND REJECTED

- 9.1 Officers have considered the option of establishing a Housing Company for pure investment purposes. However, a worked up viable business case has yet to be developed. It is clear that if the proposed approach set out in this report has a positive business case, a vehicle established for pure commercial purposes (such as properties let at full market rent for example) should also be positive. However, with a limited number of sites identified and with the need for sub market housing options being a clear strategic priority, focus has been on establishing a vehicle to support housing priorities.
- 9.2 If the Council was in a position to further increase loan funding, establishing a separate vehicle for investment purposes would be relatively straight forward, subject to appropriate development sites being identified.
- 9.3 CAB2911(HSG) considered a more complex option of dual company structures, one a company limited by guarantee and one in the form of a community benefit society. Whilst the business case as indicated in Exempt Appendix A for the dual structure is marginally more positive than the single company structure, set up, management and governance would be more complex and with little or no immediate benefits to the Council. Therefore, it is recommended that the Council initially establish a single company structure. This would not preclude the establishment of a subsidiary charitable company at a later date to exploit potential tax advantages.

BACKGROUND DOCUMENTS:-

Previous Committee Reports:-

CAB2911(HSG) dated 22 March 2017

Other Background Documents:-

None

APPENDICES:

- Exempt Appendix A – Local Housing Company Business Case Report October 2017
- Exempt Appendix B - The legal advice