Brighton & Hove City Council

CABINET
SUPPLEMENTARY AGENDA ITEM

4.00PM, THURSDAY, 14 JANUARY 2010

COUNCIL CHAMBER, HOVE TOWN HALL

SUPPLEMENTARY AGENDA ITEM

The following agenda item although provided for on the agenda front sheet was not available at the time of despatch. The Leader of the Council has agreed to accept this report as a matter of urgency for the reasons set out in the report.

CABINET MEETING	Agenda Item 156 Brighton & Hove City Council

Subject:		**Brighton & Hove Seaside Community Homes Ltd – Funding Options and Consents**		
Date of Meeting:		**14 January 2010**		
Report of:		**Director of Adult Social Care & Housing and Director of Finance & Resources**		
Contact Officer:	**Name:**	**Mark Ireland**	**Tel:**	**29-1240**
	E-mail:	**mark.ireland@brighton-hove.gov.uk**		
Key Decision:	**Yes**	**Forward Plan No: CAB14017**		
Wards Affected:	**All**			

FOR GENERAL RELEASE

Note: The special circumstances for non-compliance with Council Procedure Rule 7, Access to Information Rule 5 and Section 100B (4) of the Local Government Act as amended (items not considered unless the agenda is open to inspection at least five days in advance of the meeting) were that some of the key information following the meeting with officials from Communities and Local Government was not available in time and a decision from the Cabinet cannot be delayed.

1. SUMMARY AND POLICY CONTEXT:

1.1 At the meeting in September 2008 Cabinet agreed to set up a housing company (LDV) to deliver key strategic housing and corporate priorities and to generate funding for investment in the Housing Revenue Account (HRA) to improve council homes and assist the council in meeting the Decent Homes Standard.

1.2 Following a further report to Cabinet on 17 September 2009, Cabinet agreed that consultation should take place with the Housing Management Consultative Committee and Brighton & Hove Seaside Community Homes (the LDV) on the use of general consents to lease properties to the LDV.

1.3 The purpose of this report is to advise Cabinet of:

- The latest discussions with the Department of Communities and Local Government (CLG) over consents.
- The reasons for requesting Cabinet approval to proceed with the general consents route while keeping open the option of trying again to obtain express consent at a later date.
- A methodology on how “best consideration” could be achieved for the council from the lease of the properties.
- The latest assumptions in the financial model and the issues which will determine the level of the capital receipt to be generated based on the general consents route.
- The projected costs of reaching financial close and completing the project.

2. RECOMMENDATIONS:

That Cabinet:

2.1 Notes the outcome of the recent discussions with officials at CLG and for the reasons set out in paragraph 3.12 approves the adoption of the general consents route as the basis for securing the benefits from the LDV.

2.2 Notes the method for determining best consideration for the property leases.

2.3 Notes the latest capital receipt projections and the reasons for the reduction since the September 2008 report as set out in paragraphs 3.18 to 3.21 and appendix 3.

2.4 Approves the risk sharing matrix as set out in appendix 5 as the basis for a financial offer to the LDV.

2.5 Approves additional resources of up to £0.2m temporarily funded from General Fund reserves as detailed in paragraph 3.25 needed to further develop and finalise the general consents route and to allocate an appropriate budget to the LDV Board to undertake relevant work to deliver the project including negotiating with funders.

2.6 Notes that Cabinet and Full Council have already agreed that the Director of Adult Social Care & Housing be authorised, after consultation with the Cabinet Member for Housing, to take all steps necessary or incidental to the formation of the LDV and implementation of the proposals generally save as to decision on funding options.

2.7 Authorises the Director of Adult Social Care & Housing to take all steps necessary or incidental to implement the proposals in this report.

3. RELEVANT BACKGROUND INFORMATION/CHRONOLOGY OF KEY EVENTS:

Overview

3.1 Cabinet are reminded that the purpose of the creation of a housing Local Delivery Vehicle (LDV) was to obtain best value for money from Housing Revenue Account (HRA) assets requiring investment 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 the 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.

3.2 There are two overriding issues which affect the achievement of those purposes. The first is about consents i.e. whether the Secretary of State will give the appropriate express consents or can the council successfully use the general consents route. The issue of consents is explored in more detail in the following section. The consents route affects the assumptions that underpin the financial model and therefore the level of the capital receipt.

3.3 The second issue is about best consideration. The council's power to lease the properties on a long lease is in s.32 of the Housing Act 1985. They can only be disposed of with the consent of the Secretary of State given under that section. The Secretary of State has granted a number of general consents under s.32, but they all require best consideration to be obtained. The Secretary of State will only give express consent to dispose under this section if best consideration is being obtained by a council. Councils can dispose of properties at less than best consideration with appropriate consents from the Secretary of State. However the council has always intended to achieve best consideration for this transaction and the view of officers is that it would be extremely unlikely to obtain consent for disposal at an undervalue in any event.

3.4 A methodology for achieving best consideration has been developed independently of the council by property and valuing experts Savills and this is explored in more detail in the best consideration section of this report. In reality best consideration will only be determined when each batch of properties is actually leased, so each batch must be both financially viable for the LDV and deliver best consideration for the council. There also needs to be an element of flexibility within the figures because the value of the properties will be affected by future local housing market conditions that are extremely difficult to predict.

3.5 The method of funding for the LDV – either private borrowing through a financial institution or council borrowing – is dependent on the consents option. Council borrowing requires Secretary of State consent to enable the council to on-lend to the LDV which would be ruled out under the general consent route. This would also be the case if there is any financial assistance from the council to the company (such as guaranteeing the company’s loan from a private funder.) The funding route changes the assumptions that underpin the financial model and therefore the level of the capital receipt.

3.6 The LDV is now a registered charity with the Charity Commission and therefore as a charity no Stamp Duty Land Tax on leases or Corporation Tax on profits will be payable.

Consents

3.7 The issue of consents was addressed in detail in the report to Cabinet on 17 September 2009. The purpose of this section is to set out what has happened since. A reply from CLG to the comprehensive response dated 26 June 2009 by the Director of Adult Social Care & Housing was received on 18 September 2009. An urgent meeting was sought with the CLG to discuss the factual inaccuracies and continued areas of concern raised in their letter. This meeting took place on 29 October 2009.

3.8 Senior officers had a positive meeting with CLG when they met on 29 October to discuss the issue of consent to lease property to the LDV and to on-lend if it was decided that council borrowing provided the best option. CLG feedback at that meeting suggested they considered this was an achievable scheme and asked that a summary of the key elements of the scheme be provided together with a resubmission of the consent application to reflect changes to the lease length (see paragraph 3.16 and 3.17 below) and to newly apply for consent to on-lend. CLG promised that they would provide a response within 2 weeks of receiving the requested paperwork.

3.9 The paperwork was duly submitted on 20th November 2009 by the council but a response was not forthcoming from CLG officials within the promised 2 weeks and was finally received on 4th January 2010. A copy of the letter is attached as appendix 1. The response does not provide the expected assurance that a minded to grant consent recommendation would be made to the Secretary of State and indeed suggests that the council has reached a stalemate on this matter. In particular CLG challenges the principle of the capital receipt being driven by reliance on housing benefits . The council believes that it has addressed this issue and provided satisfactory responses and information already on all the issues raised including confirming the ongoing strategic housing need for this type of accommodation.

3.10 The Council can dispose of these properties under paragraph A5.4.1 of the s.32 General Consents issued by the Secretary of State provided they will be used as housing accommodation for occupation by persons who have a special need arising from specified causes as defined in the act. This provides an alternative consent route for the council although it places greater restrictions on the type of persons who can be housed. Housing Strategy have confirmed that most clients that present as homeless have a special need and would therefore meet the qualifying criteria.

3.11 HMCC considered a report to Cabinet regarding pursuance of the general consent route referred to as plan B. At their meeting on the 12th October HMCC were informed that the council was seeking an alternative route to the issue of leasing property to the LDV if it found that express consent from the Secretary of State was not forthcoming or was unreasonably delayed. As requested by Cabinet, HMCC discussed these matters and voted unanimously in favour of developing plan B.

3.12 Cabinet is therefore asked to approve the adoption of the general consent route on the grounds that:

- Discussions with CLG have been taking place over the last 18 months or so and have failed to make any concrete progress.
- CLG officials failed to deliver a response to the council’s last request within their promised deadline and have raised issues for which the council believes it has already provided clear explanations and justifications.
- Even if a positive response is received from the officials there are no guarantees about the timescale for a response from the Secretary of State who is relatively new in post and has not made a decision of this particular nature before.

3.13 The proposed adoption of the general consent route is subject to certain parameters:

- That the leasing of properties remains in line with the proposals reported to Cabinet and full Council in October 2008 but with a 30-50 year lease length rather than 125 years (see paragraph 3.16 and 3.17 below).
- That the HRA properties to be leased are the106 units previously agreed by Cabinet and Full Council in autumn 2008 with the balance up to 499 units being properties which are not tenanted, not adapted and have a negative Net Present Value (NPV) to the HRA i.e. the anticipated cost of new investment and ongoing maintenance cannot be recovered from projected future rental streams, as recalculated annually. A pool of about 2,000 potentially suitable HRA properties has been identified as currently meeting the criteria for leasing agreed by Cabinet and Full Council if and when they become vacant. The majority are bedsits, one bedroom and two bedroom properties, with 34 three bedroom and no four bedroom properties identified. This pool will vary annually when the NPV is recalculated. In addition, the council will consider leasing properties which are empty due to the need for funding for major repairs.
- That the capital receipt is used for affordable housing and in particular for the carrying out of improvements to council's retained HRA stock under the council's Decent Homes programme during the period from April 2009 to April 2016.

3.14 It should also be noted that the receipt generated under the general consent route will be less than the receipt generated under express consents for the reasons set out later in this report. Issues relating to continuing to pursue express consents are considered in the section of the report on alternative options.

Best consideration

3.15 Savills were selected to provide valuation advice and a copy of their report including their brief is attached as Appendix 2. The properties to be leased are only partly known at this stage as the bulk of properties will be leased from a pool of suitable HRA properties as and when they become available. The estimated value of these units depends on the type, state and location so Savills have valued a small sample of one and two bedroom properties to provide indicative information. In their valuation they have assumed satisfactory completion of all works needed to refurbish properties to the Brighton & Hove and Decent Homes Standard and provide appropriate equipment for client groups to be re- housed. Housing officers have estimated the average value of these works to be £27,000 per unit.

3.16 One group of properties produces an average value using the usual 99/125 year lease of £153,000. Another group of properties produces an average value of £100,000 on this basis. Savills have developed a methodology, based particularly on their extensive experience in London, to determine a market value for leases of less than 99/125 years. As the lease is shortened the value of the lease declines significantly. Achieving best consideration requires the capital receipt payable by the LDV to be in line with this market value of the lease. The table below sets out the capital receipts required to achieve best consideration dependent on the lease length and the average property value:

	Average valuation		
	£100,000	**£125,000**	**£150,000**
30 year lease	£11m	£18m	£24m
40 year lease	£14m	£21m	£28m
50 year lease	£16m	£24m	£31m

3.17 It is also important to note that best consideration will only be determined at the point when each group of properties is due to be leased and that each group in its own right needs to achieve best consideration for the council. Savills have provided a methodology which will guide these valuations but they also recommend that a wider robust sampling exercise is done to ensure more accurate lease lengths and property valuations are available for negotiations with a private funder. The original intention to have a 30 year break clause can be retained by the council but does not impact upon the valuation. Discussions with private funders have indicated that a 50/60 year lease would be ideal but a 40 year lease could be sufficient.

Latest estimates of the capital receipt

3.18 In the September 2008 report the receipt was forecast to be up to £43.0m under private funding and up to £36.9m using council borrowing based on the financial modelling and assumptions at that time. Since September there have been 3 major changes that have had an impact on the receipt and overall have led to current forecasts for the receipt being significantly lower than originally anticipated.

- The banking crisis has severely restricted the number of potential financial institutions willing and able to fund the LDV and this in turn together with increased financial prudence by the banks has meant that the cost of private finance has grown substantially. At the same time the cost of council borrowing has fallen slightly. This means that council borrowing now generates a significantly higher receipt than private borrowing.

- The housing benefits system has been under government review and will change from 1 April 2010. A consultation paper was issued in the summer and the recommendations set out in that paper now form the basis for the rent assumptions used in the latest financial model.

- Further detailed analysis has been undertaken of the cashflows of both the LDV and the council and some changes have been made to more accurately reflect the transfers of cash between them.

3.19 Appendix 3 contains details of all the key changes made to the assumptions since that time and the approximate impact each change has had upon the projected level of the receipt. The financial modelling needs to be regularly updated and the most recent assumptions used show an estimate of the capital receipt under express consent of about £17m to £22m for private finance and about £25m to £30m for council borrowing.

3.20 Detailed financial modelling has not yet been carried out for a general consents route and this will need to be done as a next step. However there are two key reasons why the receipt will be lower than using the express consent route. The first is that council borrowing would not be an option. The second is that leasebacks which generate higher rent levels for the smaller units, cannot be entered into under general consents as they would have been under the express consent (private finance route). This is based on recent legal advice obtained from Queens Counsel which concluded that was that it was at best doubtful whether a lease and leaseback scheme is permitted under General Consents. Moreover, there is no “safe harbour” provision to protect the LDV and its funders from the consequences of the council acting ultra vires.

3.21 The impact of the removal of the options to use council borrowing or undertake leaseback means that the receipt is estimated on a like for like basis to be in the range of £10-15m. The level of the receipt will not be known until the deal has been done and all options will be explored to maximise the level of the receipt. The receipt would be received in tranches as properties are leased with the initial tranche reduced by the one-off set up costs. The sensitivity analysis at Appendix 4 shows the impact of changes to key assumptions. Again this financial modelling was undertaken for the express consent route and needs to be updated for general consents, but it provides a reasonable indication. Further financial modelling needs to be undertaken of the impact of potential changes to the client mix and property mix but within the parameters set out earlier in the report. In addition consideration could be given to whether there are other opportunities for legitimately increasing the levels of income to the LDV. The shorter the lease length that can be agreed with the private funder and the lower the average property valuation, the more likely it is that best consideration can be achieved. There is a risk that, having explored all options to increase the receipt, best consideration cannot be attained.

3.22 Following Cabinet approval to set up the LDV officers have worked with specialist advisors to draft commercial terms that are likely to be acceptable to the council, potential private sector funders and the LDV Board. The crisis in the financial markets has meant that the choice of private sector funders is extremely limited however a credible offer has been worked up with a well known high street bank. The rates offered were in line with those that PricewaterhouseCoopers (PwC), the council’s financial advisors on this project were seeing on other local government projects including Building Schools for the Future and Housing PFI schemes. Discussions with this bank and the LDV Board have identified a risk sharing matrix which will be refined during the negotiation process. The matrix was developed for express consents and needs to be amended for general consents although the commercial principles remain unaltered. Details of the risk share highlighting the risks proposed to be taken by the council are shown in Appendix 5. The risk sharing proposals will form the basis of a financial offer to the LDV. Preliminary discussions with the private funder have indicated that they would still be interested in funding the LDV using the general consents route but it is not known at this stage whether this might alter the assumed bank margins and risk sharing.

Estimated cost of project

3.23 The provision of external specialist advice both to the council and the LDV was originally estimated to be £500,000 to be funded by the LDV once established or from the council's Right to Buy receipts if the LDV proved to be unviable. This assumed financial close by March 2009 and was based on the council receiving support for the project from CLG.

3.24 The receipts from Right to Buy receipts have been much lower than anticipated so an alternative funding source needs to be identified in case the LDV does not proceed. Analysis of the General Fund reserves position over the Medium Term Financial Strategy has shown the potential to earmark reserves for this purpose largely as a result of unexpected surpluses on the council tax collection fund and approval is sought from Cabinet to agree this alternative fallback funding source.

3.25 The amount committed to date on the project is about £375,000 but further expenditure will be incurred in order to complete the project. The work on developing the general consents route is outside the scope of the original project and is likely to lead to further resources needing to be identified of up to £200,000 in addition to the £500,000 budget already identified. The additional costs will cover valuations, legal and financial costs including costs incurred directly by the LDV for example to enable them to develop their business case and complete negotiations with a funder. The costs of developing the project have been affected by a number of issues.

- Firstly CLG has deferred giving a decision on the project and has instead requested further information and clarification on a number of issues. The report to Cabinet in September 2009 on general consents has required the advisors to work on two scenarios rather than one.
- Secondly the project timetable has been considerably delayed, both by the absence of a decision from CLG and the change in attitude towards investment risk by many of the banks which normally would have been interested in funding the project. This latter point has resulted in the advisors exploring more funding options in the financial markets.
- Thirdly the wider range of options, the delay and further due diligence on the financial inputs has required a number of re-runs of the financial model over and above that initially envisaged. This was to ensure the best receipt is obtained from the project whilst protecting the council from exposure to undue risk or challenge from the Audit Commission.

3.26 Stringent measures will continue to be taken to minimise the set up costs of the project and the reliance on the external advisors. However, in order to proceed to financial close Cabinet approval is sought to authorise spending up to an additional £200,000 in total funded temporarily from reserves. Much of the remaining work will be carried out by the LDV Board who will need a budget to carry out all the work they need to do to deliver the project. It is therefore proposed that an appropriate budget is allocated to the LDV Board to complete their work. Council officers will closely monitor the spending of the Board and provide appropriate regular budget monitoring reports for both the Board and the council.

4. CONSULTATION

4.1 Discussion with the Chair of the LDV Board on the risk share has taken place. Provisional agreement on risk share is set out in Appendix 5 but remains subject to confirmation by the funder.

4.2 HMCC have received various reports, were given a update presentation at their meeting in December and are due to receive a further update at a special meeting on 11 January.

4.3 The Audit Commission have been consulted on the accounting treatment for the LDV under both the bank funding and council funding option. The outcome of these discussions is set out in Financial Implications in Section 5 below.

5. FINANCIAL & OTHER IMPLICATIONS

Financial Implications:

5.1 Most of the financial implications are set out in the body of the report.

5.2 CLG has expressed concerns that the borrowing of the LDV would be classified as public sector debt and therefore count against macro-economic targets. The Director of Finance and Resources has reviewed the accounting treatment for the LDV and has determined that, under bank funding, the borrowing would not be included in the council's main account and therefore would not be treated as public sector debt.

5.3 The current proposal is for the LDV to procure housing management, housing maintenance, legal and financial services direct from the council. The LDV Board has insufficient resources to carry out these services itself. However the constitution of the LDV does provide for these services to be tested for value for money and it is therefore possible that the LDV may at some date in the future use the services of another provider.

5.4 The council has a requirement to maintain a balanced 30 year Business Plan for the HRA. This is a 'live' financial model which is updated on an annual basis, usually following the budget setting process and final subsidy determination. The estimated capital receipt from the LDV in September 2008 was included in the HRA Business Plan in order to enable the Plan to be fully funded and to bring in additional investment to meet the Decent Homes Standard by 2013. The 30 year HRA Business Plan for 2010/11 is currently being updated to reflect; the 2010/11 Budget, latest subsidy position and also revised investment and maintenance costs following the award of the 10 year Strategic Repairs, Refurbishment and Improvement contract to Mears. The receipt under general consents would be lower than previously assumed but on current estimates still equates to £20-30,000 per property transferred.

Finance Officers consulted: Peter Sargent & Sue Chapman Date: 08/01/10

Legal Implications:

5.5 The Councils external legal advisers, Trowers & Hamlins, have previously advised that the use of General consents was an option available to the Council in the event that CLG consent was not forthcoming or was unreasonably delayed.

5.6 Trowers and Hamlins advised that they were concerned that the lease and leaseback scheme could give rise to a possible challenge over the use of the Council's powers. Trowers & Hamlins advised that the current legislation, and the guidance that accompanies it, was unclear on this particular point and suggested that the opinion of Queens Counsel be obtained.

5.7 Queens Counsel was instructed to advise the Council on the leaseback scheme. His advice is set out in more detail at paragraph 3.20 of this report. His conclusion was that the Council could not enter into a leaseback scheme with the LDV when General Consents were being used.

5.8 Although most of the preparatory work has been done, depending on the particular funding option chosen, there will be significant work and legal due diligence exercise to be undertaken before completion of the project which requires specialist legal advice.

Lawyer consulted: *Neil Weeks* *Date: 08/01/10*

Equalities implications:

5.9 There are no changes to the equalities implications that were set out in the report to Cabinet on 24 September 2008.

Sustainability Implications:

5.10 There are no changes to the sustainability implications that were set out in the report to Cabinet on 24 September 2008.

Crime & Disorder Implications:

5.11 There are no direct implications arising from this report.

Risk & Opportunity Management Implications:

5.12 The detailed risks to both the council and the LDV are set out in appendix 5. Financial quantification of the scale of some of the risks is given in appendix 4.

Corporate / Citywide Implications:

5.13 There are no changes to the corporate / citywide implications that were set out in the report to Cabinet on 24 September 2008.

6. EVALUATION OF ANY ALTERNATIVE OPTION(S):

6.1 The report discusses in detail and shows the implications for the general consents route but there remains an option not to use the general consents and continue just to seek express consent from the Secretary of State. The capital receipt would be significantly higher under private funding for the reasons set out earlier in the report and higher still if express consent was given to allow the council to fund the borrowing of the LDV. However, it is unclear whether CLG officials could ever be persuaded of the merits of the proposal based on the extensive correspondence to date and even if they were, there are no guarantees of either when or if the Secretary of State will give his approval. The proposal to use the general consents route provides the council with greater certainty and control in contrast to the potential indefinite delay and possibility that no receipt would be generated by relying solely on express consent.

6.2 The application for express consent will not be withdrawn and the option remains to pursue this route again at a later date if there are indications of a change in view from CLG.

6.3 The HRA Business Plan profile is that significant investment is needed over the next 3 years to meet decency and after this period the level of investment is spread fairly evenly. Therefore, if this option was not pursued the HRA would need to evaluate whether it could afford to borrow instead. Borrowing £10 - £15 million over 25 years would cost approximately £0.650 - £1 million per annum which would need to be funded from both the Major Repairs Allowance and savings in the HRA revenue account. It should be noted that over the term of the borrowing the HRA would pay approximately £6 – £9 million in interest charges.

6.4 Further options will be explored to ensure that the receipt is maximised commensurate with risk.

7. REASONS FOR REPORT RECOMMENDATIONS

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

SUPPORTING DOCUMENTATION

Appendices:

1. Appendix 1 – Copy of CLG letter dated 4 January 2009 (error in date should be 2010)

2. Appendix 2 - Copy of Savills report including brief dated 27 October 2009

3. Appendix 3 – Summary of changes to key data inputs from September 2008 Cabinet report

4. Appendix 4 – Key assumptions and sensitivity analysis

5. Appendix 5 – Details of the risk share

Documents in Members' Rooms

None

Background Documents

1. Report of Director of Social Care & Housing – Local Delivery Vehicle – Cabinet 24th September 2008

2. Report of Director of Social Care & Housing – A Housing Local Delivery Vehicle – Council 9th October 2008

3. Report of Director of Social Care & Housing – Housing Local Delivery Vehicle: Update on Funding Options – Housing Local Delivery Vehicle Cabinet Committee 18th December 2008

4. Report of Director of Social Care & Housing – Use of General Consents to Lease Properties to Brighton & Hove Seaside Community Homes – Cabinet 17th September 2009

Communities and Local Government

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4 January 2009

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Our Ref:
Your Ref: JH/HJH

Dear Joy,

Thank you for your letter of 20th November withdrawing the Council's previous application for transfer consent and submitting a new application for express consent under Section 32 of the Housing Act 1985 along with your application for Section 25 consent for a proposed 30 to 50 year lease transfer for up to 499 HRA dwellings. I am sorry that we were unable to meet our original timetable but it did take longer than we agreed for the revised submission to arrive.

I know you will be disappointed to hear that there are aspects of the application that remain unclear to us from what I thought was a simpler proposition when explained at our meeting and which has again become complex in written form. Until we fully understand the detail of the specific proposal the Council are making we cannot give advice to the Minister.

The Section 25 Consent Application is necessary because the Council proposes to make a £20-30m loan to the LDV which is intended to be a private charitable company outside of the Council's control. It discounts the well being powers and cites s24 of the LG Act 1988 as the best means to obtain s25 consent. Could you explain why this is the case.

The proposition you talked us through was:

- The LDV would be a charitable company;
- Prudential borrowing would be the funding mechanism: it would be provided by the council to the company.
- There would be no private sector borrowing.
- The company would operate independently but as the funder of the company the council would have to validate (and therefore approve) the business plan;
- We requested the company would be registered by the TSA and this was agreed.

We now feel that these points need clarification as they no longer seem to be case , along with the provision of the advice you have had on the proposal, including on the following points:.

- The financial model of the LDV is dependent upon relatively high, benefit-funded rent levels and essentially on ensuring that all tenants are accordingly benefit-dependent with tenants securing employment needing to transfer. The business plan of the LDV is therefore 'at risk' over the course of the lease transfer period from policy changes and fluctuation in benefit provision and levels.
- Private sector funding is now being proposed and it is assumed that this would need to be commercially secured from a funder perspective from a) either the properties being at risk i.e. ability for the funder to require sale of the properties to fund debts or b) the Council will guarantee the cash-flow. It is not clear how the proposed borrowing will be secured and provided for.

- The option of prudential borrowing and "on-lending" of such funding by the Council to the LDV with the LDV paying back the borrowing to the Council over the business plan term raises a number of issues that need clarification including the Council's power to do so and State Aid.

- It is also not clear what is proposed regarding capital receipts for the Council if the LDV is to be funded through prudential borrowing on-lending.

- The position on classification and control under the different funding options.

These seem to be significant questions on your proposition over and above what was stated when you came to see us. We cannot at present either seek HMT's agreement to this proposed LDV, which is considered to be innovative, novel and contentious / repercussive, nor seek the Ministers agreement.

In order to put this matter to the Minister we need a single clear proposal with detailed supporting evidence to clarify the issues set out above. We look forward to hearing from you further.

Yours sincerely

Anne Kirkham

30 September 2009
Revised 8 January 2010
Brighton and Hove Report 30 Sept 09 Amended 8.01.10.doc

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Dear Judi,

Brighton and Hove City Council – Valuation Advice in Connection with Sale of Properties to Local Delivery Vehicle (LDV) – Draft Report

We refer to the meeting held at Brighton and Hove Council offices on 2nd July 2009 and your instruction of the 30 July 2009 to provide the Council with valuation consultancy services in connection with the proposed sale of up to 499 properties to a Local Delivery Vehicle (LDV).

As instructed we are reporting to the Council at this stage although we have not yet had the opportunity of meeting with the DCLG to discuss the detailed proposals of the transaction.

However we have met with Catherine Hand of Trowers and Hamlins, legal advisers to the Council in order to obtain a better understanding of the legal issues surrounding the leasehold sale of the properties by the Council and the statutory consents required. We have also spoken to Alex Gipson of The Royal Bank of Scotland (1 of 2 Funders who have expressed interest in financing this project) about their requirements in the event that they provide either project or asset backed loan facilities.

This report concentrates on the valuation issues with regard to the grant of short leases within the legal framework of the Housing Act 1985 and the price we are told that the LDV can afford to pay for the properties.

1.0 GENERAL BACKGROUND

1.1 We have been provided with copies of the following documents;

- Brighton and Hove City Council – Housing Green Paper Options;
- Brighton and Hove City Council – LDV Options – September 2008;
- Overarching Agreement – Trowers and Hamlins, draft 2nd May 2009
- Trowers and Hamlins Commentary on Valuation Issues

1.2 We have also reviewed the General Housing Consent 2005 (Section 32 of the Housing Act 1985 and Section 25 of the Local Government Act 1988).

1.3 Brighton and Hove City Council is faced with projected funding gap of around £45m in order to achieve the improvements required to its stock of around 12,000 council homes. 50% of these properties currently fall below Decent Homes Standard. The Council's latest estimate assumes a total sale receipt of between £35-45 million based on current PwC calculations within the draft Business Plan.

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1.4 The Council needs to establish the long term sustainable supply of temporary accommodation for homeless households and other vulnerable people for whom the Council has a duty to provide housing. Project demand is approximately 700 units per annum. Following the failed LSVT tenants ballot, the Council have set the following parameters for any future option;

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

1.5 The Council have now developed the concept of a Local Delivery Vehicle (LDV) which will lease a maximum of 499 properties from the Borough over a 5 year period. The acquisition cost will be financed by funding provided by private finance, based upon rental income averaging £204 per unit per week. We understand that the nett income to the LDV will be £144 pw, allowing for Council management/admin charge of £60 pw. Out of the income of £144 pw the LDV needs to allow for various costs including management and maintenance and thus the actual income will be less.

1.6 The properties will be leased to the LDV with vacant possession and the City Council will retain nomination rights. The properties will be let by the LDV on assured shorthold tenancies to vulnerable households in housing need at Local Housing Allowance (LHA) rent level.

1.7 The previous proposal was for the properties to be leased by the Council to the LDV for 125 years with a break clause after 30 years although the Council would like to consider developing a short term lease for a 30 year period. A certain number of properties will be leased back to the City Council at Cap and Threshold rents.

1.8 Disposal of these properties is governed by the CLG and the Council would need to seek the necessary consent under the Housing Act 1985 or the Local Government Act 1988 and each of these routes have their own valuation requirements. Please refer to Section 3 for discussion on the different approaches to Consent and Valuation.

1.9 In our advice we will be exploring Market Value in relation to the price that the LDV can afford to pay for the properties.

2.0 VALUATION BRIEF

2.1 A suitably experienced valuer is required to provide formal advice on the most appropriate means of structuring the lease arrangements and valuing the properties, such that the certified “best value reasonably achieved in the circumstances” approximates to the price the LDV can afford to pay.

2.2 In providing this valuation advice, the brief to the valuer was to:

- Understand and ensure that any proposals comply with the CLG valuation requirements under section 32 of the Housing Act 1985

- Provide advice on what adjustments could be made to the leases to reduce “best value reasonably achieved”. Such adjustments should be those restrictions that a prudent local authority selling its property needs to apply to preserve the value of its asset. No attempt should be made to reduce value by introducing artificial restrictions

- Indicate the likely impact any given adjustment to the terms of the lease is likely to have on value

- identify and recommend any other means of structuring the lease arrangements or conducting a valuation that would restrict the “best value reasonably obtained” in a method acceptable to the CLG and within RICS guidelines

- Provide a recommendation and risk assessment to the City Council on the most appropriate way forward to achieve the aim of balancing the valuation and the price the LDV is able to pay

2.3 The Project Leader at Brighton and Hove City Council is Judi Wilson (Tel: 01273 293143) and the legal advisors are Trowers and Hamlins, Catherine Hands (Tel: 020 7423 8617).

2.4 We have been asked to submit an interim report by 21^{1h} August 2009.

3.0 PRINCIPAL CONSIDERATIONS AND VALUATION ISSUES

3.1 Trowers “Overarching Agreement” relating to the leasing of the 499 units is a most helpful document as it sets out the parameters for the Council sale of all properties on long leases.

3.2 The properties are to be let to vulnerable persons, i.e. Homeless, Physical Disabilities, Learning Disabilities, Mental Heath and Children and Young Peoples Trusts.

3.3 There are 3 routes for the Council to go with regard to obtaining DCLG consent, namely;

a) A General consent under Section 32 of the Housing Act 1985 where the intended use of the properties falls within the vulnerable/special needs category, which must be valued at “best consideration that can reasonably be obtained” or;

b) Apply for a “Specific” approval under Section 32 of the Housing Act 1985. This would be because the properties are not to be wholly let by the LDV to those categories of tenants required for the general Consent. It is assumed that the same valuation as under a) above applies.

c) Seek specific approval under Section 25 of the Local Government Act 1988 for an “under value” should the intended use not fit the vulnerable/special needs category or the value of the lease term is more than the LDV can afford to pay.

3.4 Whichever route is chosen we have kept valuation issues as simple as possible. We have done this by interpreting the valuation requirements to be the same as, or as close as possible to Market Value (as defined by RICS).

3.5 We think that lease length and any user restrictions imposed by the lease are the principal factors affecting value that we can validly reflect (and that do not artificially restrict value). We have explored the subtle interplay between them and the opinions of value we need to reach in order to facilitate the sale of the properties to the LDV at a price which it can afford to pay and still generate a sufficient receipt for the Council.

3.6 We have noted comments made by Trowers and Hamlins, that 100% Nomination Rights in favour of the Council, cannot be taken into account by a Valuer even if it is considered that there could be a negative/positive affect on value. Similarly, a break clause in a longer lease is not something which a Valuer can take into account as it would be seen as an artificial mechanism to reduce value.

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4.0 PROPERTY VALUATIONS – OUR SAMPLING EXERCISE AND THE PROPOSED PURCHASE VALUATIONS

4.1 Each of the buildings are being converted to provide self contained one or two bedroom flats. They will need to be valued and this will involve physical inspection internally and externally, perusal of approved plans, permissions, schedule of works etc. and, on completion, a final inspection.

4.2 The valuation of each building will assume satisfactory completion of all works to obtain lettable condition. We assume that a Condition Survey has been carried out by the Council prior to commencement of the works. At a later stage, it is likely to be a requirement of the LDV that there is some form of validation of the works carried out by the Council and for valuation purposes 30 year planned maintenance elemental costs will need to be established for each building within the portfolio.

4.3 We have obtained both plans and costed specifications from the Council in connection with 3 example properties, as follows:

Property 1, Moulsecombe BN1 7
Property 2, Preston Park, BN1 6
Property 3, Port Hall, BN1 5

4.4 Based on our research of the 3 buildings, we estimate that the average value of a typical 1 and 2 bedroom flat, with the benefit of all repair, conversion and improvement works is in the region of about £153,000.These assume the usual 99/125 year length leases. This is of course a desktop exercise at the present time and we are looking at averages. See table below:

Address	Area	Postcode	Proposed	Estimated MV-VP
Property 1	Moulsecombe	BN1 7	2 bed flat 2 bed flat	£130,000 £130,000
Property 2	Preston Park	BN1 6	1 bed flat 2 bed maisonette	£150,000 £175,000
Property 3	Port Hall	BN1 5	1 bed flat SF 1 bed flat FF 2 bed flat	£140,000 £160,000 £185,000
			average	**£152,857**
			say	**£153,000**

4.5 We ran a number of sensitivities to test property values against a range of lease lengths. Seven units were valued in different locations to those included in the desk top exercise. Here the average value of the properties surveyed are lower than those detailed in the desktop as 3 of the 4 properties are in or close to established areas of council housing where property values are lower. As detailed in the matrix below the average property value is £100k which delivers a value of £75k for a length lease of 60 years.

4.6

Address		Assumed Accommodation	Value of Flats
Property 4	BN2 6	1 bed x 2	**£110,000**
Property 5	BN1 3	1 bed x 1 & 2 bed x 3	**£540,000**
Property 6	BN3 7	1 bed x 2	**£170,000**
Property 7	BN41 1	1 bed x 1	**£80,000**
		Average	**£100,000**

4.7 We are informed by the Council that the latest PwC Business Plan for the LDV makes the assumption that the basic unmodernized value of a typical flat unit will be £55,000 and the average cost of bringing the property up top a lettable standard will be £27,000, a total cost to the LDV of purchasing from the Council at £82,000.

4.8 The average LDV purchase price of £82,000 is therefore equivalent to say, 54% of the “when completed” upgraded flat value of £153,000. We understand that this is the price that the LDV can afford to pay, taking into account the forecast rental income from the properties and the cost of management and maintenance.

4.9 In order to provide a more definitive matrix of purchase price levels and lease lengths, a more robust valuation sample will need to be undertaken and in our view this is the next step. These valuations can also then be used for Bank security lending purposes.

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5.0 SHORT LEASES – VALUES

5.1 As the LDV is unable to purchase the properties at full Market Value i.e. a modernised flat on a more usual 99 or 125 year lease, due to the cost of management, maintenance and loan servicing, Savills have been asked to consider the values and market for shorter leases.

5.2 There is an established and buoyant market for a wide range of short leases in prime London property as there is the expectation of both lease extension or enfranchisement. However, in Brighton and Hove there is less appetite for short leases due the caution and reluctance of mortgage lenders to advance on such cases and there is more choice of longer leases available. In reality, what happens is that either the vendor or purchaser will apply to the freeholder for a lease extension or new lease and the property then becomes fully mortgageable. The break point is usually around 60-70 years unexpired.

5.3 We have carried out research on the sale and value of typical Brighton flats on shorter than average unexpired terms and established that there is a pattern to these values. However there is limited evidence of transactions where there are less than 50 years to run on the lease. Thus we have also had regard to the established market for short leases in London prime property where Savills Research have built up a matrix of values based on known transactions over the years. We have then applied an appropriate discount to these figures based on our latest research to reflect the South Coast market.

5.4 We set out below a guide matrix which expresses the shorter unexpired lease term of years as a percentage of the value of the longer 99/125 years unexpired term.

5.5 It should be borne in mind that if the Council grants a lease of a set term of years to the LDV, the Council will still retain the freehold reversion, which has an increasing value as the unexpired term of the lease decreases.

Lease Length Remaining (yrs)	Savills % of Long Lease Value - Brighton
125	100%
95	95%
90	90%
85	87.5%
80	85%
75	82.5%
70	80%
65	77.5%
60	75%
55	70%
50	60%
45	57.5%
40	55%
35	50%
30	50%
25	40%
20	40%

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6.0 OUR ADVICE ON VALUATION APPROACH AND TERMS OF SALE

6.1 To help inform our advice we need to understand the relationship between lease term and ability of the LDV to fund the purchase. To this end we have had a telephone discussion with RBS, a potential funder and set out below a brief summary of likely issues/opinions which obviously affect the structure of the sale and mortgageability from the LDV`s point of view. We are not aware of the view being taken by Clydesdale Bank. However, these terms will all be subject to negotiation with the mandated Bank at a later stage when the structure of the deal is clearer.

- The deal is being considered primarily on a project finance basis, although with one eye on the asset value and lease length. The asset backing provided by the properties is of lesser importance as they are looking at the values of the cash flows being generated.
- Operational risk within the project is limited, occupancy risk is being taken by the Council on some/all of the properties, but actual headline income risk remains with the LDV for a considerable period. The amount of rent that can be collected by LDV will be linked to local housing allowances. These of course are generally linked to market rents and will be subject to ongoing government review.
- For a 30 year funding package, they have suggested that a 50 year leasehold interest would give them the necessary comfort. We understand that there is nothing scientific in coming to this number and it could be flexible.
- The concept previously discussed of the Council having some form of option to break at year 30 would still work - subject to an obligation to repay any outstanding debt at that stage.
- The Bank`s preference remains for a 125 year leasehold interest selling on this basis. If 125 year leases, there will be “undervalue” issues for the LDV. The market value for a 125 year interest is higher than the premium to be payable which is based on 30 year cash flows.

6.2 Based on our discussions with the various parties i.e. the Council, Legal Advisors and potential Funder, it is our opinion that, on the basis of the projected purchase cost across the 499 properties to be sold by the Council, we think that the LDV should acquire the flats on minimum 40 year fixed leases, as this is the length of lease which provides a value/cost that the LDV can avoid to pay and which should be fundable. Doubtless this will require further discussion.

6.3 If we were instructed to carry out valuations of these properties, we would carry them out on the basis of Market Value and that this will be the “best value reasonably obtained” whether or not an application is made to the DCLG for either a General or Specific Consent for the sale under the Housing Act 1985. If there was a sale at below MV, this would constitute an “undervalue” requiring Consent by way of a Section 25 determination under the Local Government Act 1988. This would be relevant if a lease term in excess of 40 years was selected by the Council.

6.4 When considering the likely principal terms of such a lease if applying for a Specific Consent under Section 32 of the Housing Act 1985, it should be borne in mind that each of these terms will need to have some degree of flexibility dependant on Business Plan and funding requirements. As already stated we cannot have regard to the following for valuation purposes as we believe that they would be deemed to artificially reduce value.

- User clause linked to the proposed tenant occupation (, i.e. Homeless, Physical Disabilities, Learning Disabilities, Mental Heath and Children and Young Peoples Trusts.
- 100% Nomination rights.
- No break clause
- Rent at Local Housing Allowance level.

6.5 Our matrix of values with regard to the lease term in Section 5.5 above, sets out alternative scenarios which the parties may wish to consider although, in the event that a lease term in excess of circa 40 years is selected there will be probable “undervalue” implications as discussed in 6.3.

6.6 We trust that we have provided the Council with the valuation advice they require at this point in time in order to progress the detailed structure of the sales, the next stage being the agreed meeting between Trowers and Hamlins, Savills and the DCLG.

Yours sincerely

Chris Carlisle
Director

Summary of changes to key data inputs from September 2008 Cabinet report

The Cabinet report in September 2008 was based on the Stage 2 report prepared jointly by the council's external legal and financial advisors to the project. The Stage 2 report incorporated the outcome of two financial models – one based on bank funding and one based on council borrowing. Both models included a number of key data based on information available at that time.

The projected lease payment to the council for each of these models was up to £43.0 million for bank funding and up to £36.9 million for council borrowing. Since the Stage 2 report a number of the key data have been revised. The latest modelling projects a lease premium of about £17-22 million (the equivalent of £34-44k per property) for bank funding and £25-30 million (£50-60k per property) for council funding both based on express consents being granted by the Secretary of State. The modelling and assumptions here are based on the most recent available information. The cost of borrowing and the bank cover ratios are based on the information arising from the soft market testing conducted in mid-2009. The data needs to be viewed in conjunction with the information at Appendix 4 which sets out key sensitivities in the assumptions.

The reduction in the lease premium is the result of a number of changes to the data, details of which are set out in the following paragraphs.

Cost of borrowing
One of the major costs to the LDV will be interest payments on the debt. Since the Stage 2 report changes in the financial markets has resulted in the cost of bank funding increasing, whereas the cost of council funding has decreased. Table 1 summarises the changes and the impact on the lease payment.

Table 1 – Impact of changes in cost of borrowing

	Stage 2	Current	Impact
Bank funding	6.5%	7.04%	-£2.6m
Council funding	5.25%	4.52%	+£4.5m

Bank cover ratios
A bank will require the LDV to generate sufficient income (after operating costs) that exceeds the cost of debt repayment and interest on an annual basis. This is known as the cover ratio and is used by the bank to protect itself against the risk of non payment by the LDV. Since the Stage 2 report cover ratios have increased as banks become more risk adverse. Table 2 summarises the changes and the impact on the lease payment.

Table 2 – Impact of changes in bank cover ratio

	Stage 2	Current	Impact
Bank funding	1.05	1.17	-£4.3m
Council funding	1.05	1.05	-

Rents - Leaseback
The Stage 2 report was based on the council procuring the properties under two methods:

- "leaseback" where the council leases back the properties and become the landlord for the tenant, and
- a management agreement whereby the LDV remains the landlord but the council contracts to "manage" the properties on behalf of the LDV.

The rent income to the LDV under the leaseback option is higher than the management agreement option. The Stage 2 report includes a significant number of properties under the leaseback option for the full 30 year period.

HB subsidy only allows for leases not exceeding 10 years to be granted. However, the DWP have confirmed that the same HB subsidy would apply if a new lease were entered into, the proviso being that the council discusses this possibility with CLG first. Table 3 summaries the change and the impact on the lease payment.

Table 3 – Impact of reducing leaseback period to 10 years

	Stage 2	Current	Impact
Bank funding	Years 1-30	Years 1-10	-£7.4m
Council funding	n/a	n/a	-

Rents – Housing benefit levels
The Stage 2 report was based on housing benefit rates as at July 2008. In addition the Department of Work & Pensions is consulting on changes to the housing benefit rules which will be implemented in April 2010. The latest model takes into account updated rates (as at September 2009) and the proposed new system of benefit calculation. Table 4 summarises the change and the impact on the lease payment.

<u>Table 4 – Impact of changes in housing benefit rates and rules</u>

	Stage 2	Current	Impact
Bank funding	June 2008	Sept 2009	+£2.1m
Council funding	June 2008	Sept 2009	+£2.4m

Additional payments by council to LDV
The Stage 2 report included additional sums payable by the council for management of homeless clients at £30 per week per property and community care clients at £50 per week per property. Further detailed analysis has been undertaken of the cashflows of both the LDV and the council and some changes have been made to more accurately reflect the transfers of cash between them.

Recent legal advice indicates that unless there is a justifiable reason for the payment, any payment would be treated as “financial assistance” and the council would not have the legal powers to make the payment without Secretary of State consent. Table 5 summarises the change and the impact on the lease payment.

<u>Table 5 – Impact of removing additional payment for homeless client group</u>

	Stage 2	Current	Impact
Bank funding	£30	-	-£6.6m
Council funding	£30	-	-£10.3m

In addition the analysis work has identified that the provision for management costs included in the Stage 2 report did not fully allow for costs of the extra work required to manage the CYPT and community care clients. Table 6 summarises the change and the impact on the lease payment.

<u>Table 6 – Impact of increasing management cost or removing additional payment for special needs client group</u>

	Stage 2	Current	Impact
Bank funding	£50	-	-£6.1m
Council funding	£50	-	-£9.2m

Key assumptions and sensitivity analysis

A number of sensitivities around key assumptions have been modelled using the express consents models. The following table shows summaries the base assumption in the financial model together with an estimate of the impact on the capital receipt for key sensitivities.

Assumption	Base assumption	Impact on capital receipt of change from base assumption	
		Council funding	Bank funding
Provision for voids ± 1%	6%	± £1.2m	± £0.8m
Provision for bad debts ± 1%	3%	± £1.2m	± £0.8m
Movement in Local Housing Allowance ± 1%	Varies depending upon property size	± £1.0m	± £0.6m
Cost of refurbishment ± £1,000	£27,000	± £0.5m	± £0.5m
LDV operating costs ± 1%	£3,806 per unit	± £5.3m	± £3.4m
Interest rate on council funding ± 1%	4.52%	± £1.7m	-
Interest rate on bank funding ± 1%	7.04%	-	± £1.0m
Refurbishment programme ± 1 month	6 months	± £0.2m	± £0.2m

<u>Details of the risk share</u>

The following table sets out the key risks in the project and the proposed allocation of the risks between the council and LDV. This will need to be updated for the use of general consents although the commercial principles remain unaltered.

No	Risk Area	Context	Risk Responsibility	Comments
1.	Rent Levels	Largely dependent on DWP (Department for Work & Pensions) policies. Potential to mitigate if property could earn more rent income on the open market. Gross weekly rent is based on: - Leaseback properties at 90% of LHA rate plus £60 management fee - Other properties at 100% of LHA rate		
	Rent collection – Risk that rent is not received	Leaseback properties – council collects rent Other properties – council collects rent through management agreement Properties let direct by LDV at market levels	Council Council if appointed under management agreement LDV	Rent is paid to the tenant unless special circumstances exist which enable payment direct to the landlord- direct payments are assessed individually
	LHA rate – Risk that LHA rises by less than inflation	LHA (Local Housing Allowance) is set locally by the Rent Office. It is proposed by DWP that, from 2010/11, LHA rates for leasebacks will be set annually in January for the financial year immediately following. For direct lets between the LDV and tenant the LHA rate will be set annually using the prevailing LHA rate for the month the HB claim is made. LHA rates can change each month	LDV	An analysis of LHA rates since 2004 indicates that LHA rates have increased in line with RPIX + ½% (as per the financial model).

No	Risk Area	Context	Risk Responsibility	Comments
	Manage-ment fee – Risk that fee does not rise with inflation	depending on the market evidence gathered by the Rent Service. Management fee is payable for properties managed by the council (i.e. non-leaseback properties). Proposed management fee for 2010/11 equals £73 per property per week	Council	
2.	Demand – Risk that demand falls	It is unlikely the demand in general, for non-general needs accommodation will diminish in Brighton & Hove, therefore the key risk is more likely to be higher quality/cheaper accommodation being offered by another party.	Council	Where cheaper accommodation was being offered by another party the council would assess the feasibility of either - buying back properties and using cheaper accommodation with another provider, or - staying with the LDV. There may be an opportunity to have a value for money provision in the agreement
2.1	Property allocation – Risk that less than 499 properties transfer to LDV	LDV business plan provides for 499 properties for lease to the LDV. Council fails to identify 499 properties Council identifies 499 properties but LDV rejects	Council Council if LDV can demonstrate properties are not "financially viable"; otherwise LDV	Council has identified some 2,000 properties that would currently satisfy the criteria for lease to the LDV when they become vacant. It is unlikely that 499 properties suitable for lease to the LDV can not be identified

No	Risk Area	Context	Risk Responsibility	Comments
2.2	Property mix – Risk that property mix varies from model and reduces income	LDV business plan provides for a property mix that matches the council's projected requirement for properties. Council requirement does not match property mix	Council	Nomination agreement provides for Council to place clients in LDV accommodation Linked to Demand risk
3.	Voids – Risk that void levels are higher than anticipated	Some level of voids is predictable – the model assumes 6% of the time the units will not be inhabited. The turnover will affect the cost of maintenance and rents income earnings.	LDV up to 6% of gross rent. Council for voids over and above 6%.	As part of its own due diligence the council will need to be satisfied that the 6% assumption is consistent with current performance levels for similar properties/ client groups and where possible show performance against other authorities
4.	Bad debt – leaseback – Risk that bad debts are higher than anticipated	This can vary depending on whether rents money is paid via the tenant. An assumption of 3% lost income is made at present.	Council	As part of its own due diligence the council will confirm that it is satisfied that the 3% is consistent with current performance levels for similar properties/ client groups. Where there are special needs clients, the landlord can apply to receive the rent direct
5.	Bad debt - LDV own tenants –	This can vary depending on whether rents money is paid via the tenant. An	LDV up to 3% of gross debt.	As above. It is anticipated that the Bank will

No	Risk Area	Context	Risk Responsibility	Comments
	Risk that bad debts are higher than anticipated	assumption of 3% lost income is made at present.	Council for bad debts over 3% if appointed under management agreement.	want this risk to form part of the management agreement.
6.	Housing manage-ment – Risk of under-pricing and inflation higher than anticipated	Mispricing of the original service and also cost inflation during the project.	Pricing – Council RPI - LDV	Pricing based on management specification
7.	Reactive mainte-nance – Risk of under-pricing and inflation higher than anticipated	Mispricing of the original service and also cost inflation during the project. Price should include provision for vandalism costs.	Council	Council accepts this risk which is will pass down to its contractor on the basis that the housing management service which includes a repairs provision will be entered into with the council. The risk reverts to the LDV where they choose to select alternative management providers.
8.	Planned /Cyclical maintenan ce – Flats – Risk that works are understate d and increase by more than inflation	The category includes works both internal and external works. It is usual for a technical advisor to issue a planned works programme for the project properties. This profile, together with a look-forward reserve account, would be integrated into the financial model. In this case, this forecast is likely to be	Structural – council Non structural – council RPI – LDV	As part of its own due diligence the council will satisfy itself that the annual sum paid by the LDV is sufficient to meet the projected cost of planned / cyclical maintenance.

No	Risk Area	Context	Risk Responsibility	Comments
		possible (or practical) only for the internal works. The external works for flats will depend largely on the council's own asset management plan (assuming the flats are located in council-owned blocks). This means that it may be possible for the LDV to take the internal planned works risk, but any private funder may have significant reservations about the LDV taking external works risk as it would have no control over this cost (either the level or the timing of when it is incurred).		
8.1	Planned /Cyclical mainte-nance – Houses – Risk that works are understate d and increase by more than inflation	The category includes works both internal and external works. It is usual for a technical advisor to issue a planned works programme for the project properties. This profile, together with a look-forward reserve account, would be integrated into the financial model. In this case, this forecast is likely to be possible (or practical) only for the internal works. The external works for houses will depend on the LDV's own asset management plan.	Structural – LDV Non structural – LDV RPI – LDV	
9.	LDV operating costs – Risk that these are	These costs are within the LDV's power to control.	LDV	LDV board to review operating costs

No	Risk Area	Context	Risk Responsibility	Comments
	higher than anticipated			
10.	Interest on cash balances – Risk that investment returns are lower than anticipated	The LDV may hold large cash balances if it is required to hold, for instance, a debt service reserve. If this is the case, interest earned on cash balances should be substantial.	LDV	LDV to ensure cash balances are managed to minimise capital risk.
11.	Tax – Risk that tax payments are higher than anticipated	Structuring undertaken during this project development phase should minimise the risk of paying VAT on refurbishment costs.	LDV	Tax is minimised by operating as a charity with a VAT shelter put in place. LDV now registered as a charity therefore no Stamp Duty Land Tax on leases or Corporation Tax on profits will be payable.
12.	Insurance – Risk that insurance costs are higher than anticipated	Insurance can vary significantly – for instance, the cost of insurance increased by 150%-200% for many PFI projects in late 2001 which in some cases resulted in some SPVs defaulting on their loans. It is worth discussing this point with the Council's insurance advisors.	LDV	
13.	Surpluses – Risk that surpluses are not used effectively or become taxable	The financial model shows the LDV generating significant levels of surplus cash over the life of the project due to the cover ratio requirements of the bank. Funders will want to approve a methodology for the use of these surpluses to give them a degree of	LDV (See comments)	Funder has indicated it will expect the LDV to set aside surpluses to cover debt servicing costs in the event the LDV fails to achieve income

No	Risk Area	Context	Risk Responsibility	Comments
		control over how they are spent and ensure a sufficient level remains in the LDV to cover any future issues.		levels. Surpluses above this requirement to be shared with the council.
14.	Inflation Risk – Risk that inflation is higher than anticipated		LDV	Risk of inflation is with LDV. Inflation allowance included within financial model.