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**
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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