

Subject:	Brighton & Hove Seaside Community Homes Ltd – Response to Financial & Commercial Offer from Brighton & Hove City Council		
Date of Meeting:	11 November 2010		
Report of:	Strategic Director, Place		
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Wards Affected:	All	Forward Plan No: CAB18729	

FOR GENERAL RELEASE**1. SUMMARY:**

- 1.1. At the meeting in September 2008, Cabinet agreed to set up a housing company (Local Delivery Vehicle, LDV) to deliver key strategic housing and corporate priorities and to generate funding for investment in the Housing Revenue Account to improve council homes and assist the council in meeting the decent homes standard. In particular, the housing company aims to provide a stable supply of accommodation for people with particular needs and to whom the council owes a housing duty.
- 1.2. Cabinet is being asked to approve the recommendations detailed in section 3 of this report in order to bring about completion of the Local Delivery Vehicle (LDV) project. The LDV, known formally by its company name, Brighton & Hove Seaside Community Homes (BHSC), will need to secure a funder and negotiate a loan in order to lease, property from the council in exchange for a substantial capital receipt subject to a final decision for leasing which meets the 'Best Consideration' test. The funds received by the council will be used to support the decent homes programme and meet tenants' aspirations for improvement to their homes.
- 1.3. In September 2010, the Council received a response and revised offer from BHSC, which detailed an indicative capital receipt based on certain assumptions on income and expenditure levels. Officers and advisors have assessed this provisional proposal and have produced this report accordingly. Cabinet is asked to approve the key components of this revised offer and delegate authority for completion of the required suite of documents as explained in paragraph 1.5 below. Paragraphs 5.12-5.16 summarise both BHSC's proposals and the council's revised response.
- 1.4. Cabinet's approval of this report will provide BHSC with the assurance it needs to conclude negotiations with their selected funder. It is paramount that BHSC negotiates in the knowledge that the Council has accepted the main risk parameters of the project and that the Council is comfortable with the income and expenditure details on which funder lending will be based.

- 1.5. It is acknowledged by council officers that whilst Cabinet is being asked to approve the revised commercial and financial offer as it currently stands, a number of issues may change through the course of negotiations, particularly income certainty risk. It is on this basis that Cabinet is being recommended to agree the financial and commercial offer, subject to negotiations, and that the decision on financial, commercial and legal close rests with the Chief Executive, the Strategic Director of Place and the Director of Finance in consultation with the Leader of the Council, the Cabinet Member for Housing and the Cabinet Member for Finance.
- 1.6. The appended Options Assessment reiterates why this proposed transaction with the LDV remains the preferred option. (see appendix 1)

2. POLICY CONTEXT

- 2.1. As at the 30th September 2010 a third of all council homes in Brighton & Hove fell below the decent homes standard and do not meet tenants' aspirations for improvements to their homes. The financial situation is such that the authority cannot, under its own resources within the existing subsidy system, achieve the standard for all homes. The Housing Revenue Account (HRA) 3 year Capital Programme approved at Cabinet on February 2010 highlighted a need to fund £77m over this period, of which £44.6m is to meet the decent homes standard by 2013. The capital programme is funded from a mixture of capital receipts from the LDV, borrowing, reserves and the major repairs allowance (provided through housing subsidy).
- 2.2. Following the outcome of the tenants' stock transfer ballot in 2007, it was agreed by the leader of the council that the stock will be retained by the council. They identified a strategy to fund the investment gap to achieve the decent homes standard and meet tenants' aspirations for improvement to the stock. Two key approaches have been followed to meet the investment gap.
- 2.3. Firstly, the development of a procurement strategy for the repair and maintenance of the council's housing stock which was approved by the Policy and Resources Committee on 3rd April 2008 with the support of Housing Management Sub-Committee and Housing Committee. As a result of the strategy, the council has awarded a ten-year Repairs, Refurbishment and Improvement Strategic Partnership contract to Mears at a contract value of approximately £20 million per annum. This contract is anticipated to save approximately £46 million on capital works over 30 years compared to previous costs. In addition, Mears' commitment to continuous improvement and Value for Money should enable the council to meet the target reduction in unit rates for responsive repairs, voids and cyclical maintenance as detailed in the 30-year HRA Business plan.
- 2.4. Secondly an asset management plan, including the creation of the Local Delivery Vehicle sitting outside the council to utilise HRA assets. These assets would require reinvestment and once refurbished would be occupied by non-secure tenants. The net result would be to lever in additional investment to improve council housing stock.

- 2.5. As part of this review , options set out in the Housing Green Paper, “Homes for the Future: more affordable, more sustainable”, provided local authorities with the platform to set up local delivery or similar special purpose vehicle to make the most of existing homes and land to bring in investment. In September 2008 Cabinet agreed to set up such a vehicle and develop this initiative.

3. RECOMMENDATIONS:

- 3.1. That Cabinet accepts in principle the revised financial and commercial approach set out in the provisional offer from BHSC, as set out in paragraphs 5.1 – 5.9 of this report and detailed in the Part 2 report, subject to the effects of the council’s and funder’s due diligence.
- 3.2. That Cabinet accepts the revised risk table in appendix 2 and that this table is subject to a final review of the risks relating to income streams and additional funder requirements.
- 3.3. That Cabinet gives delegated authority to the Chief Executive, Strategic Director of Place and Director of Finance, in consultation with the Leader of the Council, the Cabinet Member for Housing and the Cabinet Member for Finance to take all necessary steps to conclude the matter and bring about financial, legal and commercial close, including the completion of any and all documents as necessary.
- 3.4. That Cabinet agrees that a further tranche of set up funding of up to £600,000 is made available to enable the project to reach financial and commercial close, on the basis that officers will seek to recover BHCC set up costs as part of the overall funding arrangement (see paragraph 6.4)
- 3.5. That Cabinet notes the revised timetable detailed in paragraph 6.3.

4. RELEVANT BACKGROUND INFORMATION/CHRONOLOGY OF KEY EVENTS:

Background Information

- 4.1. The revised financial and commercial offer provides a total investment package of circa £29.m towards the investment and improvement of council housing. The amount includes a capital receipt of circa £18m to fund decent homes work to retained stock together with refurbishment costs of circa £11m for leased stock.
- 4.2. Cabinet is advised that the figures quoted are based on a number of assumptions which may change following negotiations with the selected funder; however the key principals on which the LDV was agreed at the September 2008 Cabinet meeting remain consistent.
- 4.3. These principles, endorsed by HMCC, allowed for the setting up of a local delivery vehicle to bring in additional investment to improve council homes, to assist in meeting decent home standards and tenant aspirations for improvement of the council stock, so as to meet strategic housing and corporate priorities.

- 4.4. In March 2009 the LDV was incorporated as Brighton & Hove Seaside Homes (BHSCH), a company limited by guarantee. It was registered as a charity with the Charity Commission in January 2010. The company board consists of 12 members grouped into thirds, each third coming from a particular constituency, i.e. the tenant body endorsed by the city's area panel, councillors approved by the governance committee and independent members from within Brighton & Hove. The board meet regularly to set policy and progress the company's objectives, including its main aim to lease properties from the council for occupation by vulnerable households in housing need.
- 4.5. In January 2010 Cabinet was asked to and did approve the General Consent financial model in order to progress the project following an inconclusive response from CLG to the council's request for Express Consent. On the 12th October 2009 HMCC endorsed approval to proceed to the use of General Consent in circumstances where Express Consent had been refused or was unreasonably delayed. As requested by Cabinet, HMCC discussed these matters and voted unanimously in favour of developing the alternative consent route.
- 4.6. The general consent route is subject to the parameter that best consideration can be demonstrated. Cabinet should note that:
- the leasing of properties remains in line with the decisions of full Council in October 2008 and the decision made by Cabinet on the 14th January 2010, that the leases shall be for terms of 30-50 years;
 - the HRA properties to be leased comprise properties already used as temporary accommodation and other HRA properties which meet the criteria for leasing agreed by Cabinet and Council, as follows:
 - that the property is not tenanted;
 - no RSL involvement
 - that the property has 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) and a requirement for investment;
 - that the property is not an adapted dwelling
- 4.7. Approval to proceed with General Consent paved the way to the council developing and issuing a formal financial and commercial offer to BHSCH. The council issued its offer to BHSCH on the 13th February 2010 and received a response from BHSCH on the 6th September 2010. Details can be seen in paragraph 5.1 – 5.9.
- 4.8. Baker Tilly, an accountancy firm, was appointed in May 2010 by the Board to provide financial advice. They have developed the business case and financial model on the Board's behalf in order to respond to the council's financial and commercial offer and to develop a robust proposal which can be submitted to funders.
- 4.9. The council has reviewed and assessed the BHSCH proposal in order to provide a response. As part of its review, it has refined the property investment and operational costs by contrasting the average costs for all properties against

the specific properties projected to be leased to BHSCH. This has enabled both refurbishment and operational costs to reduce, enabling the threshold amount for best consideration purposes to be achieved. The net impact is that the council's key principles of setting up an LDV for the purposes of bringing additional investment, improving council homes and assisting in the decent homes programme are closer to being realised.

5. SUMMARY OF THE COUNCIL'S OFFER AND THE RESPONSE FROM BHSCH

- 5.1. It is important to note that the key financial conditions associated with the council's offer have not been altered. Thus the revised proposal (a) is made on the basis that the best consideration test will be met, (b) supports the HRA funding gap and property investment programme and (c) assumes that sufficient revenues can be generated to enable the company to meet its running costs and funding obligations.
- 5.2. The Council's offer is based on the lease of 106 temporary accommodation units at various values and 393 empty council properties scattered across the city which the council have assessed are at a negative net present value (NPV). The properties, in varying condition, require investment to bring them to modern day decent homes standards and the tenants' aspirations for improving the stock.
- 5.3. The set of income and expenditure assumptions are summarised below. The council's proposal was developed on a cash flow model that, once funded from private sector funders, will generate a sizeable capital receipt. The cash flow model detailed the net cash flows that would be available to the BHSCH over a 30-year period on which funds can be raised. The assumption built into the model is that the loan will be completely paid up at year 30.
- 5.4. BHSCH will be reliant on Local Housing Allowance, this being the applicable benefit to cover the rent for tenants occupying private sector landlord accommodation. Although it should be noted that the impact of the Chancellors Annual Spending Review (ASR) still means this is viable Funders will want to test and ensure that the numbers supporting income assumptions are sound, given that BHSCH is reliant on this income stream to fund any loan.
- 5.5. Rent levels will be set at the prevailing Local Housing Allowance (LHA) rate at the time the tenancy is drawn up. Rents will usually be reviewed on the anniversary of the tenancy start date, or sooner if the tenant moves.
- 5.6. BHSCH's response includes modelling to mitigate any risk arising from government proposals to use CPI as the inflation measure for increasing Local Housing Allowance (LHA) rates. The adjustments show the measurement against market rents which from April 2011 will reflect the 30th percentile of market rates instead of the median rate and from 2013 will attach any increases in the LHA rates to the Consumer Prices Index (CPI) which is a lower than the Retail Price Index (RPI), the current inflation indicator.
- 5.7. The rental income is supported by a 100% council nominations agreement and a management agreement with the council to ensure that occupancy is at least

94% and therefore rental flow is maintained. The financial model includes a provision for void periods and bad debts which in the original offer totalled 9% of the gross rent.

- 5.8. Revenue expenditure is comprised of four property specific operating costs. These consist of:
- management costs
 - repairs & maintenance charges
 - cyclical maintenance and
 - capital costs
- all of which are subject to VAT at the standard rate.
- 5.9. Brighton & Hove Seaside Community Homes will also be responsible for its company overheads including costs associated with the initial set-up of the project and the company's operational running costs such as insurance, tax liabilities and the like.
- 5.10. The council's proposal recognised that the company's charitable status afforded it a number of tax benefits that minimise its tax liabilities and have therefore accounted for this in its financial modelling.
- 5.11. BHSCCH was asked to respond directly to the council's proposal and submitted their provisional response in September 2010. This response reflects changes made to LHA rates and inflation assumptions. The key changes in the BHSCCH response are as follows:
- A 1% per annum reduction in the inflation indicator. In the council's formal offer, income revenues were increased by the Retail Price Index (RPI) from 2011. Now revenues will increase by the Consumer Price Index (CPI) which, by excluding housing costs, is a lower inflation indicator.
 - Changes to the assumptions around rental income for all property sizes
 - LHA rent measured against 30th percentile of market rents instead of the current median measure.
 - LHA rents are set every three months against market rents. As detailed above the measure is taken at the median rental values in the market place. From 2011 rents will be measured against the 30% percentile of market rents. In effect LHA rents will be set against rents at the lower end of the rental spectrum rather than at the middle. The combined effect of this and the rent changes detailed above have resulted in an average reduction of 25% of the total projected revenues.
- 5.12. BHSCCH's financial model has taken account of the changes summarised in 5.11. Their response also proposed different property specific operating costs resulting in a lower unit property rate. Other changes include modelled costs for insurance and staffing which have been developed further than that detailed in the council's proposal.
- 5.13. Risk allocation detailed in the BHSCCH counter proposal changed the risk share. Indicative soundings taken from a number of funders have helped the council understand funder requirements and therefore the revised proposal which Cabinet is being asked to approve takes the external funder perspective into view and refocuses the risks to the parties best able to manage this.

- 5.14. The revised offer takes a realistic view of all of the variables including the project's risks and presents information that the council believes will secure funding.
- 5.15. In summary, the revised offer from BHSCH:
- Reflects the revised LHA changes.
 - Reflects the revised inflation indices.
 - Revises the initial refurbishment costs and reduces these from those detailed in the offer document.
 - Revises the property specific operating costs and reduces these from the details detailed in the offer document.
 - Updates the insurance and staffing costs.
 - Revises the risk matrix to reflect funder approach and changes to income levels.
- 5.16. The requirement to pass the best consideration test, as referred to in the report to Cabinet on 14th January 2010, remains unchanged. However best consideration will only be determined at the point when each group of properties is due to be leased. Each group in its own right will need to achieve best consideration for the council.

6. PROJECT REQUIREMENTS, STRUCTURE, TIMETABLE AND BUDGET

- 6.1. A formal internal structure for development and delivery of the LDV has been in place since inception of the project. The project structure remains flexible to accommodate the different requirements in the project cycle and is likely to change to reflect the next phase of the project's journey.
- 6.2. The project team has needed to take account of external issues that have affected the project's timetable. The dates provided below indicate key points of project progression, leading to project close.
- 6.3. Key Dates
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|---|---|------|
| Member approval to proceed to the final stage | 11 th November | 2010 |
| Preferred funder selected | 20 th December | 2010 |
| Due diligence phase | 3 rd January – 4 th March | 2011 |
| Commercial & Financial close | 31 st March | 2011 |
- 6.4. BHSCH's counter proposal assumes that some of the Council's set up costs are not repaid at all in order to maximise the capital receipt and other elements are repaid over the life of the scheme rather than up front. The Council's position is that in order to protect its General Fund resources it will seek repayment of all those costs. However the phasing of this will be a matter for negotiation. Should the costs not be recovered the Council will need to write them off against reserves. A review of usable reserves will be carried out as part of the budget report to Cabinet on 9th December. However, on the basis of current in-year spending patterns it is anticipated that there will be sufficient additional reserves available to cover the costs incurred on this project to financial close. Treatment of any future surpluses that BHSCH may generate will also be a matter for negotiation.

7. CONSULTATION

- 7.1. From the outset, this project has proceeded on the basis of tenant and leaseholder involvement and approval. This has been facilitated through consistent updates to Housing Management Consultative Committee (HMCC) and Area Panels.
- 7.2. The four tenant board members of BHSCH have kept council tenant and leaseholder representatives informed of progress with the project through written and oral updates to all Area Housing Management Panel meetings. Non-confidential minutes of BHSCH's board meetings have been sent regularly, as requested, to members of the council's tenant and leasehold Tenant Compact Monitoring Group. Articles in the tenant and leaseholder magazine Homing In have regularly updated all the council's tenants and leaseholders. The Audit Commissions' recent review of the council's new repairs and improvement partnership states that consultation with residents on the LDV is good.

8. FINANCIAL & OTHER IMPLICATIONS:

Financial Implications:

- 8.1. The report sets out the benefits for the Council of achieving a substantial capital receipt to invest in the council housing stock and securing temporary accommodation units to support its strategic housing objectives. The financial modelling undertaken by the council produces a capital receipt figure broadly consistent with the figure of £18m calculated by BHSCH for the lease of the properties with circa £11m required for refurbishment work, creating a total package of circa £29m. The changes to the inputs in the financial model are set out in more detail in the Part 2 report alongside an assessment of the associated risks.
- 8.2. Detailed information on best consideration is set out in the Part 2 report.

Finance Officer Consulted: Catherine Vaughan

Date: 01/11/10

Legal Implications:

- 8.3. The legal issues are referred to in the main body of the report and in the Part 2 report. It is assumed that the best consideration criteria set out in paragraph A5.4.1 of the General Housing Consents 2005 being relied on, will be satisfied. In the event that it is not satisfied, Express Consent will be required.

Lawyer Consulted: Bob Bruce

Date: 20/10/10

Equalities Implications:

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

Sustainability Implications:

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

Crime & Disorder Implications:

- 8.6. There are no crime and disorder implications.

Corporate / Citywide Implications:

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

- Protect the environment whilst growing the economy
- Make better use of public money
- Reduce inequality by improving opportunities

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

9. EVALUATION OF ANY ALTERNATIVE OPTION(S)

- 9.1 As detailed in the report.

10. REASONS FOR REPORT RECOMMENDATIONS

- 10.1 As detailed in the report.

SUPPORTING DOCUMENTATION

Appendices:

1. Table 1 Options Assessment
2. Appendix 2; Table 2 Key Issues & Risk Table

Documents In Members' Rooms

None.

Background Documents

1. Brighton & Hove City Council - LDV Options - Stage 2 Report - September 2008
2. Cabinet Report – Agenda Item 75 – Brighton & Hove City Council – Local Delivery Vehicle 24th September 2008
3. Cabinet Report September 2009
4. Cabinet Report January 2010 - Brighton & Hove Seaside Community Homes Ltd – Funding options and consents